November 06, 2020

Paradeep Phosphates Limited: Ratings continue on watch; rating assigned to enhanced bank lines

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term Loans	290.0	824.0	[ICRA]A @; Rating continues under 'Watch with Negative implications'; assigned
Fund Based Long Term Facilities	1365.0	1365.0	[ICRA]A @; Rating continues under 'Watch with Negative implications'
Non -Fund Based Short Term Facilities	2570.0	2570.0	[ICRA]A1 @; Rating continues under 'Watch with Negative implications'
Commercial Paper Programme	250.0	250.0	[ICRA]A1 @; Rating continues under 'Watch with Negative implications'
Total	**4,475.0**	**5,009.0**	

**Instrument details are provided in Annexure-1*

Rationale

The ratings factor in the improvement in the profitability of Paradeep Phosphate Limited (PPL) in H1 FY2021 driven by healthy volume offtake and expansion in contribution margins over the last couple of years aided by healthy operational performance of the plant. The profitability is expected to remain healthy in the current fiscal owing to the robust demand of phosphatic fertilisers given the robust offtake in the current kharif season and expectation of healthy offtake in the upcoming rabi season driven by higher purchasing power and healthy reservoir levels. As per unaudited results, The company posted an operating profit of Rs. 336.3 crore in H1 FY2021 vis-à-vis Rs. 518.3 crore in FY2020. The operating margin of the company expanded to 14.5% in H1 FY2021 vis-a-vis 12.4% in FY2020. The net profit of the company increased to Rs. 171 crore in H1 FY2021 vis-à-vis Rs. 194.0 crore in FY2020 driven by an increase in the operating profit and lower interest outgo. The interest outgo reduced substantially driven by lower interest rates and lower working capital borrowings. The borrowings levels have moderated driven by healthy collections from market and stable subsidy inflow. The capitalisation and coverage indicators improved in H1 FY2021 with leverage (Total debt/OPBDITA) at 3.0x at the end of H1 FY2021 as against 4.4x at the end of FY2020. The gearing of the company improved to 1.1x at the end of H1 FY2021 as against 1.4x at the end of FY2020. The ratings had been placed on Watch with Negative implications as on June 19, 2020, Zuari Agro Chemicals Limited (rated [ICRA]B & /[ICRA]A4 &; &-rating Watch with developing implications) announced plans for a slump sale of its Urea and Phosphatic fertilizer plant located in Goa to Paradeep Phosphate Limited (PPL) in agreement with OCP Morocco at an enterprise value of $ 280 million. The ratings of PPL had been placed 'Under watch with Negative implications' given that the acquisition is likely to lead to moderation in the return and credit metrics of the company going forward. The agreement between ZACL and PPL, however, is non-binding in nature. The transaction is subject to various statutory approvals besides which the funding plans for the slump sale remains a key monitorable and currently the due diligence for valuation is underway. ICRA will closely monitor the developments and would keep the investors updated on the implication of the same on the credit profile of the company.

The ratings continue to factor in the company's established position as one of the largest manufacturers of phosphatic and complex fertilisers in India and its leading market position in its marketing territories. The ratings also factor in the substantial gap between domestic production and consumption leading to limited demand-related risks and the company's moderate cost position due to high operating efficiency and part backward integration into the manufacture of phosphoric acid. The company's established relations with overseas raw materials' suppliers due to the latter belonging to the promoter group generally results in smooth availability of raw materials.

The ratings are constrained by the vulnerability of the company's profitability to agro-climatic and regulatory risks, with the former being reflected by muted demand in some past years and the latter being reflected by substantial delays in subsidy receipts from the GoI in recent years leading to high short-term borrowings. The ratings also continue to factor in the company's relatively high segmental concentration towards phosphatic/complex fertilisers, significant exposure to forex fluctuation risks being a major importer and high working capital intensity of its fertiliser business. The performance of P&K fertiliser manufacturers (such as PPL) is relatively more vulnerable to regulatory (subsidy levels) as well as economic variables (such as supply-demand, commodity prices and currency movements). Further, substantial increase in the prices of P&K fertilisers post the implementation of NBS have adversely impacted demand due to significant price differential with urea. Additionally, the operations of the company remain working capital intensive resulting from the delay in subsidy receipt from the GoI.

