Deepak Nitrite Limited Revised

March 18, 2019

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount(Rs. crore)	Rating Action
Term Loans	426.00	277.00	[ICRA]A+ (Positive); Reaffirmed and Outlook revised from 'Stable'
Fund based limits	300.00	300.00	[ICRA]A+ (Positive); Reaffirmed and Outlook revised from 'Stable'
Non-fund based limits	170.00	170.00	[ICRA]A1+; Reaffirmed
Fund & Non-Fund Based Limits (Interchangeable)	200.00	200.00	[ICRA]A+(Positive)/[ICRA]A1+; Reaffirmed and Outlook revised from 'Stable'
Commercial Paper	200.00	200.00	[ICRA]A1+; Reaffirmed
Total	**1,296.00**	**1,147.00**	

*Instrument details are provided in Annexure-1

Rationale

The revision in the rating outlook to Positive factors in the successful commissioning of the phenol and acetone greenfield project under the company's wholly-owned subsidiary, Deepak Phenolics Limited ([ICRA]BBB+ (Positive) / [ICRA]A2), in November 2018 and the healthy ramp up of operations seen in the initial months which would translate into healthy revenue growth and cash accruals for DNL on a consolidated basis. The Positive outlook also takes into account the favourable environment for speciality chemicals business driven by healthy demand from the end-user industries which would support DNL's standalone profitability levels for the near to medium term. ICRA positively notes the turnaround in the company's OBA[1] operations with the product turning profitable at the OPBITDA[2] level in 9M FY2019 driven by a successful change in sales strategy along with reduction in certain fixed costs.

The reaffirmation of the ratings takes into account the long operating track record of the company in the chemical industry, its diversified product mix as well as exposure to diversified end-user industries, and the leading market position enjoyed by the company in most of its products in the domestic as well as global markets. The ratings continue to factor DNL's multi-purpose manufacturing facility with significant backward and forward integration linkages that provide flexibility to change the product mix and cater to changing market requirements, and its technical expertise to handle complex and hazardous chemical processes like nitration, hydrogenation and diazotisation.

The ratings are, however, constrained by the exposure of the company's profitability to volatility in the raw material prices, though the same is reduced in certain products through formula-linked price contracts. While the OBA operations have turned profitable in the current fiscal, further ramp up remains to be seen as returns from the project continue to be muted thereby impacting DNL's overall return metrics. The ratings further take into account the high borrowing levels at a consolidated level on account of the large debt-funded phenol / acetone project commissioned recently due to which the gearing and debt coverage metrics remain moderate.

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[1] Optical Brightening Agent

[2] Operating Profits before Interest, Taxes, Depreciation and Amortisation

Outlook: Positive

ICRA believes DNL will continue to benefit from its leading presence in the domestic and global market for bulk and specialty chemicals. The ratings could be upgraded if the company is able to sustain healthy revenue growth and profit margins resulting in material deleveraging of its consolidated balance sheet and improvement in return metrics. The outlook may be revised to 'Stable' if the company faces any weakening in its profitability owing to movements in product prices and/or raw material costs or undertakes any sizeable capex that delays the expected improvement in the capital structure.

Key rating drivers

Credit strengths

Long operating history and established track record of the company in the global chemical intermediates industry – DNL has nearly five decades of operational presence in the business of manufacturing chemicals. Over the years, the company has grown to become a market leader in the domestic market for inorganic intermediates (sodium nitrite), nitro toluenes, and fuel additives. It is also among the top three global players in the market for xylidines, cumidines, and oximes.

Diversified product profile mitigating the risk associated with cyclicality in different product segments – While the company started with a limited portfolio of low-value bulk chemicals, sodium nitrite and sodium nitrate, it has grown its product portfolio to include high-value specialty chemicals used in multiple end-user applications and currently sells 15-20 different chemical products. The company has also added pharma intermediaries and more agro-chemical products to its portfolio. The regular introduction of new products has helped the company diversify the risk related to a particular product segment.

Multi-purpose manufacturing facility, with significant backward and forward integration linkages – The company's production facilities include production processes that allow vertical integration for most products thereby leading to significant cost savings. Also, the facilities are designed to provide flexibility to change the product mix to cater to market requirements.

Increasing scale of operations and cash accruals – DNL has reported a significant revenue growth and improvement in operating profitability in 9M FY2019 led by turnaround in OBA operations and a healthy performance in all its product segments. Further, healthy revenue and cash flow generation from DPL's recently commissioned project would also lead to an increase in the scale of operations for DNL on a consolidated basis.

Credit challenges

Profitability exposed to volatility in raw material prices though the same is reduced in certain products through formula-linked price contracts – Prices of most of the company's key products are linked to the movement in crude oil prices. The change in price levels, however, varies across product categories and is not commensurate with the change in crude price due to formula-linked pricing. Also, prices of some of the other key products, such as sodium nitrite, TFMAP, OBA, DASDA, etc. which form about 45%~50% of the company's sales currently, are delinked with movement in crude oil prices.

