December 06, 2022

Deepak Fertilisers & Petrochemicals Corporation Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long term – Fund-based term Loan	733.00	733.00	[ICRA]AA-(Stable); reaffirmed
Long term – Fund-based cash Credit	150.00	150.00	[ICRA]AA-(Stable); reaffirmed
Short term – Non-fund based Limits	845.00	845.00	[ICRA]A1+; reaffirmed
Long term/Short term - Unallocated limits	228.00	228.00	[ICRA]AA-(Stable)/[ICRA]A1+; reaffirmed
Total	**1,956.00**	**1,956.00**	

**Instrument details are provided in Annexure-1*

Rationale

While arriving at the ratings, ICRA has taken a consolidated view of Deepak Fertilisers and Petrochemicals Corporation Limited (DFPCL) and its subsidiary Smartchem Technologies Limited (STL) due to their managerial, operational and financial linkages, collectively referred to as the Group/consolidated entity.

The ratings reaffirmation considers the company's diversified product portfolio comprising fertilisers and industrial chemicals, and its strong market position in the industrial chemical business, especially in ammonium nitrate (TAN), nitric acid and iso propyl alcohol (IPA). The ratings also factor in DFPCL's high financial flexibility.

ICRA takes note of the continued growth in cash accruals in H1 FY2023, supported by improved margin in the chemical segment on the back of a favourable product-raw material price spread and the increase in value-added products. ICRA also takes note of the moderation in working capital intensity in recent years, leading to lower working capital debt utilisation. ICRA also draws comfort from the healthy progress of the ammonia project being implemented under Performance Chemiserve Limited (PCL), a subsidiary of STL, which is now expected to be completed by Q1 FY2024. The timely completion and stabilisation of the project without any major cost overrun will be a key monitorable.

The healthy product-raw material spread and consequently the high margins are expected to be sustained in the near term, which coupled with no upward revision in the ammonia project cost and staggering of the TAN capacity expansion project, will result in better-than-expected credit metrics in the medium term. Going forward, the growth in sales volumes is expected to be supported by improving utilisation levels, capacity expansion and backward integration to drive long-term growth.

The ratings are, however, constrained by the agro-climatic and regulatory risks in the fertiliser business and the vulnerability of the chemical division's profitability to the inherent price cyclicality. Further, the company's profitability remains sensitive to any large fluctuation in spot/term R-LNG prices. For its ammonia project, DFPCL's ability to tie up its gas requirements and achieve the desired parameters, post-commissioning, would be important.

Further, ICRA also notes the appeal filed by STL in response to the receipt of assessment and demand orders for the block period (assessment year 2013-2014 to assessment year 2019-2020) pursuant to the search operation conducted by the income tax department in November 2018, resulting in a demand of Rs. 569 crore (including interest). ICRA will continue to monitor the development on this front.

The Stable outlook takes into account the company's established position in both the chemical and the fertiliser segments and ICRA's expectation that the company's credit profile will benefit in the medium term from the favourable demand, shift in product mix towards more value-added products and savings from backward integration from the ammonia project.

Key rating drivers and their description

Credit strengths

Strong market position in domestic industrial chemical business – DFPCL has a strong market position in the existing chemical businesses of TAN, nitric acid and IPA. It is one of the leading players of TAN in the domestic market, supported by the superior product quality of low density AN (LDAN), which commands a premium over AN-melt manufactured by domestic players and imported fertiliser grade AN. The company is among the only two producers of IPA in the domestic market. DFPCL is also the leading manufacturer of concentrated nitric acid (CNA) in the domestic market. It is also expanding its capacities in TAN, which would allow it to maintain its dominant position over a longer term.

Diversified portfolio with shift towards value-added products - DFPCL has a broad-based product mix, derived from two streams using natural gas or ammonia as the primary feedstock. The company's ability to suitably modify its product mix in response to the changes in market conditions partially mitigates the risks associated with cyclicality. The company has also been increasing value-added products in the chemical and fertiliser segments and the trend is expected to continue in the near to medium term.

Favourable demand prospects - The domestic demand outlook for the company's key products such as TAN, IPA, nitric acid remains healthy. The demand for TAN will be driven by demand from the coal mining and infrastructure sectors, while demand for nitric acid would be supported by planned capacity addition in the downstream segments. The IPA market is expected to maintain a healthy growth, led by the growing end-user industry, namely the pharma sector, apart from dyes and paints. The demand for the fertiliser segment is also expected to remain healthy.

Healthy financial flexibility - The Group has a healthy financial flexibility, reflected in its fund-raising and refinancing ability. In the past, it had raised funds through rights issues and from multilateral agencies. Further, in FY2022, DFPCL had raised ~Rs. 510 crore through QIP[1], which was subscribed by marquee domestic and international financial institutional investors.

