DCM Shriram Limited

May 30, 2018

Summary of rated instruments

Instrument	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term Loans	118.57	179.29	[ICRA]AA(Stable) reaffirmed
Fund based Limits	870.00	870.00	[ICRA]AA(Stable) reaffirmed
Non-fund based Limits	885.0	686.00	[ICRA]A1+ reaffirmed
Commercial Paper Programme	800.00	800.00	[ICRA]A1+ reaffirmed
Fixed Deposit Programme	40.00	40.00	MAA+(Stable) reaffirmed
Unallocated	311.43	449.71	[ICRA]AA(Stable)/[ICRA]A1+ reaffirmed
Total	**3025.00**	**3025.00**	

*Instrument details are provided in Annexure-1

Rating action

ICRA has reaffirmed the long-term rating of [ICRA]AA (pronounced ICRA double A) for the bank lines of the company. ICRA has also re-affirmed the short-term rating of [ICRA]A1+ (pronounced ICRA A one plus) for the bank lines and the commercial paper programme of the company. ICRA has also reaffirmed medium term rating of MAA+ (pronounced M double A plus) for Rs. 40 crore fixed deposit programme of the company. The outlook on the long-term rating and medium-term rating is Stable.

Rationale

The reaffirmation of the rating takes into account healthy ramp up in utilisation of expanded caustic soda capacity at Bharuch in FY2018, robust profitability from the chlor-alkali segment, strong financial risk profile characterised by comfortable coverage and capitalisation indicators (Total debt/OPBDITA of 0.7 times as on March 31, 2018 and interest coverage of 12.6 times for FY2018), and robust liquidity position. The ratings continue to factor in the diversified business profile of the company, high operating efficiency of the chlor-alkali division and low-cost coal-based captive power generation facilities at the Kota (Rajasthan) and Bharuch (Gujarat) plants. Despite undertaking large capex the liquidity position of the company is robust owing to healthy cash accruals generated by the chlor-alkali division resulting in large un-utilised bank limits. The ratings also factor in the forward integration of the sugar segment into manufacturing of ethanol and increasing co-gen power capacity which should partially mitigate the risk related to the cyclicality of the sugar business.

The ratings, however, are constrained by the cyclical nature of sugar, chlor-alkali and poly-vinyl chloride (PVC) businesses, sensitivity of chemicals and PVC businesses' profitability to exchange fluctuations and import duty levels. The ratings also factor in the weak profitability from sugar sales being witnessed since Q4 FY2018 and expected to continue in the FY2019. However, the 150 kilo litre per day (kld) distillery commissioned in Jan-2018 and anticipated capacity addition of 30MW co-gen power in FY2019 will enable the company to partially offset the weakness in profitability from sugar sales. The ratings also take into consideration the vulnerability of profitability of the fertiliser and farm solutions divisions to regulatory policies and delays in subsidy receipts and agro-climatic risks. The bioseed division is working capital intensive and research intensive, apart from its exposure to agro-climatic risks. The ratings also factor in the significant capex (~Rs.1125 crore in FY2019 and FY2020) being undertaken by the company for capacity expansion of its sugar division by 5000 TCD and a 30MW co-gen power plant and Distillery, capacity expansion for caustic-soda at Bharuch (332 TPD) and Kota (168 TPD), replacement of 50MW captive power plant at Kota, 40 TPD PVC capacity expansion and setting up of an Aluminium Chloride plant along with regular maintenance capex. The coverage and capitalisation indicators of the company are expected to remain healthy despite large capex owing to healthy cash accruals from the caustic soda segment and commissioning of the distillery which will mitigate weak profitability from sugar sales. Significantly higher debt-funded capex plans leading to material deterioration in capitalisation and credit metrics would be a key rating sensitivity. Besides, significant fall in the profitability of sugar segment would be another key rating monitorable.

Outlook: Stable

The outlook on the long-term rating is Stable given the expectations of continued healthy profitability and cash generation coupled with low debt levels and repayment obligations in the near term.

Key rating drivers

Credit strengths

Diversified business profile with benefits derived from integration: DCM Shriram has a diversified business profile with presence across chlor-alkali, PVC, sugar, urea, agri-inputs like Bioseeds, agro-chemical trading, fenesta and cement segment. DCM Shriram has two plants located at Kota (Rajasthan) and Bharuch (Gujarat) with both plants having access to low cost coal-based power through captive power plants. The Kota plant is an integrated facility manufacturing caustic soda, chlorine, PVC, cement and urea. The integrated nature of operation ensures company's competitiveness in the chemicals and the PVC segment. It also allows the company to decide on the basket of products to be produced resulting in maximisation of earnings per unit of power produced.