ICRA also takes note of the ~Rs. 500 crore capex program of Paradeep Phosphate Limited (PPL) for debottlenecking of its DAP/NPK capacity, capacity expansion for its phosphoric acid plant and installation of a phosphoric acid evaporator to be funded in a debt: equity ratio of 3:1. Under the debottlenecking project, the company aims to increase the overall manufacturing capacity of DAP/NPK from 1.3 MMTPA to 1.7 MMTPA by FY2023 in a phased manner. The total capital outlay for the debottlenecking project is Rs. 220 crore. With increase in DAP/NPK capacity, the requirement for strong phosphoric acid to manufacture DAP will also go up. In order to meet the increased requirement of strong phosphoric acid, PPL will install a 350 TPD evaporator to convert weak phosphoric acid manufactured by the company to strong phosphoric acid at a capital outlay of Rs. 65.0 crore. The commissioning of the evaporator has been slightly delayed owing to the Covid-19 pandemic led restrictions to H1 FY2022 vis-à-vis end of FY2021 earlier, the total evaporator capacity will increase to 1000 TPD. The company will also increase its phosphoric acid manufacturing capacity from 1100 TPD to 1500 TPD to be completed by mid of FY2023 (as against end of FY2022) to meet the increased demand for phosphoric acid inhouse. As phosphoric acid manufactured inhouse is cheaper than imported phosphoric acid, the in-house production of strong phosphoric acid enables the company to earn higher contribution margins on manufactured DAP. Any major cost or time over runs in these project will remain a key rating sensitivity.

Key rating drivers

Credit strengths

Established position as one of the largest manufacturers of DAP and complex fertilisers in India: PPL is one of the largest manufacturers of DAP/NPK fertilisers in India with a total installed capacity of 1.3MMTPA. The plant can switch between production of DAP and NPKs as per demand and contribution levels. With the planned debottlenecking of the DAP/NPK trains the manufacturing capacity will rise further to around 1.7 MMTPA by the end of FY2023.

Leading market position in DAP and NPK complexes in most of its marketing territories: PPL enjoys leading market share in most of its territories like Orissa, West Bengal, Bihar and Uttar Pradesh. PPL also benefits from being part of Adventz Group wherein the marketing function is now unified along with Zuari Agro Chemicals Limited (ZACL) and Mangalore Chemicals & Fertilisers Limited (MCFL) leading to synergies in terms of product placement and market reach. PPL has a network of 2540 dealers and around 25,000-30,000 retailers.

Favourable domestic demand outlook for phosphatic fertilisers due to deficient soil and substantial gap between domestic production and consumption: The ideal N:P: K nutrient balance for Indian soil is 4:2:1 while the actual ratio was 7.1:2.7:1 at the end of FY2019. The nutrient imbalance is a result of overuse of urea and low use of NPK which makes the soil acidic. With schemes like soil health cards being implemented by GoI to determine the soil health and advice to farmers on the right fertilisers to use the demand outlook for P&K fertilisers remains positive. The domestic demand for P&K fertilisers stands at around 25-28 MMT whereas the domestic capacity for P&K fertilisers is about 15.8 MMT resulting in significant portion being met through imports. Thus, the offtake risk remains low.

Efficient cost structure with part backward integration into manufacturing of phosphoric acid: PPL is partially backward integrated into production of phosphoric acid by using rock phosphate and sulphuric acid which provides cost advantage to PPL as phosphoric acid produced is cheaper than imported phosphoric acid. PPL had commissioned a 1.32 MMTPA sulphuric acid plant in FY2016 which has improved the cost structure of the company owing to lower cost of power (produced from steam generated from the sulphuric acid plant) and sulphuric acid. Additionally, with the company planning to install an evaporator to increase the inhouse production of strong phosphoric acid and increase in the phosphoric acid production capacity to 1500 TPD the extent of backward integration will further improve leading to improvement in the contribution margins.

Favourable relations with overseas suppliers results in easy availability of raw materials: One of the promoters of PPL is Office Cherifien des Phosphates (OCP), Morocco which is one of the largest producers of phosphoric acid globally. PPL procures part of its phosphoric acid requirement from OCP. Since OCP is one of its promoters, PPL does not face any challenges in procurement of its key raw material.

