Zuari Agro Chemicals Limited

August 10, 2018

Summary of rated instruments

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long Term Fund Based	1,200.0	1200.0	[ICRA]BBB+ (Stable); reaffirmed
Long Term Fund Based Interchangeable[#]	75.0	75.0	[ICRA]BBB+ (Stable); reaffirmed
Long Term un-allocated limits	265.0	265.0	[ICRA]BBB+ (Stable); reaffirmed
Short Term non-fund-based limits	2,750.0	2750.0	[ICRA]A2+; reaffirmed
Total	**4215.0**	**4215.0**	

*Instrument details are provided in Annexure-1

Rs 75 crore of long term limit is fully interchangeable with short term non-fund-based limits

Rating action

ICRA has reaffirmed the long-term rating [ICRA]BBB+ (pronounced ICRA triple B plus) assigned to the bank lines of Zuari Agro Chemicals Limited (ZACL). ICRA has also reaffirmed the short-term rating of [ICRA]A2+ (pronounced ICRA A two plus) assigned to the bank lines. The outlook on the long-term rating is Stable.

Rationale

The rating reaffirmation takes into account the improved performance of ZACL in FY2018 owing to healthy contribution from DAP/NPK segment, healthy energy savings from urea operations and improvement in working capital cycle of the company. The rating reaffirmation also factors in the deferment of revision in the energy norms for urea units under NUP-2015 to FY2021. The deferment would allow the company to benefit from energy savings at current level for another two years and give time for implementation energy saving schemes by the end of FY2020. ICRA also notes that the amalgamation of the various subsidiaries with ZACL, which had been announced in December 2015, was completed during FY2018. The net profit of the company increased to Rs. 30.3 crore in FY2018 as contribution margin from sale of DAP/NPK fertiliser remined healthy driven by subdued raw material prices as against a net loss of Rs. 60.6 crore in FY2017 which was primarily driven by an inventory write-off of ~Rs. 64.3 crore in FY2017 owing to GoI driven reduction in retail price of DAP/NPK fertilisers in July 2016. The working capital intensity of the company also moderated to 45.1% in FY2018 from 51% in FY2017 driven by an increase in creditor days as company gets favourable credit terms from OCP who is a Joint Venture (JV) partner with ZACL in Indo Maroc Phosphore S.A. (IMACID) from where ZACL procures majority of its phosphoric acid requirements along with improvement in collection efficiency from trade debtors. The gearing of the company was unchanged at 4.7 times at the end of FY2018 from FY2017 while Total Debt/OPBDITA improved to 9.2 times at the end of FY2018 from 12.1 times at the end of FY2017 driven by improvement in the operating profit while the debt levels saw marginal increase during the year. ICRA also notes that the company plans to infuse equity of ~Rs. 500 crore through a rights issue in FY2019 for funding the upcoming energy efficiency capex which is expected to prevent deterioration of the capital structure.

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 because 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 MCFL and PPL and derive operational and financial synergies, which may be favourable for the companies in the medium to long term.

The ratings continue 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 metrics. The company will be undertaking Rs. 1300 crore capex (funded in debt-equity mix of 70%-30%) to meet the energy norms applicable under NUP-2105 from FY2021 which will result in energy consumption reducing to 5.39 Gcal/MT with an additional 2 lakh MT of urea capacity. Owing to the large debt funded capex the gearing of the company is expected to increase to more than 3 times towards the end of FY2020. However, post completion of the project, the debt metrics are expected to improve with debt repayments and additional contribution from the urea capacity and higher energy savings which should add ~Rs. 150-200 crore to the operating profits. 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. Besides the already high debt levels owing to subsidy delays and the debt funded acquisition of MCFL resulted in further increase in the debt levels of the company. Further, the MCF acquisition may not generate any major returns for ZACL in the medium term, although long-term synergies and growth opportunities exist.

The ratings are also constrained by the 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 significant price differential with urea. The subsidy inflow post implementation of Direct Benefit Transfer (DBT) for the fertiliser sector has been affected by initial operational hiccups leading to elongation in the working capital cycle in the recent months. However, these issues are expected to be transitionary in nature and as the system stabilises the subsidy inflow is expected to stabilise.

ICRA also takes note of the ~Rs. 11.6 crore write-off for investments in MCA Phosphates Pte Ltd., a limited liability company incorporated in Singapore and holding 30% stake in a Fosfatos del Pacifico S.A. The total investment of ZACL is ~Rs. 119 crore in the venture and any further material write-offs may result in negative pressure on the credit profile of the company and will remain a key monitorable.

Outlook: Stable

ZACL's financial performance is expected to remain stable in the near to medium term given the healthy contribution from the sale of DAP/NPK fertilisers, healthy energy savings from urea plant and deferment of revision in energy norms under NUP-2015 to FY2021.