High operating efficiency of chlor-alkali division and low-cost coal-based captive power generation facility at Kota (Rajasthan) and Bharuch (Gujarat) plants: DCM's chlor-alkali operations at Kota (330 TPD) and Bharuch (1013 TPD) are supported by 209 MW coal based captive power capacity. The production of caustic soda is an energy intensive process and DCM's access to low cost power favourably impacts its costs structure and thus results in healthy profitability from the segment.

Healthy cash accruals from chloro-vinyl division due to higher volumes post expansion and rise in caustic soda and chlorine prices: DCM had undertaken capacity expansion for chlor-alkali at Bharuch (Gujarat) in FY2017 increasing the capacity to 1013 TPD from 450 TPD earlier. The capacity utilisation for the newly commissioned capacity has been healthy in FY2018 with caustic soda sales volumes increasing by 29% yoy to 426,518 MT in FY2018 owing to healthy demand growth for caustic soda. The increased sales along with rise in caustic soda and chlorine realisations has resulted in healthy cash accruals for the company with rise in PBIT of chloro-vinyl segment to Rs.724 crore in FY2018 from Rs.289 crore in FY2017.

Commissioning of a 150 kld distillery to act as a mitigant to the cyclicality of sugar industry: DCM Shriram commissioned a 150 kld distillery in January 2018 at its Hariawan sugar facility and the sales of ethanol commenced in April 2018. The distillery will partly mitigate the risks related to volatility in the sugar prices and to cane pricing on the performance of the company. The distillery will utilise the molasses produced by the sugar units of the company to produce ethanol and thus aid profitability for the segment.

Robust capital structure and liquidity position driven by healthy cash accruals and large unutilised bank limits: The capital structure of the company has remained robust characterised by low gearing and leverage, healthy interest coverage and liquidity position resulting from large unutilised bank limits. The gearing of the company declined to 0.2 times at the end of FY2018 from 0.4 times at the end of FY2017, Total Debt/OPBDITA improved to 0.7 times at the end of FY2018 from 1.4 times at the end of FY2017 as total debt declined to Rs.756 crore at the end of FY2018 from Rs. 1074 crore at the end of FY2017. The debt levels of the company were lower also due to curtailment of DAP/MOP fertiliser trading by the company which was a working capital intensive and low profitability business for the company.

Credit challenges

Cyclical nature of sugar, chemicals and polyvinyl chloride (PVC) businesses: Sugar industry is a cyclical industry wherein the input price i.e. cane price is regulated i.e. set by government mandate while the realisations are market driven. The realisations are driven by the sugar production, inventory and demand levels while raw material availability is exposed to agro-climatic risks. The chemicals and PVC businesses are also exposed to the vagaries of currency fluctuations and duty structures apart from cyclicality associated with global and domestic supply-demand balance

Deterioration in the profitability of the sugar segment in FY2018; weakness expected to continue in the near term: The sugar production in SY2018E is expected to reach 31.5 MMT nearly 55% higher than SY2017 while the consumption is expected to remain stable at around 25.5 MMT resulting in a significant inventory overhang. As a result, sugar prices crashed to Rs. 26-27/kg by March 2018 as against Rs. 33-36/kg during 9M FY2018 resulting in large inventory losses for the company (Rs. 185 crore) in FY2018. High inventory losses in Q4 FY2018 led to fall in PBIT of the sugar segment to Rs.94 crore in FY2018 from Rs. 315 crore in FY2017. Going forward, the weakness in the sugar segment is expected to continue given the expectation of another year of robust sugarcane production owing to a healthy monsoon. The weakness however is expected to be partially mitigated by improved forward integration.

Pressure on the profitability of Bio-seed segment: The performance of the bio-seed segment has remained weak for past few years owing to losses in the international segment and subdued profitability in the domestic market. During FY2018, the international operations of the segment witnessed some improvement, though the same was offset by the inventory and debtor write-offs undertaken for the domestic segment. Going forward, the profitability of the segment is expected to remain subdued given the pressure on the price of BT cotton seeds while the associated costs continue to rise.