Credit challenges

Acquisition of ZACL's goa plant to result in weakened credit profile in absence of adequate equity contribution by the promoters to fund the acquisition: With PPL in the process of due diligence for acquisition of ZACL's Goa plant on a slump sale basis, the return and credit metrics of the company are expected to moderate in absence of adequate equity contribution by the promoters to fund acquisition. The return metrics however will weaken post acquisition for PPL given that the performance of ZACL's plants has been weak in the recent past.

Segmental concentration towards phosphatic / complex fertilisers as compared to some of the other leading fertiliser manufacturers in India: PPL's entire product portfolio is concentrated on phosphatic and complex fertilisers while many other players have a relatively diverse product portfolio. As a result, PPL is more vulnerable to the vagaries of volatility in the P&K fertiliser segment.

Vulnerability of profitability to agro-climatic conditions: Agriculture sector in India remains vulnerable to the vagaries of monsoon as the area under irrigation remains low. The sector being highly regulated also remains vulnerable to changes in the regulations by GoI.

Sharp rise in prices of P&K fertilisers post NBS have adversely impacted demand due to high price differential with urea: 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 company depends on the movement of international prices of raw material as majority of the raw materials are imported. The ability of the company to pass on any increase in raw material prices to end-consumers through revision of retail prices also plays a crucial role in protecting the profitability of the company. However, the industry has passed on the impact of change in raw material prices as well currency fluctuations albeit with a bit of lag. Thus, at some points the industry may witness erosion of margins for short span of time in a scenario of rising raw material prices which is corrected after a lag.

Being a substantial importer, exposed to risk of currency fluctuations, although mitigated by firm hedging policy: PPL imports majority of its raw material requirements including rock phosphate, ammonia, Muriate of Potash (MOP) and part of phosphoric acid for production of DAP/NPK fertiliser which exposes it to foreign exchange risks. The risk is however partly mitigated by the nearly complete hedging of the foreign exchange exposure the company undertakes.

Working capital requirements have remained high in recent years due to delays in subsidy receipts from the GoI: 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. PPL has made efforts towards improving its working capital cycle which is reflected in the improvement in collection efficiency from trade debtors. PPL also gets 60-90-day interest free credit period from one of its parent OCP for purchase of phosphoric acid and rock phosphate which has also helped in reducing the working capital intensity for the company.

Moderate return and capitalisation indicators owing to high working capital intensity of operations: While PPL has witnessed improvement in its operating profit over the last few years, high interest costs continue to be a drain on the profitability of the company. Owing to delay in subsidy receipts from the GoI, the operations continue to remain capital intensive with high working capital borrowings. As a result, the capital structure of the company remains moderate.

Liquidity Position: Adequate

The liquidity position is impacted by the large working capital borrowings for meeting the delay in the subsidy receipts from the GoI resulting in higher interest burden and lower net profits. Nevertheless, the liquidity position of the company is expected to remain adequate given the adequacy of cash accruals to meet the equity funding required for the capex being incurred and the debt repayments to be made for the term loans.

Rating sensitivities

Positive Triggers: The rating upgrade looks unlikely in the near to medium term given the continued delay in the subsidy from GoI expected to keep the credit metrics subdued.

Negative triggers: Deterioration in the working capital cycle and/or significant leveraging of the balance sheet to acquire ZACL's assets against expectations of equity funded acquisition and/or significant underperformance of the acquired assets once the acquisition goes through.

Analytical approach:

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for entities in the fertiliser industry
Parent/Group Support	NA
Consolidation / Standalone	The ratings are based on standalone financials of the company

About the company:

Paradeep Phosphates Limited (PPL) was incorporated in 1981 as a joint venture between the Government of India (GoI) and the Republic of Nauru to set up facilities for the manufacture of di-ammonium phosphate (DAP) at Paradeep, Orissa. In 1993, the Republic of Nauru disinvested its equity stake to the GoI and PPL became a public sector enterprise wholly owned by the GoI. In February 2002, GoI disinvested 74% of PPL's equity in favour of Zuari Maroc Phosphates Private Limited (ZMPPL), a 50:50 joint venture between Zuari Industries Limited (ZIL, a K.K. Birla Group company) and Maroc Phosphores, Morocco (part of OCP Group, Morocco). ZIL was demerged into Zuari Agro Chemicals Limited (ZACL, earlier Zuari Holdings Limited, rated [ICRA]B / [ICRA]A4 with ratings on watch with developing implications and Zuari Global Limited w.e.f. July 1, 2012. Currently, ZMPPL holds 80.45% stake in PPL, while the remaining 19.55% is held by the GoI. As on September 30, 2002, the company's net worth had turned negative due to continuing losses and it was referred to BIFR in February 2003. After several rounds of hearings involving various stakeholders, the BIFR approved a final restructuring scheme in October 2008. The company formally exited BIFR in August 2011.

