ICRA

March 16, 2017

Deepak Nitrite Limited

Instruments*	Amount Rated (Rs. crore)	Rating Action
Commercial Paper programme	40 (enhanced from 60 to 100)	[ICRA]A1+ assigned

**Instrument details are provided in Annexure-1*

Rating Action

ICRA has assigned a short-term rating of [ICRA]A1+ (pronounced ICRA A one plus) to the Rs. 40 crore[1] (enhanced from Rs. 60 crore to Rs. 100 crore) commercial paper programme of Deepak Nitrite Limited (DNL)[2]. ICRA also has a long-term rating of [ICRA]A+ (pronounced ICRA A plus) with Stable outlook and a short-term rating of [ICRA]A1+ outstanding on the Rs. 726-crore bank facilities of DNL.

Rationale

The rating takes into account the long operating track record of the company in the chemical industry, its diversified product mix as well as exposure to diversified end-user industries. Besides, DNL enjoys the leading market position in most of its products in the domestic as well as global markets. The rating also factors in DNL's multi-purpose manufacturing facility with significant backward and forward integration linkages that provide flexibility to change the product mix and cater to the changing market requirements, and its technical expertise to handle complex and hazardous chemical processes like nitration, hydrogenation and diasotisation. The rating further takes into account healthy increase in the company's cash accruals over the last five-year period with scale up in revenues driven by successful introduction of new products as well as increased proportion of higher-margin products in the sales mix.

While assigning the rating, ICRA takes note of the delays in ramping up of operations at Dahej facility for Optical Brightening Agent (OBA) to optimal levels. The company is, however, taking steps to improve the profitability of the OBA operations by changing its sales strategy along with reducing certain fixed costs. Thus, its ability to achieve healthy ramp-up of OBA operations with improvement in its profitability and return indicators would remain important from the credit perspective. The company's profitability is exposed to the volatility in raw material prices, though the same is reduced in certain products through formula-linked price contracts. ICRA also notes the large-size phenol and acetone project being undertaken by the company's subsidiary, Deepak Phenolics Limited ([ICRA]BBB (stable)) with commissioning targeted in January 2018. While the standalone project economics remains favourable, the ability to ramp up the utilisation levels of the plant, post-commissioning, so as to be able to service the debt on a standalone basis would remain important from the credit perspective. The extent of financial support, if required, extended by DNL beyond its committed equity would be a key rating sensitivity.

[1] 100 lakh = 1 crore = 10 million

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

Key rating drivers

Credit Strengths

- Long operating history of the company and an established position in the global chemical intermediates industry
- Diversified product profile mitigating the risk associated with cyclicality in different product segments
- Multi-purpose manufacturing facility i.e. the same plant can produce different products as per different campaigns, with significant backward and forward integration linkages, providing flexibility to change the product mix to cater to market requirements
- Capability to handle complex and hazardous chemical processes like hydrogenation, nitration and diasotisation
- Healthy scale-up of revenues supported by healthy capacity utilisation levels and successful introduction of new products on a regular basis; improvement in profitability levels and sales led to healthy increase in cash accruals in recent years

Credit Weaknesses

- Delay in ramping up of operations to optimal levels for OBA at Dahej facility as a result of which the OBA operations are yet to achieve breakeven
- Profitability exposed to volatility in raw material prices, though the same is reduced in certain products through formula-linked price contracts
- Large size phenol and acetone project being undertaken through an Special Purpose Vehicle
    - Implementation risks associated with the project with commissioning planned in January 2018, though the progress remains satisfactory so far
    - High equity requirements would moderate DNL's return indicators in the medium term
    - While standalone project economics remains favourable, the ability to ramp up the utilisation levels of the plant, post-commissioning, so as to be able to service the debt on a standalone basis would remain important from the credit perspective
- DNL's consolidated gearing levels to remain high over the medium term due to the set-up of the large-scale phenol and acetone projects

Description of key rating drivers highlighted above:

DNL has a diversified portfolio consisting of three segments namely, Basic Chemicals, Fine & Specialty Chemicals and Performance Products, with about 50% of total sales contributed by Basic Chemicals at present. It also supplies to a diversified end-user industries such as Dye/Pigments, Colourants, Agrochemicals, Pharma and Specialty Chemicals. It has market presence in over 20 countries across the world and enjoys a dominant market position in some of its key chemicals. The company's profitability remains exposed to the movement in prices of certain key raw materials like 2, Ethyl Hexanol, toluene and benzene, which remain volatile due to their linkage with crude oil prices. The company, however, hedges itself from the volatility in raw material prices to some extent (mainly in case of benzene and toluene-based products) by entering into formula-based contracts for significant portion of the sales.