Key rating drivers

Credit strengths

Established track record of the company in fertiliser and other agri-businesses: ZACL has had an established track record in the fertiliser and other agri-business since 1967. ZACL through its subsidiaries and joint ventures is engaged in manufacturing of fertilisers, seeds, and other agri-inputs.

Diversified product portfolio including urea, DAP and NPK complexes as well as traded products: ZACL is engaged in manufacturing of urea as well as DAP/NPK fertilisers at its Goa manufacturing facility along with water soluble fertilisers (WSF) and Single Super Phosphate (SSP) manufactured at other plants of the company. It also undertakes trading of various fertilisers to provide wide range of agri products to the farmers. ZACL also benefits from access to the DAP/NPK fertilisers manufactured by its JV Paradeep Phosphate Limited (PPL).

Favourable long-term demand outlook for fertilisers in India due to scarcity of nutrients in the soil: Indian soil remains deficient in nutrient content which has resulted in lower agri-productivity. With increasing population, the demand for food will increase which will make productivity improvement imperative for the agri sector. Thus, the demand outlook for fertilisers remains positive in India.

High operating efficiency of the plants, although the company has faced certain operational issues in recent years: Though ZACL's plants had faced operational issues in the past, the operational efficiency has improved over the last few years. Urea as well as DAP/NPL plant has shown healthy capacity utilisation in last few years. Urea plant has witnessed improving capacity utilisation and energy efficient operations post implementation of gas pooling for the fertiliser sector resulting in lowering of gas costs for ZACL.

Strong marketing network and leading market position in Karnataka and Maharashtra: ZACL caters to the southern and western part of India and enjoys leading market position in Karnataka and Maharashtra. ZACL along with PPL enjoy a major part of the DAP/NPK market in south –western part of India and a strong marketing network.

Gas pooling has significantly reduced gas costs and hence, subsidy receivables: ZACL used to operate on R-LNG before implementation of gas pooling which resulted in high cost of production of urea for the company. Post implementation of gas pooling the gas costs for production of urea has declined significantly leading to lower subsidy receivables which in turn has resulted in lower working capital borrowings for the company. ZACL's urea production also became competitive against urea imports as the cost of production declined.

Financial flexibility on account of being part of the Adventz Group (part of the erstwhile K.K. Birla Group): ZACL derives financial flexibility on account of being part of the Adventz Group (erstwhile K.K. Birla Group) which was instrumental in the company getting indirect support through purchase of land to counter the losses during FY2014. ICRA notes that the Adventz Group is also looking to consolidate its fertiliser operations by the integration of different departments of ZACL and PPL to derive operational and financial synergies, which may be favourable for the companies in the medium to long term.

Credit challenges

Vulnerability of profitability to agro-climatic conditions, regulatory risks and seasonality of the fertiliser business: Agriculture sector in India remains vulnerable to the vagaries of monsoon as the area under irrigation remains low which exposes fertiliser sector to volatility as well. The sector being highly regulated also remains vulnerable to changes in the regulations by GoI.

Performance of non-urea fertilisers is relatively more vulnerable to regulatory and economic variables: Non-urea fertiliser demand is relatively more volatile as the preference for urea is driven by the price differential. In case of weak monsoon, the non-urea fertilisers have seen more impact on demand relative to that on urea. The domestic manufacturers are also affected by movement in international prices of end products as well as raw material which impact the profitability. Post implementation of Nutrient Based Subsidy (NBS) for P&K fertilisers, the price differential between urea and P&K fertilisers has widened which has adversely impacted demand for P&K fertilisers. The profitability of the companies depends on the movement of international prices of raw material as majority of these are imported. The ability of the company to pass on any increase in raw material prices to end-consumer through revision of retail price also plays a crucial role in protecting profitability which may be constrained by high level of stocks or poor monsoon etc.

Imports expose ZACL to forex risk; partly mitigated by the hedging policy of the company: ZACL imports its entire requirement of phosphoric acid, ammonia and MOP for production of DAP/NPK fertiliser which exposes it to foreign exchange risks. The risk is however partly mitigated as the company leaves very small amount of its foreign exchange exposure as unhedged.

High debt funded capex to meet energy norms under NUP-2015: ZACL will be undertaking significant debt funded capex to meet energy consumption norms applicable under NUP-2015 from FY2021 onwards. The capex for the project is around Rs. 1300 crore and is to be funded in a debt-equity ratio of 70:30. The capex is expected to keep the credit metrics subdued in the near term.

Subdued capital structure characterised by low capitalisation, high debt and low core profitability: Capital structure of the company has weakened since demerger from Zuari Industries Limited. Low capitalisation, high debt due to subsidy receivable driven working capital borrowings along with weak core profitability over the past few years has resulted in weak capital structure. Going forward the debt funded capex will keep the capital structure subdued unless equity infusion is completed in a timely manner by the company.

High working capital intensity due to subsidy delays and high trade receivables resulting in high borrowings: As the subsidy receivables from GoI continue to remain outstanding for as long as 4-5 months working capital borrowings to fund the receivables keep the borrowing levels elevated. The high receivable days also lead to high working capital intensity for the business and high interest costs for the company impacting profitability.