PPL is currently among the top few integrated DAP plants in India with an installed annual capacity of 0.72 million metric tonnes per annum (MMTPA) of DAP / NPK complex fertilisers (effective capacity of 1.3 MMTPA), 0.30 MMTPA of phosphoric acid and 1.32 MMTPA of sulphuric acid. Actual production of DAP / NPK fertilisers has remained higher than the installed capacity over the past few years due to initiation of several operational improvement and debottlenecking projects by the management. The company is almost fully reliant on imported raw materials (rock phosphate, phosphoric acid, ammonia, sulphur, potash, etc.) for its operations and has a dedicated jetty at the Paradeep Port for these imports.

Key financial indicators (audited)

	FY2019	FY2020	H1 FY2021
Operating Income (Rs. crore)	4,357.90	4,192.90	2,326.81
PAT (Rs. crore)	159.5	194	171.0
OPBDIT/OI (%)	11.33%	12.36%	14.45%
RoCE (%)	11%	10%	16%
Total Outside Liabilities/Tangible Net Worth (times)	2.8	2.1	1.7
Total Debt/OPBDIT (times)	6.3	4.4	3.0
Interest Coverage (times)	3.1	2.7	6.0
DSCR	1.9	1.7	3.2

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); NWC: Net Working Capital; DSCR= (Net Profit After Tax + Gross Interest + Depreciation) / (Gross Interest + long term & short term Repayment + Dividend on Preference Shares); H1 FY2021 results are un-audited

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

	Instrument	Current Rating (FY2021)					Rating History for the Past 3 Years				
		Type	Amount Rated	Amount Outstanding	Rating		FY2020	FY2019		FY2018	
					6-Nov-2020	20-Jul-20	30-Aug-19	13-Sep-18	10-Aug-18	11-Dec-17	16-Aug-17
1	Term Loan	Long Term	824.0	234.2	[ICRA]A @; Rating continues on watch with Negative implications; assigned	[ICRA]A @; Rating on watch with Negative implications	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]BBB+ (Positive)	-
2	Fund Based Facilities	Long Term	1365	-	[ICRA]A @; Rating continues on watch with Negative implications	[ICRA]A @; Rating on watch with Negative implications	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]BBB+ (Positive)	[ICRA]BBB+ (Positive)
3	Non-fund Based Facilities	Short Term	2570	-	[ICRA]A1@; Rating continues on watch with Negative implications	[ICRA]A1@; Rating on watch with Negative implications	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A2+	[ICRA]A2+
4	Commercial Paper	Short Term	250	-	[ICRA]A1@; Rating continues on watch with Negative implications	[ICRA]A1@; Rating on watch with Negative implications	[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 click here

Annexure-1: Instrument Details

ISIN o	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
-	Term Loan	December 2018	-	December 2023	190.0	[ICRA]A @; Rating continues on watch with Negative implications
-	Term Loan	May 2016	-	April 2021	50.0	[ICRA]A @; Rating continues on watch with Negative implications
-	Term Loan	April 2016	-	April 2021	30.0	[ICRA]A @; Rating continues on watch with Negative implications
-	Term Loan	April 2016	-	May 2021	20.0	[ICRA]A @; Rating continues on watch with Negative implications
-	Term Loan	May 2020	-	December 2026	214.0	[ICRA]A @; Rating continues on watch with Negative implications
-	Proposed Term Loan	-	-	-	310.0	[ICRA]A @; Rating continues on watch with Negative implications
-	Fund based long term	-	-	-	1365.0	[ICRA]A @; Rating continues on watch with Negative implications
-	Non-fund based short term	-	-	-	2570.0	[ICRA]A1 @; Rating continues on watch with Negative implications
-	Commercial Paper	-	-	7-365 days	250.0	[ICRA]A1 @; Rating continues on watch with Negative implications

Source: Paradeep Phosphate Limited.

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
NA		

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