Zuari Agro Chemicals Limited

Instrument	Amount In Rs. Crore^	Rating Action
Long-term Fund-based Limits	1,200	[ICRA]BBB+, outlook revised from Stable to Negative
Long- term Unallocated Limits	300	[ICRA]BBB+, outlook revised from Stable to Negative
Short-term Non-fund Based Limits	2,600	[ICRA]A2+ retained
Short-term Unallocated Limits	100	[ICRA]A2+ retained
Unallocated Limits	15	[ICRA]BBB+, outlook revised from Stable to Negative / [ICRA]A2+

The rating for the Rs. 1,200 crore fund-based facilities and the Rs 300 crore long term unallocated limits of Zuari Agro Chemicals Limited (ZACL) has been retained at [ICRA]BBB+ (pronounced ICRA triple B plus). The rating for the Rs. 2,600 crore non-fund based facilities and the Rs 100 crore short term unallocated limits has been retained at [ICRA]A2+ (pronounced ICRA A two plus). The long term rating has been retained at [ICRA]BBB+ and the short term rating has been retained at [ICRA]A2+ for the unallocated limits of Rs. 15 crore.[†] The outlook on the long-term rating has been revised from Stable to Negative.

For arriving at the ratings, ICRA has taken a consolidated view of ZACL and its fully owned subsidiary, Zuari Fertilisers and Chemicals Limited (ZFCL) (rated [ICRA]BBB- (Negative) / [ICRA]A3) as well as Mangalore Chemicals and Fertilizers Limited (MCF) in which ZFCL has a 53.03% stake and Paradeep Phosphates Limited (PPL) (rated [ICRA]BBB+(Negative) / [ICRA]A2+) in which ZACL has a 40.225% stake. This is because all these companies have a common management, considerable operational linkages and the management plans to merge them over the medium term. The revision in outlook takes into account the large losses incurred by ZACL, its fully owned subsidiary ZFCL and PPL in H1 FY2017. On a standalone basis ZACL incurred large losses on its inventory holding which had to be written down owing to the price intervention by the GoI. In June end 2016, GoI directed fertiliser public sector undertakings to cut retail prices for non-Urea fertilizers such as DAP (reduced by Rs 2,500/MT) MOP (reduced by Rs. 5000/MT) and NPK complexes (reduced by Rs 1000/MT) owing to the decline in raw material prices in the international market. Due to decline in prices in the market, private players had to follow suit which led to large inventory losses on unsold inventory and accordingly ZACL recognised an exceptional loss of Rs 43.9 crore in Q1 FY2017. Pursuant to the loss in Q1, though the company posted a profit in Q2 FY2017, however consolidating with its subsidiary ZFCL the losses stood at Rs 82.9 crore in H1 FY2017. The loans availed by ZFCL from banks and financial institutions and from ZACL for the acquisition of shares of MCF have resulted in large losses for the company in FY2016 and H1 FY2017 and would continue to strain the financial profile of ZACL and ZFCL over the near-to-medium term due to high interest costs. Nevertheless PPL and MCF are expected to aid the profitability of the group, owing to significant decline in the prices of key raw materials (ammonia and phosphoric acid) over Q2 and Q3 FY2017 which has led to expansion in margins of non-urea fertilizers. Because of the losses, the group’s capital structure has weakened considerably, which it plans to address through a rights issue of equity in the near term. Ability of the group to improve key profit metrics and correct the high leverage will be a rating sensitivity in the near term.

The ratings continue to factor in the established position of the company in the fertiliser and other agri-businesses, diversified product portfolio and healthy operating efficiency and its strong marketing network and leading market position in Karnataka and Maharashtra. The ratings also factor in the financial flexibility on account of being part of the Adventz Group (part of the erstwhile K.K. Birla Group). ICRA notes that the Adventz Group is also looking to consolidate its fertiliser operations by the integration of different departments of ZACL and group companies MCF and PPL to derive operational and financial synergies, which may be favourable for the companies in the medium to long term.

The ratings are continuing to be constrained by the continuing high debt levels due to significant subsidy delays by the Government of India and the resulting weak debt coverage indicators and modest core profitability

^ 100 lakh = 1 crore = 10 million

† For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications

metrics. The ratings also factor in the decline in gas costs for the company following the implementation of gas pooling for the urea sector by the Government of India, although the company has also lost out on energy savings to some extent, thereby leading to moderately lower profits from the urea business compared to the earlier levels. Besides the already high debt levels owing to subsidy delays, ZFCL had also contracted a term debt of Rs. 300 crore (now reduced to Rs 210 crore) for the acquisition of the MCF shares. Besides, ZACL has also provided inter corporate deposits to ZFCL for the acquisition. Further, the MCF acquisition may not generate any major returns for ZACL in the medium term, although long-term synergies and growth opportunities exist. ICRA also notes that the New Urea Policy 2015 (NUP 2015) requires the company to reduce the energy consumption of its urea operations to 6.5 GCal/MT by FY2019, which would entail significant capex. While the scale of the investment is not clear, ICRA anticipates that the investment required would be large and may require significant debt funding.

The ratings are also constrained by vulnerability of profitability of the industry to agro-climatic conditions, regulated nature of the industry and seasonality associated with the fertiliser business. The performance of the non-urea sector is relatively more vulnerable to regulatory (subsidy) as well as economic variables (such as supply-demand, commodity prices and currency movements); profitability for the segment can be volatile depending upon ruling international prices of raw materials as well as ability to raise retail prices in an adequate manner. Demand for the segment has also been affected in recent years due to high retail prices of these fertilisers resulting in a price differential with urea.

On a standalone basis, in FY2016, ZACL recorded a net loss of Rs. 15.9 crore on an operating income of Rs. 5,261.1 crore against net profit of Rs. 12.4 crore on an operating income of Rs. 5,510.9 crore in FY2015. As per unaudited and standalone results in H1 FY2017, the company recorded net loss of Rs 26.7 crore on an operating income of Rs 2030.7 crore.

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