MCF acquisition leading to cash outflow: ZACL had acquired 53.03% ownership in MCFL through its subsidiary Zuari Fertilisers & Chemicals Limited (ZFCL, now merge with ZACL) with a total cash outflow of Rs. 510 crore. The acquisition was majorly debt funded and ZACL continues to service the debt leading to cash outflows in the form of interest and debt repayments.

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 fertiliser industry

About the company:

Zuari Agro Chemicals Limited (erstwhile Zuari Holdings Limited) constitutes the fertiliser operations of the Adventz Group following the demerger of Zuari Industries Limited (ZIL). It is also the holding company for the other agri-business operations of the Adventz Group. The group has interests in agri-inputs, engineering, infrastructure, real estate, consumer durables and services sectors. It was a part of the erstwhile K.K. Birla Group. In April 2011, the Bombay High Court (Goa bench) approved the demerger of ZIL's fertiliser business into Zuari Holdings Limited (later renamed as ZACL), while the residual entity ZIL (later renamed as Zuari Global Limited) retained the non-fertiliser business operations and investments. The demerger scheme was applicable w.e.f July 1, 2012.

The erstwhile ZIL was promoted in 1967 in financial and technical collaboration between the K.K. Birla Group and the U.S. Steel Corporation to manufacture urea, compound nitrogenous fertilisers and phosphates in Goa. In 1985, ZIL promoted Chambal Fertilisers & Chemicals Limited (CFCL, rated [ICRA]A1+) to produce urea using natural gas at Gadepan, Rajasthan. In 2002, ZIL acquired Paradeep Phosphates Ltd (PPL - rated [ICRA]A(Stable)/[ICRA]A1) through a JV company, as part of the disinvestment process of GoI. PPL manufactures DAP and NPK fertilisers, with its plant located at Paradeep, Orissa. While the equity shareholding of ZIL in PPL is now held by ZACL (40.225% of entire shareholding of PPL through the JV company), the 13.3% shareholding of ZIL in CFCL continues to be held by ZGL.

ZACL's plant is located in Goa and comprises of a urea plant of 0.4 MMTPA capacity, complex (NPK) plant of 0.36 MMTPA capacity and DAP-cum-Complex plant of 0.36 MMTPA capacity, which is capable of manufacturing a range of complexes. ZACL completed its feedstock conversion project and is now using gas as a feedstock for manufacturing urea (it was earlier using naphtha). For complexes and DAP, it uses imported ammonia and phosphoric acid. As of end-June 2017, 66.08% of the shareholding of ZACL was held by the promoter group, while the rest is held by domestic and foreign institutional investors and public.

Key financial indicators (audited)

	FY2017	FY2018
Operating Income (Rs. crore)	4076.5	4647.6
PAT (Rs. crore)	-60.4	30.3
OPBDIT/OI (%)	6.3%	7.3%
RoCE (%)	6.6%	9.8%
Total Debt/TNW (times)	4.7	4.7
Total Debt/OPBDIT (times)	12.1	9.2
Interest coverage (times)	0.8	1.1

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

	Instrument	Current Rating (FY2019) Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating Aug 2018	Chronology of Rating History for the Past 3 Years: Date & Rating in FY2018 September 2017	August 2017	Date & Rating in FY2017 December 2016	Oct 2016	Date & Rating in FY2016 Sep 2015
1	Fund Based	Long Term	1200.0	-	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Negative)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)
2	Fund Based Interchangeable	Long Term	75.0	-	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	-	-	-	-
3	Un-allocated limits	Long Term	265.0	-	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Negative)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)
4	Non-fund-based limits	Short Term	2750.0	-	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+

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
-	Fund Based	-	-	-	1200.0	[ICRA]BBB+ (Stable)
-	Fund Based Interchangeable	-	-	-	75.0	[ICRA]BBB+ (Stable)
-	Un-allocated limits	-	-	-	265.0	[ICRA]BBB+ (Stable)
	Non-fund-based limits	-	-	-	2750.0	[ICRA]A2+

Source: Zuari Agro Chemicals Limited

ANALYST CONTACTS

K Ravichandran
+91 44 4596 4301
ravichandran@icraindia.com

Prashant Vasisht
+91 124 4545 322
prashant.vasisht@icraindia.com

Varun Gogia
+91 124 4545 373
varun.gogia@icraindia.com

RELATIONSHIP CONTACT

L Shivakumar
+91 22 6114 3406
shivakumar@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries:

+91-124-2866928 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

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For more information, visit www.icra.in

ICRA Limited

Corporate Office
Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002
Tel: +91 124 4545300
Email: info@icraindia.com
Website: www.icra.in

Registered Office
1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001
Tel: +91 11 23357940-50

Branches

Mumbai	+ (91 22) 24331046/53/62/74/86/87
Chennai	+ (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,
Kolkata	+ (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008,
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