Muted returns from OBA operations – The company has witnessed various challenges in ramping up its OBA operations since OBA is a performance chemical and goes through an elongated approval process by the customer. DNL has employed certain strategies to bring the OBA capacity utilisation to a steady level and improve the profitability of its operations. DNL's OBA sales have increased in YTD FY2019 owing to growing demand from the paper and detergent industry and firming up of DASDA and OBA prices. The OBA segment reported positive OPBDITA for 9M FY2019; nonetheless, the returns continue to remain modest thereby depressing the overall returns of DNL. The ability of the company to sustain the turnaround in OBA's performance and further ramp up operations will be a key monitorable.

High borrowing levels at consolidated level – DNL's borrowings at a consolidated level remains high owing to a debt of Rs. 840 crore on the books of Deepak Phenolics Limited (DPL) raised to fund the phenol/acetone project. The high borrowing levels has led to modest gearing and debt coverage metrics for DNL on consolidated basis. Nonetheless, healthy cash flows following ramp up in DPL's operations would support the deleveraging plans of the company, going forward.

Liquidity Position:

The company's cash flow position improved in FY2018 vis-a-vis FY2017 with increase in operating profits and reduction in working capital intensity. Going ahead, the company's liquidity profile will remain healthy supported by steady cash accruals and adequate working capital limits from the bank. Also, the company has met ~99% of its equity commitment towards its phenol project which frees up its future cash flows. DNL also has a sanctioned term loan facility of Rs. 270 crore (Rs. 50 crore outstanding) which further supports the company's liquidity profile.

Analytical approach:

Analytical Approach	Comments
Applicable Rating Methodologies	Rating Methodology for Entities in the Chemical Industry
Parent/Group Support	Not Applicable
Consolidation / Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of Deepak Nitrite Limited. As on March 31, 2018, the Company had 2 wholly-owned subsidiaries that are enlisted in Annexure-2.

About the company:

Deepak Nitrite Limited (DNL) is the flagship of the Deepak Group, which was incorporated in the year 1970 by Mr. C.K. Mehta. It began as a fully indigenous sodium nitrite and sodium nitrate manufacturer and has gradually widened its product portfolio, enjoying a leading market position in most of its products in the domestic as well as global markets. DNL's product portfolio consists of Basic Chemicals, Fine & Speciality Chemicals (FSC) and Performance Products. DNL's manufacturing facilities are located at Nandesari and Dahej in Gujarat, Taloja and Roha in Maharashtra and Hyderabad in Telangana. DNL's growth has also been aided by strategic acquisitions of companies with complementary product lines in the past. In November 2018, the company commissioned its phenol and acetone manufacturing plant at Dahej at a project cost of ~Rs. 1,400 crore through its SPV, Deepak Phenolics Limited. As on date, DNL has infused Rs. 552.5 crore as equity in the project of its total equity contribution of Rs. 560 crore. Of DNL's total equity contribution, 50% would be in the form of non-cumulative optionally convertible preference shares.

Key financial indicators (Consolidated - audited)

	FY2017	FY2018
Operating Income (Rs. crore)	1,370.7	1,651.5
PAT (Rs. crore)	96.5	79.0
OPBDIT/OI (%)	10.0%	12.2%
RoCE (%)	16.4%	15.5%
Total Debt/TNW (times)	1.0	1.1
Total Debt/OPBDIT (times)	5.3	4.9
Interest coverage (times)	4.0	4.5

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

		Current Rating (FY2019)					Chronology of Rating History for the past 3 years			
					Date & Rating		Date & Rating in FY2018	Date & Rating in FY2017		Date & Rating in FY2016
	Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Mar 2019	Oct 2018	Jan 2018	Mar 2017	Dec 2016	Dec 2015
1	Fund Based Limits – Cash Credit	Long Term	300.00	NA	[ICRA]A+ (Positive)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)
2	Term Loan	Long Term	277.00	77.00	[ICRA]A+ (Positive)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)
3	Fund Based/ Non-Fund Based Limits (Interchangeable)	Long Term & Short Term	200.00	NA	[ICRA]A+ (Positive)/ [ICRA]A1+	[ICRA]A+ (Stable)/ [ICRA]A1+	[ICRA]A+ (Stable)/ [ICRA]A1+	[ICRA]A+ (Stable)/ [ICRA]A1+	[ICRA]A+ (Stable)/ [ICRA]A1+	[ICRA]A+ (Stable)/ [ICRA]A1+
4	Non-Fund Based Limits – LC, BG	Short Term	170.00	NA	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
5	Commercial Paper	Short Term	200.00	NA	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[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 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
NA	Term Loan	FY2015	NA	FY2026	277.00	[ICRA]A+ (Positive)
NA	Cash Credit	NA	NA	NA	300.00	[ICRA]A+ (Positive)
NA	Non-fund Based Limits	-	-	-	170.00	[ICRA]A1+
NA	Commercial Paper	-	-	7-365 days	200.00	[ICRA]A1+
NA	Fund Based/ Non-fund Based Limits (Interchangeable)	-	-	-	200.00	[ICRA]A+ (Positive)/ [ICRA]A1+

Source: Deepak Nitrite Limited

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Deepak Phenolics Limited	100.00%	Full consolidation
Deepak Nitrite Corporation Inc., USA	100.00%	Full consolidation

Corrigendum

Document dated March 18, 2019 has been corrected with revision as detailed below:

Page 1 – Sub Total of Previous rated amount column was inadvertently captured Rs. 1196.00 crore instead of Rs. 1296.00 crore. This has now been corrected.

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