October 10, 2019

# Archean Chemical Industries Private Limited: Rating Upgraded

## Summary of rating action

| Instrument* | Previous Rated Amount (Rs. crore) | Current Rated Amount (Rs. crore) | Rating Action |
|---|---|---|---|
| Non-convertible Debenture Programme | 840.00 | 840.00 | [ICRA]B+(Stable); upgraded from [ICRA]B (Stable) |

**Instrument details are provided in Annexure-1*

## Rationale

The revision in rating considers the improvement in operational profile of Archean Chemicals Industries Private Limited (ACIPL or 'the company') due to improvement in capacity utilisation post fund infusion by India RF (joint venture between Bain capital Credit and Piramal Enterprises Limited) in FY2019 as well as in the current fiscal via NCDs. The funding was used for refinancing an older bank debt, which has reduced near term payment commitments as the mandatory coupon payment is moderate (10-12%) and the mandatory principal repayment falls due at the end of the debt tenure of six years. However, any excess cash flows would be applied towards additional coupon payment earlier (to meet the defined coupon on the debt of 17%) and towards principal prepayment. ICRA also takes comfort from the debt service reserve account (DSRA) created out of the issuance, which will be maintained during the tenure of the loan. ICRA notes the improvement in revenue and operating margin during FY2019 backed by growth in sales volume of industrial salt and improvement in bromine realisation. However, the profit margin was adversely impacted by large inventory write off and provision for bad debts, partly offset by write offs of some interest liabilities to erstwhile lenders and promoters. The rating also notes the cost advantage provided by an integrated manufacturing plant and access to Rann brine as raw material. Further, ICRA also considers the steps taken by the company to control costs and improve operational efficiency, including appointment of reputed consultants for the same, appointment of internal auditors and adoption of hedging policy to mitigate forex risks. The company is also in advanced stages expanding its bromine production capacity, funded by the proceeds from the NCD, which is expected to be completed in Q4 FY2020. ICRA also takes note of the long-term offtake agreement with Sojitz Corporation, Japan, for salt offtake that provides comfort for ACIPL's revenue stability.

Nonetheless, the rating remains constrained by the highly leveraged capital structure and stretched coverage indicators owing to low net worth arising from accumulated past losses; susceptibility of operations to excessive rainfall; vulnerability of margin to volatility in global product prices and high effective interest rate on the NCDs. It will be crucial for the company to complete the expansion project on time and improve its scale and profitability substantially to improve its liquidity profile and meet its repayment obligations.

The Stable outlook on the [ICRA]B+ rating reflects ICRA's opinion that ACIPL will witness healthy sales growth across all the three product segments owing to robust domestic and international demand. ICRA also expects ACIPL's profitability to improve from the increase in share of its higher margin bromine segment, post completion of its project expansion in the current fiscal.

## Key rating drivers and their description

## Credit strengths

**Fund infusion by India RF –** ACIPL raised Rs. 840 crore by issuing NCD to India RF in FY2019 and H1 FY2020 in three tranches. The company utilised the funds for refinancing the erstwhile bank loans, working capital funding and ongoing capex for bromine expansion. The refinancing has reduced the near to medium term repayment obligations, as the mandatory coupon payment is moderate (10-12%) and the mandatory principal repayment falls due at the end of the debt tenure of six years. However, any excess cash flows would be applied towards additional coupon payment earlier (to meet the defined coupon on the debt of 17%) and towards principal prepayment.

**Healthy sales growth in recent fiscals; diversified product portfolio** – ACIPL manufactures industrial salt, bromine and sulphate of potash (SOP) at its integrated marine chemicals facility. In FY2019, the company witnessed the healthy revenue growth of 29% supported by healthy growth in sales volume and realisaton for industrial salt segment backed by healthy demand from Sojitzs and new customers and strong improvement in sales realisation of bromine due too strong international demand. The company is currently expanding its bromine production capacity, which is expected to be operational by Q4 FY2020. The timely completion of the project and stabilisation of operations will be crucial for improving ACIPL's financial profile.

**Integrated manufacturing plant provides cost advantages in manufacturing process –** ACIPL's integrated manufacturing plant is located at Hajipir near the Rann of Kutch (Gujarat). The company uses the abundant and unique Rann brine as raw material, which provides it with a cost advantage over other producers. This advantage also creates entry barriers for new market entrants. The company has also taken several steps to improve operational efficiency and reduce costs in last one year and had appointed reputed consultants for the same. Further, the company has appointed internal auditors to strengthen control systems and adopted risk management measures including hedging policy to mitigate forex risks.

**Marketing arrangements in place likely to reduce business risks to a large extent –** The company has a long-term offtake agreement with Sojitz Corporation of Japan for 2 million tonne of industrial salts per annum. The company has also added new customers in recent fiscals with long-term contracts, which will ensure sustained revenue contribution from the segment. This provides some revenue stability, given the share of salt in the overall revenue pie. The marketing of bromine, the other key product, has also been successful, with ACIPL acquiring several new international customers for the product category.

## Credit challenges

**Financial profile characterised by highly leveraged capital structure and stressed coverage indicators –** The company's capital structure is highly leveraged with gearing of 17.4 times as on March 31, 2019 due to low net worth arising from accumulated losses from the past few years. The coverage indicators have also been stretched by subdued profit margins, with interest coverage and TD/OPBDITA of 0.6 time and 10.3 times in FY2019. OPM was impacted by large inventory write offs and provisions for bad debt, standing at 13% in FY2019 compared to 18.9% in FY2018. Adjusted for inventory adjustments, the OPM would have been ~23.9%. The NPM witnessed improvement to 7.3% in FY2019 from -18.0% due to write off of interest liability towards erstwhile lenders and promoters.