Credit challenges

Profitability vulnerable to cyclicality in input prices - The company's profitability remains exposed to the cyclicality in input prices and the ability to pass on the same to the customers. Further, any availability issues of key raw materials also have an adverse impact. However, the risk has been partly mitigated by supplier diversification. Going forward, with the increasing backward integration, the availability risk will be mitigated further.

Exposure to regulatory risks - The company's fertiliser business is exposed to agro-climatic risk and operates in a regulated environment. The selling prices of its products remain dependent on the subsidy allocated by the GoI to the various nutrients. DFPCL, thus, remains exposed to any sharp variation in the subsidy amount and delays in receipt of the same, apart from any other regulatory intervention on the product prices. ICRA also notes the regulatory overhang over additional claims by GAIL towards domestic gas supply. The matter is sub-judice.

Large debt-funded capex - The Group is setting up an ammonia manufacturing facility of 1,500 MTPD (~510,000 MTPA) at Taloja, Maharashtra, close to the existing facilities of DFPCL. The project had witnessed time overrun (from Q4 FY2022 to Q1 FY2024) and cost overrun (from Rs 2,920 crore to Rs 4,350 crore) due to delays in land acquisition, pandemic-related issues and some changes in project specifications. The cost escalations have been mainly due to the increase in IDC component, EPC costs and some impact of rupee depreciation. However, in the last one year, there has been healthy project progress with no additional escalation in costs. Till October 2022, the company has achieved a healthy overall project progress and the Group has incurred a total cost of around ~Rs. 3,250 core for the project. The balance capex of around ~Rs. 1,100 crore will be incurred up to Q1 FY2024. The project is expected to commence operations from May 2023. Due to the healthy cash accruals in FY2021

[1] Qualified Institutional Placement

and FY2022 and the fund raised through QIP, the project is now expected to be funded in a debt-to-equity ratio of ~61:39 compared to 70:30 expected earlier.

Further, a major portion of the capex related to the TAN project is expected to be incurred only after the ammonia project has begun operations. However, ICRA also notes the completion of financial closure by the company for the TAN project. Due to these factors, the credit metrics are expected to be better in the medium term than the earlier expectations. ICRA expects the offtake risks for these projects to be limited, though the timely execution of the projects as well as a ramp-up of the operations within the revised timeline and budgeted cost would remain a key sensitivity.

Liquidity position: Adequate

At a consolidated level, the company's liquidity position remains adequate, led by healthy accrual generation, decline in net working capital intensity and healthy financial flexibility. The cash flow from operations stood healthy at ~Rs. 282 crore in H1 FY2023 and has witnessed a healthy increase in recent years (~Rs. 1,157 core in FY2022 and ~Rs. 990 crore in FY2021 compared with ~Rs. 515 crore in FY2020) and is also expected to be healthy in the current fiscal. The company has a comfortable cushion available in the form of unutilised working capital limits.

Further, DFPCL (consolidated) had a healthy free cash balance (including investment) of ~Rs. 1,000 crore as on September 30, 2022. It is expected to incur a capex of around ~Rs. 1,100 crore in H2 FY2023 and ~Rs. 1,400 crore in FY2024 for the ammonia and TAN projects, including regular maintenance, which would be funded through a mix of debt and internal accruals. However, due to the long repayment tenure of the term loans, the annual debt repayments are likely to remain modest at around ~Rs. 270-290 crore per annum in FY2023 and FY2024. The company has a healthy financial flexibility allowing it to raise funds from the debt and equity markets, as demonstrated in the past.

Rating sensitivities

Positive factors – A healthy improvement in cash accruals on a sustained basis, aided by the timely completion of new projects, leading to improvement in the credit metrics could lead to a rating upgrade. A specific credit metric that could lead to an upgrade is a net debt/EBITDA of less than 1x on a sustained basis.

Negative factors – Decline in profitability or a stretch in working capital position of existing operations or any further time and cost overruns in capex projects, leading to a deterioration of the debt metrics on a sustained basis could lead to a rating downgrade.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Rating Methodology for Entities in the Fertiliser Industry Rating Methodology for Entities in the Chemical Industry Corporate Credit Rating Methodology
Parent/Group support	Not Applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has combined the business and financial risk profiles of Deepak Fertilisers & Petrochemicals Corporation Limited with its subsidiary, Smartchem Technologies Limited as the latter is an integral part of DFPCL's operations. For arriving at the ratings, ICRA has considered the consolidated financials of Deepak Fertilisers & Petrochemicals Corporation Limited. As on September 30, 2022, the company had six subsidiaries, four step-down subsidiaries and one JV, that are enlisted in Annexure-2

About the company

DFPCL was incorporated in 1979 and the Group is involved in the manufacturing of nitro-phosphate (NP), nitrogen-phosphorous-potassium (NPK) and bentonite sulphur fertilisers and industrial chemicals such as technical ammonium nitrate (TAN), methanol, nitric acid and iso-propyl alcohol (IPA). The manufacturing facilities are at Taloja, Dahej, Srikakulam and Panipat. It also owns a commercial mall in Pune. DFPCL's promoters - Mr C. K. Mehta and Mr S.C. Mehta - hold a 45.46% stake in the company with the rest being held by public and institutional investors.