Investment to meet target energy consumption norm for urea segment may not be remunerative: The energy norm applicable for DCM's urea unit under NUP-2015 were to be revised downward from April 1, 2018 onwards. However, deferment of the same by two years will allow the company to continue with the current energy savings for additional two years. Meeting the new target energy consumption norm may require material investments which may not generate meaningful returns. Currently, the company uses coal to generate power which is more cost efficient (cost of coal being only about half of gas) vis-à-vis alternates even though it is less energy efficient. Thus, even after meeting the target energy consumption, there may not be any savings in subsidy. DCM is yet to finalise the capex and timelines for implementation of energy savings schemes.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below.

Links to applicable criteria:

Corporate Credit Rating Methodology
Rating Methodology for Entities in the Chemical Industry
Rating Methodology for Entities in the Sugar Industry
Rating Methodology for Entities in the Fertiliser Industry

About the company:

DCM Shriram Limited (DCM Shriram) is a diversified company with interests in agri-value chain (urea, sugar, seeds and trading of agri-inputs) and the chloro-vinyl chain (chlor-alkali and PVC). Apart from these, the company is involved in certain other related businesses to take advantage of vertical integration, such as Fenesta Building System (UPVC doors and windows), cement (produced at its integrated Kota plant) and PVC compounding (50:50 JV with Axiall Inc., USA). The company's operations are based out of Kota and Bharuch (for chloro-vinyl value chain) and central Uttar Pradesh (for sugar). In Kota, the company has a fully integrated unit with chlor-alkali, PVC, urea and cement plants and a captive power plant. The company also has a chlor-alkali plant in Bharuch along with a captive power plant. The sugar operations of the company are based in central Uttar Pradesh (UP). The bioseed division of the company is headquartered in Hyderabad. The company had previously expanded into another large venture named Hariyali Kisaan Bazaar, a chain of rural retail stores, which was rationalised in FY2012 and FY2013 owing to continuing losses. The company is a public limited company with 63.88% of the shareholding being held by the promoter group as of March 31, 2018, while the rest is held by institutional investors and the public.

Key financial indicators (audited)

	FY2017	FY2018
Operating Income (Rs. crore)	5788	6900
PAT (Rs. crore)	552	669
OPBDIT/OI (%)	13.5%	15.2%
RoCE (%)	22.5%	26.5%
Total Debt/TNW (times)	0.4	0.2
Total Debt/OPBDIT (times)	1.4	0.7
Interest coverage (times)	11.0	12.6

Source: ICRA estimates; OI: Operating Income; PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; ROCE: PBIT/Avg (Total Debt + Tangible Net-Worth + Deferred Tax Liability - Capital Work in Progress)

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

Instrument	Current Rating (FY2019)				Chronology of Rating History for the past 3 years			
	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs Crore)	Date & Rating	Date & Rating in FY2018	Date & Rating in FY2017		Date & Rating in FY2016
				May 2018	June 2017	May 2016	April 2016	June 2015
Term Loan	Long Term	179.29	179.29	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]A+ (Stable)
Fund based	Long term	870.00	-	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]A+ (Stable)
Non-fund based	Short Term	686.00	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
Commercial Paper	Short Term	800.00	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
Fixed Deposit	Medium term	40.00	-	MAA+ (Stable)	MAA+ (Stable)	MAA- (Stable)	MAA- (Stable)	MA+ (Stable)
Unallocated	Long Term/Short Term	449.71	-	[ICRA]AA (Stable)/ [ICRA]A1+	[ICRA]AA (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]A+ (Stable)/ [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: Instrument Details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
-	Term Loan-1	March 2014	-	March 2019	32.29	[ICRA]AA (Stable)
-	Term Loan-2	October 2016	-	October 2026	54.00	[ICRA]AA (Stable)
-	Term loan-3	January 2018	-	January 2028	93.00	[ICRA]AA (Stable)
-	Cash Credit		-		870.00	[ICRA]AA (Stable)
-	Non-fund based	-	-	-	686.00	[ICRA]A1+
-	Commercial Paper	-	-	7-365 days	800.00	[ICRA]A1+
-	Fixed Deposit	-	-	-	40.00	MAA+ (Stable)
-	Unallocated	-	-	-	449.71	[ICRA]AA (Stable)/ [ICRA]A1+

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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.

For more information, visit www.icra.in

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