September 06, 2021

Dhanuka Agritech Limited: Long term rating upgraded; Outlook revised to Stable from Positive; short term rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund based-working Capital Facility	30.00	30.00	[ICRA]AA; upgraded from [ICRA]AA- with Outlook Revised to Stable from Positive
Non Fund Based-LC/BG	33.35	33.35	[ICRA]A1+ reaffirmed
Total	**63.35**	63.35	

**Instrument details are provided in Annexure-1*

Rationale

The rating upgrade factors in the significant improvement in Dhanuka Agritech Limited (DAL) credit profile in FY2021 and expectation of the same going forward. The rating upgrade also factors in the planned backward integration into manufacturing of technicals which is expected to provide raw material security as well expansion in the contribution levels as well. The company will be spending around Rs. 300 crore over the next three years on the capex related to setting up of technicals manufacturing plant which it plans to funds through internal accruals going forward. ICRA expects the cash generation from operations along with ~Rs. 223.0 crore of cash at hand at the end of FY2021, to remain adequate to meet the capex requirements as well as cash outflow to investors in the form of dividends/buybacks leading to no reliance on term debt. The performance of the company in FY2021 was marked by robust revenue growth and significant expansion in the operating margins leading to strong cash generation and net cash position improving sharply. The performance is expected to moderate marginally in FY2022 given the erratic monsoon in the ongoing Kharif season and increase in the raw material prices which have impacted the operating margins. Nevertheless, the cash flows are expected to remain healthy to keep the credit profile healthy going forward as well.

Additionally, the ratings factor in DAL's established market position supported by its diverse product portfolio (across all agrochemical categories), strong brand presence, wide distribution network and geographical presence in the domestic market. Its long-standing relations with reputed international technicals manufacturers, which enable it to regularly introduce specialty formulations, also support the ratings. DAL's liquidity position remains comfortable on the back of healthy internal accrual generation, robust free cash balances/liquid investments, undrawn bank lines and no debt repayment liability.

However, the ratings are constrained by moderately high working capital intensity of the business and intense competition in the industry that limits the pricing flexibility of industry participants, including DAL, and susceptibility of operations to any adverse regulatory development related to manufacturing/sales of agrochemicals or any discontinuation of tie-ups with international technical manufacturers. Moreover, DAL's revenues and profitability remain vulnerable to agroclimatic conditions, volatility in raw material prices and foreign exchange rates, given that part of the raw material requirement is met through imports. ICRA notes that the management had in the past demonstrated support towards the inorganic growth plans of Dhanuka Laboratories Limited (DLL), a group entity, although currently no support has been extended to the entity. Any materially large support to the Group's ventures would remain a key monitorable.

The stable outlook on the rating reflects ICRA's expectation of DAL's credit profile to remain stable going forward driven by healthy cash generation coupled with large cash balances at hand which should allow the company to comfortably meet the capex requirement over the next three years with company expected to remain free from long term debt.

Key rating drivers and their description

Credit strengths

Amongst the leading players in the industry, with sizeable scale of operations, established brand name and well entrenched distribution network- DAL has an established operational track record and its promoters have extensive experience of around three decades in the agrochemical industry. The company is one of the few scaled up players in the industry with healthy scale of operations and well entrenched distribution network spanning across the country. The company undertakes several initiatives for educating and supporting farmers, which has enabled the company to develop strong brand recall among the end-users.

Well diversified product portfolio and geographical presence largely mitigate the risk of poor performance of any region or crop- DAL has well diversified portfolio of products across the product segment i.e. insecticides, herbicides etc. as well as across crops. The company also has a well-entrenched distribution network spanning across the country. As a result, DAL's performance is largely protected against poor performance of particular crop or region.

Long standing relations with reputed MNC technical manufacturers allow entry into the speciality products segment which offer better margins compared to generic products- DAL has associations with reputed international technicals manufacturers (such as Nissan Chemicals, FMC Corporation, and Hokko Chemicals), which provide access to speciality molecules. Almost 50–60% of the company's revenues are driven by the sales of speciality formulations, which also support profit margins. Going forward too, increased revenue contribution from speciality formulations is expected to aid the company's profit margins as the company has a healthy pipeline of new product launches.

Comfortable financial profile as marked by strong liquidity position, steady revenue growth, comfortable capital structure and healthy coverage metrics- DAL's financial risk profile remains comfortable characterised by healthy cash generation, low debt levels and robust liquidity position. The capitalisation and coverage metrics of the company have remained robust with gearing levels of 0.01x in FY2020 and FY2021 and interest coverage of 94.7x in FY2021. The liquidity profile of the company remains strong with nearly Rs. 223.0 crore of cash and equivalents at the end of FY2021 and largely unutilised working capital limits coupled with no debt repayment obligations.

Expected benefits of backward integration post operationalisation of technicals manufacturing plant from FY2023 onwards albeit project execution risks remain- DAL is embarking on setting up of a technicals manufacturing plant in Dahej, Gujarat with a total capital outlay of Rs. 300 crore over the next three years. The plant will provide raw material security and benefits of backward integration in the form of lower raw material costs. Thus, ICRA expects DAL to start deriving benefit from backward integration in FY2023 when the first phase of the plant is expected to be commissioned. However, given the large scale of the project being setup, the company will remain exposed to project execution risks.