DFPCL's fertiliser and chemical business verticals have inter-linkages in the form of use of common raw materials and synergies in the manufacturing processes. The capability of the business segments to attract a different set of investors and strategic partners in order to scale up the size and operations is significant and hence, in FY2018, DFPCL demerged its fertiliser and TAN businesses into a wholly-owned subsidiary, Smartchem Technologies Limited (STL), with effect from January 1, 2015. STL further owns ~94% equity in a subsidiary company, Performance Chemiserve Limited (PCL). The Group is setting up a 1,500 MTPD ammonia plant under Performance Chemiserve Limited.

As per FY2022 audited financials, DFPCL, on a consolidated basis, reported a net profit of Rs. 687.5 crore on an OI of Rs. 7,663.3 crore, against a net profit of Rs. 406.4 crore on an OI of Rs. 5,808.5 crore in FY2021.

Key financial indicators (audited)

DFPCL – Consolidated	FY2021	FY2022	H1 FY2023*
Operating income (Rs. crore)	5,808.5	7,663.3	5,750.4
PAT (Rs. crore)	406.4	687.5	711.3
OPBDIT/OI (%)	16.5%	17.7%	21.5%
PAT/OI (%)	7.0%	9.0%	12.4%
Total outside liabilities/tangible net worth (times)	1.5	1.2	1.3
Total debt/OPBDIT (times)	2.6	1.9	1.2
Interest coverage (times)	5.1	8.8	14.2

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

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2023)					Chronology of rating history for the past 3 years			
		Type	Amount rated (Rs. crore)	Amount outstanding as on Sep 30, 2022 (Rs. crore)	Date & rating on		Date & rating in FY2022		Date & rating in FY2021	Date & rating in FY2020
					Dec 06, 2022	July 29, 2022	July 13, 2021	June 14, 2021	April 14, 2020	-
1	Term loan	Long-term	733.0	399.2	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	-
2	Cash credit	Long-term	150.0	-	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	-
3	Non-fund based limits	Short-term	845.0	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1	-
4	Unallocated	Long-Term / Short-Term	228.0	-	[ICRA]AA- (Stable)/[ICRA]A1+	[ICRA]AA- (Stable)/[ICRA]A1+	[ICRA]A+ (Stable)/ [ICRA]A1+	[ICRA]A+ (Stable)/ [ICRA]A1+	-	-
5	Nonconvertible debenture	Long Term							[ICRA]A+ (Stable) withdrawn	

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term Fund-based – Cash Credit	Simple
Long-term – Term Loan	Simple
Short-Term – Non-Fund Based Limits	Very Simple
Long-Term/ Short-Term – Unallocated Limits	Not applicable

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 analysing 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 are available on ICRA's website: Click Here

Annexure-1: Instrument details

ISIN No.	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. Crore)	Current Rating and Outlook
NA	Fund Based: Term Loan I	FY2018	NA	FY2028	258.00	[ICRA]AA-(Stable)
NA	Fund Based: Term Loan II	FY2018	NA	FY2028	190.00	[ICRA]AA-(Stable)
NA	Proposed term loans	NA	NA	NA	285.00	[ICRA]AA-(Stable)
NA	Fund Based: Cash Credit	NA	NA	NA	150.00	[ICRA]AA-(Stable)
NA	Non-Fund Based Limits	NA	NA	NA	845.00	[ICRA]A1+
NA	Unallocated	NA	NA	NA	228.00	[ICRA]AA-(Stable)/[ICRA]A1+

Source: Company

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Smartchem Technologies Limited	100.0%	Full Consolidation
Deepak Nitrochem Pty Limited	100.0%	Full Consolidation
Deepak Mining Services Private Limited (DMSPL)	100.0%	Full Consolidation
SCM Fertichem Limited	100.0%	Full Consolidation
Ishanya Realty Corporation Limited	100.0%	Full Consolidation
Ishanya Brand Services Limited	100.0%	Full Consolidation
Yerrowda Investments Limited	85.0%	Equity Method
Mahadhan Farm Technologies Limited [Subsidiary of STL]	100.0%	Full Consolidation
Performance Chemiserve Limited [Subsidiary of STL]	94.0%	Full Consolidation
Platinum Blasting Services Pty Limited (PBS) [Subsidiary of STL]	65.0%	Full Consolidation
Australian Explosives Pty Limited (AME) [Subsidiary of PBS]	65.0%	Full Consolidation

Source: Company

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About ICRA Limited:

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