**Higher interest cost on NCDs –** The effective interest rate on the NCDs is high at 17%, however , the mandatory payments are restricted to 10-12% interest rate till FY2025, while the differential interest will be paid along with mandatory payments based on cash accruals generated during the initial years as per the cash sweep agreement, or a redemption premium will be paid at the end of the tenure. Therefore, the company's ability to generate healthy cash accruals to meet repayment obligations remains crucial and will be dependent on timely completion and stabilisation of the bromine expansion project.

**Operations and margin vulnerable to several external factors–** The company's operations are exposed to the risk of excessive rainfall, which can adversely impact the quality of key raw materials as well as lead to an operational stoppage, impacting the scale of production. The margins are also vulnerable to volatility in global product prices and forex rate movement.

## Liquidity position: Stretched

ACIPL's liquidity profile is stretched by moderate profit margins, high interest obligations, moderately high working capital intensity and an ongoing bromine expansion project in the current fiscal. The capex is being funded from the NCD. ICRA notes that the company has created three months' DSRA from the NCD proceeds as well as internal accruals, which supports near term liquidity and the same will be increased to six months' DSRA, with improvement in financial performance. ACIPL also plans to avail working capital facilities of ~Rs. 75 crore at lower interest rates (allowed under the terms of NCD), which will also support the liquidity position. However, timely completion of the project and stabilisation of operations and improvement in scale and profitability will be crucial for improvement in liquidity profile.

## Rating sensitivities

**Positive Trigger:** Strong improvement in revenue and profitability, backed by healthy capacity utilisation, on a sustainable basis leading to improvement in coverage indicators and debt protection metrices could lead to a rating upgrade

**Negative Trigger:** The rating could witness a downgrade if lower than expected cash accruals, delays in bromine plant expansion or a stretch in working capital cycle puts pressure on its liquidity and credit metrics.

## Analytical approach

| Analytical Approach | Comments |
|---|---|
| Applicable Rating Methodologies | Corporate Credit Rating Methodology<br>Rating Methodology for Entities in the Chemical Industry |
| Parent/Group Support | NA |
| Consolidation/Standalone | The rating is based on standalone financial statements of the rated entity |

## About the company

Incorporated in July 2009, ACIPL set up an integrated marine chemicals complex for producing sulphate of potash, industrial salt and bromine. The project was commissioned in June 2015. The manufacturing plant is located at Hajipir in the Kutch district of Gujarat. The integrated complex utilises the naturally available brine flowing over the marine mineral deposits at the Rann of Kutch. The Archean Group is already one of the leading producers of industrial salt in the country and through this project it has also become the first domestic manufacturer of SOP. ACIPL is part of the Archean Group, which is a conglomerate with businesses across building materials, mining and minerals, industrial chemicals and fertilisers.

In FY2019, the company reported a net profits of Rs. 41.1 crore (adjusted for interest write off of Rs 114.3 crore) on an operating income (OI) of Rs. 565.5 crore, as compared to a net loss of Rs. 79.2 crore on an OI of Rs. 438.8 crore in the previous year.

## Key financial indicators (audited)

| | FY2018 | FY2019 |
|---|---|---|
| Operating Income (Rs. crore) | 438.8 | 565.5 |
| PAT (Rs. crore) | (79.2) | 41.1 |
| OPBDIT/OI (%) | 18.9% | 13.0% |
| RoCE (%) | 1.6% | 16.2% |
| | | |
| Total Outside Liabilities/Tangible Net Worth (times) | -43.5 | 25.4 |
| Total Debt/OPBDIT (times) | 12.4 | 10.3 |
| Interest Coverage (times) | 0.8 | 0.6 |
| DSCR | 0.6 | 0.2 |

## Status of non-cooperation with previous CRA: Not applicable

## Any other information: None

## Rating history for past three years

| | Instrument | Current Rating (FY2020) | | | | Rating History for the Past 3 Years | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Type | Amount Rated | Amount Outstanding | Rating | FY2019 | | | FY2017 | FY2016 | |
| | | | | | 10-Oct-2019 | 7-Dec-2018 | 30-Aug-2018 | 16-Apr-2018 | 29-Nov-2018 | 13-Jan-2016 | 06-Oct-2015 |
| 1 | NCD | Long Term | 840.00 | 840.00 | [ICRA]B+ (Stable) | [ICRA]B (Stable) | Provisional [ICRA]B (Stable) | | | | |
| 2 | Term Loans | Long Term | 240.25 | 0.00 | - | [ICRA]D; Withdrawn | [ICRA]D | [ICRA]D | [ICRA]D | [ICRA]D | [ICRA]BB- (suspended) |
| 3 | Fund-based facilities | Short Term | 53.41 | 0.00 | - | [ICRA]D; Withdrawn | [ICRA]D | [ICRA]D | [ICRA]D | [ICRA]D | |
| 4 | Long-term, unallocated facilities | Long Term | 404.34 | 0.00 | - | [ICRA]D; Withdrawn | [ICRA]D | [ICRA]D | | | |

*Amount in Rs. crore*

## 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](www.icra.in)

## Annexure-1: Instrument details

| ISIN | Instrument Name | Date of Issuance / Sanction | Coupon Rate | Maturity Date | Amount Rated (Rs. crore) | Current Rating and Outlook |
|---|---|---|---|---|---|---|
| INE128X07028 | NCD | 22-Nov-2018 | 17% | 21-Nov-2024 | 840.00 | [ICRA]B+(Stable) |

*Source: Archean Chemical Industries Private Limited*

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## About ICRA Limited:

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