DNL's OBA plant has seen healthy ramp-up, with 40% revenue growth in FY2016. Nonetheless, the company's OBA operations are loss making at the PBIT[3] level since the scale-up of operations remains slower than the initial estimates due to the elongated product acceptance period by the customers. As a result, the company has been unable to achieve the desired levels of market penetration. The company aims to change its sales strategy as well as reduce certain fixed costs, mainly at its U.S.-based marketing subsidiary and also in other geographies, so as to improve the profitability levels of this segment. DNL's large-scale greenfield project at Dahej for manufacturing of 200,000 MTPA phenol and 120,000 MTPA

[3] Profit before interest and tax

acetone is proceeding as per schedule with 55% of the construction work completed and planned COD (Commercial Operation Date) in January 2018. In March 2017, DNL raised additional Rs. 150 crore through its second Qualified Institutional Placement (QIP) issue to meet part of the equity requirements for the project, though timely tie-up of the balance equity funding remains important. The project economics remains favourable given the widespread applications of the products and their healthy demand within the country along with limited domestic manufacturing capacities for the same. Nonetheless, the ability of the plant to ramp up its utilisation levels, post-commissioning, so as to be able to service the debt on a standalone basis would remain important. While the project debt is ring-fenced with no guarantees from DNL, any financial support extended by DNL beyond its committed equity would be a key rating sensitivity.

DNL's revenues declined by 12% on a y-o-y basis in Q3FY2017 due to stoppage of production at Roha facility (due to a fire outage) and Hyderabad facility (due to a notice given by Telangana Pollution Control Board [PCB]). The Hyderabad facility has resumed operations after the PCB revoked its earlier order. At Roha facility, a part of the factory remains closed, though other areas have become operational and the impact on future revenue growth would be limited. Overall, the company's profitability levels remain steady and it has seen healthy improvement in cash accruals over the last five-year period with increase in scale of operations and increased proportion of higher-margin products in the sales mix. The company's gearing remains comfortable with the issue of QIP as well as land sale in Pune which has strengthened its net worth. However, the proceeds are to be utilised for meeting the equity commitment in the greenfield phenol/acetone project. The consolidated gearing is thus expected to remain high over the near to medium term.

Analytical approach: Not Applicable

Links to applicable Criteria
Rating Methodology for entities in the Chemical Industry

About the Company:
Deepak Nitrite Limited (DNL) is the flagship of the Deepak Group, which was incorporated in 1970 by Mr. C.K. Mehta. It began as a fully indigenous sodium nitrite and sodium nitrate manufacturer and has gradually widened its product portfolio, enjoying a leading market position in most of its products in the domestic as well as global markets. DNL's product portfolio consists of Basic Chemicals, Fine & Speciality Chemicals (FSC) and Performance Products. DNL's manufacturing facilities are located at Nandesari and Dahej in Gujarat, Taloja and Roha in Maharashtra and Hyderabad in Andhra Pradesh. DNL's growth has also been aided by strategic acquisitions of companies with complementary product lines in the past periods. DNL is setting up a large-scale greenfield project at Dahej for manufacturing phenol and acetone at a project cost of Rs. 1,400 crore (revised from previous estimate of Rs. 1,200 crore due to enhancement in scope of the project) through a subsidiary, Deepak Phenolics Limited.

In FY2016, DNL reported a Profit after Tax (PAT) of Rs. 65.1 crore on an operating income of Rs. 1,330.1 crore. In 9MFY2017, DNL reported PAT of Rs. 91.3 crore on an operating income of Rs. 896.1 crore.

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating History for last three years:

Table: Rating History

S. No.	Name of Instrument	Current Rating			Chronology of Rating History for the past 3 years			
		Type	**Rated amount (Rs. Crore)**	**Month - year & rating**	**Month - year & Rating in FY2017**	**Month - year & Rating in FY2016**	**Month - year & Rating in FY2015**	**Month - year & Rating in FY2014**
				Mar 2017	**Dec 2016**	**Dec 2015**	**Dec 2014**	**July 2013**
1	Term Loans	Long term	106	[ICRA]A+ (stable)	[ICRA]A+ (stable)	[ICRA]A+ (stable)	[ICRA]A+ (stable)	[ICRA]A+ (stable)
2	Fund based Limits	Long term	300	[ICRA]A+ (stable)	[ICRA]A+ (stable)	[ICRA]A+ (stable)	[ICRA]A+ (stable)	[ICRA]A+ (stable)
3	Non-fund based Limits	Short term	170	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
4	Fund & Non-Fund Based Limits (Interchangeable)	Long & Short term	150	[ICRA]A+ (stable) / [ICRA]A1+	[ICRA]A+ (stable) / [ICRA]A1+	[ICRA]A+ (stable) / [ICRA]A1+	[ICRA]A+ (stable) / [ICRA]A1+	[ICRA]A+ (stable) / [ICRA]A1+
5	Commercial Paper programme	Short term	60	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+

Complexity level of the rated instrument:

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1

Details of Instruments

Name of the instrument	Date of issuance	Coupon rate	Maturity Date	Size of the issue (Rs. Cr)	Current Rating and Outlook
Term Loans	--	--	FY2020	106	[ICRA]A+ (stable)
Fund based Limits	--	---	--	300	[ICRA]A+ (stable)
Non-fund based Limits	--	---	--	170	[ICRA]A1+
Fund & Non-Fund Based Limits (Interchangeable)	--	---	--	150	[ICRA]A+ (stable) / [ICRA]A1+
Commercial Paper programme	February 2017	6.4%	March 2017	100	[ICRA]A1+

Source: DNL

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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