Credit challenges

High competitive intensity of the industry limits pricing flexibility- The intensely competitive and fragmented nature of the agro-chemical industry exerts pricing pressure and necessitates constant marketing and branding expenditure. Nevertheless, DAL benefits to an extent because of its strong brand presence.

DAL's operations are vulnerable to varying agro climatic conditions and regulatory risks - The company's sales and profitability remain susceptible to agro-climatic conditions, development of pest-resistant genetically modified (GM) seeds and regulatory risks inherent in the business. This is also demonstrated by revenue growth moderation and contraction in margins in the past years due to sub-par monsoon seasons. The Government of India (GoI) had recently issued a draft order for banning the use of 27 pesticides after consultation with the Central Insecticides Board and Registration Committee (CIBRC/Registration Committee). While the same is being reassessed basis representations made by the industry participants, imposition of the same ban can adversely impact industry participants, including DAL.

Exposure to raw material price and foreign exchange volatility – Lack of backward integration into technical manufacturing and dependence on imports for around 20–30% of its raw material requirement exposes DAL's profit margins to volatility in raw material prices as well as foreign exchange rates. Moreover, given that tie-ups for technicals is critical for DAL's business position, it remains exposed to the risk of discontinuation of such tie-ups or increase in competition from other formulators, or the primary supplier developing its own formulation.

Moderately high working capital intensity - Given the seasonality inherent in demand, diverse product portfolio, dependence on imports for raw materials and wide distribution network across the country, the company needs to maintain high raw material and finished goods inventory. This has continued to result in high working capital intensity for it.

Liquidity position: Strong

The company's liquidity position is strong on the back of healthy internal accrual generation, sizeable free cash balances/liquid investments (~Rs. 223 crore as of end of March 2021), undrawn bank lines (~Rs. 30 crore) and no debt repayment liability. Going forward as well, despite undertaking sizeable capex over the next three years, the liquidity position is expected to remains strong driven by healthy cash generation.

Rating sensitivities

Positive factors – The ratings could be upgraded if DAL demonstrates significant growth in revenue accompanied with healthy cash generation with limited reliance on debt.

Negative factors – The rating could be revised if there is considerable decline in revenue and pressure on profit margins due to lower offtake, or any adverse regulatory development. Moreover, any moderation in the credit profile or the liquidity position due to elongation in the working capital cycle, sizeable debt funded capex or funding support extended to related companies beyond the board approved limit, could also lead to a downward revision in the ratings.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Agrochemical Industry
Parent/Group Support	Not Applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of DAL; as on March 31, 2021, the company had one subsidiary (enlisted in Annexure-2).

About the company

DAL is part of the Delhi-based Dhanuka Group. It is involved in the formulation and marketing of agro-chemicals like insecticides, pesticides, herbicides, etc. The company's manufacturing facilities are in Sanand (Gujarat), Udhampur (Jammu and Kashmir) and Keshwana (Rajasthan).

Key financial indicators (audited)

DAL Consolidated	FY2020	FY2021
Operating Income (Rs. crore)	1,120.1	1,387.5
PAT (Rs. crore)	141.3	210.6
OPBDIT/OI (%)	15.6%	19.4%
PAT/OI (%)	12.6%	15.2%
Total Outside Liabilities/Tangible Net Worth (times)	0.3	0.4
Total Debt/OPBDIT (times)	0.0	0.0
Interest Coverage (times)	102.0	94.7

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2022)				Chronology of Rating History for the past 3 years			
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of March 31, 2021 (Rs. crore)	Date & Rating in	Date & Rating in FY2021	Date & Rating in FY2020		Date & Rating in FY2019
					September 6, 2021	September 21, 2020	July 11, 2019	May 6, 2019	-
1	Working Capital Facilities-Fund based	Long-term	30.00	0.00	[ICRA]AA (Stable)	[ICRA]AA- (Positive)	[ICRA]AA- @	[ICRA]AA- (Stable)	-
2	Non-fund Based-LC/BG	Short term	33.35	27.2	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+ @	[ICRA]A1+	-

@= Under watch with negative implications

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term Fund-based – Working Capital facilities	Simple
Short Term-Non-fund Based	Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analyzing an entity's financial, business, industry risks or complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments, is available on ICRA's website: www.icra.in

Annexure-1: Instrument details

ISIN No/Banker Name	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (RS Crore)	Current Rating and Outlook
-	Fund Based-Working Capital facilities	-	-	-	30.00	[ICRA]AA (Stable)
-	Non-fund Based-LC/BG	-	-	-	33.35	[ICRA]A1+

Source: *Company*

Annexure-2: List of entities considered for consolidated analysis

Company Name	DAL's Ownership	Consolidation Approach
Dhanuka Agritech Limited	100.00% (rated entity)	Full Consolidation
Dhanuka Agri Solutions Private Limited	100.00%	Full Consolidation

Source: *DAL's annual report FY2021*

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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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