

Deepak Phenolics Limited

March 18, 2019

Summary of rating action

Instrument*	Previous Rated Amount(Rs. crore)	Current Rated Amount(Rs. crore)	Rating Action
Term Loans	840.00	840.00	[ICRA]A- (Stable); Upgraded from [ICRA]BBB (Stable)
Fund Based Limits - Cash Credit^	55.00	480.00	[ICRA]A- (Stable); Upgraded from [ICRA]BBB (Stable)
Non-fund Based Limits - Interchangeable	0.00	(480.00)	[ICRA]A2+; Upgraded from [ICRA]A3+
Non-fund Based Limits	65.00	0.00	-
Total	960.00	1,320.00	

*Instrument details are provided in Annexure-1; ^ utilisation of fund based limits would not exceed Rs. 450 crore at any point of time

Rationale

The upgrade in ratings takes into account the successful commissioning of the phenol/ acetone project by Deepak Phenolics Limited (DPL) in November 2018 within the budgeted project cost along with the healthy ramp up in operations with an average of 80% plant utilisation achieved for the first two months post commissioning. ICRA expects the company to be able to sustain healthy operating rates for its plant supported by the growing domestic market for both phenol and acetone which so far was largely met through imports. DPL has been successful in penetrating the market through the seed marketing activities carried out during the pre-commissioning period as well as the established distributor network available with its parent company, viz. Deepak Nitrite Limited ([ICRA]A+ (Positive) / [ICRA]A1+). Further, the company's operations are likely to benefit from the high levels of crack spreads¹ at least for the near term that would support its profitability and cash flows.

The ratings continue to take into account the strong parentage of the company, being a wholly-owned subsidiary of Deepak Nitrite Limited (DNL), which is a leading company in the chemical industry with extensive experience. The ratings also factor in the healthy demand in the domestic market for the company's products as well as limited domestic competition. The company has taken the process technology for its plant from leading global players in petrochemical technology.

The ratings are, however, constrained by the risks arising from import competition from existing capacities of established global players. The ratings are also constrained by the exposure of the project metrics to the movement in the spreads between the products and the feedstock, which are volatile and cyclical in nature. The profitability of the company would also be exposed to regulatory risks arising from any changes in the custom duty differential between the feedstock and final products and revision in anti-dumping duty applicable on imports of phenol and acetone, as well as the movement in the exchange rates. While the standalone project economics remains favourable, the company's ability to operate at steady utilisation levels so as to be able to service the debt on a standalone basis would be important from a credit perspective.

¹ Difference between product prices (i.e. phenol and acetone) and raw material costs (benzene and propylene)

Outlook: Stable

ICRA believes DPL will benefit from its parentage and healthy domestic demand for its products. The outlook may be revised to 'Positive' if the company's plant sustains healthy operating rates resulting in healthy cash flows as well as reduction in gearing levels. The outlook may be revised to 'Negative' if the company faces any material deterioration in its profitability owing to adverse movements in the crack spreads or if the company undertakes any material debt-funded capex leading to deterioration in its debt coverage metrics.

Key rating drivers

Credit strengths

Successful commissioning of the project within the budgeted cost; healthy ramp up of operations – DPL's phenol/acetone project was commissioned in November 2018. The company was able to ramp up its plant to healthy utilisation levels in a short period (~80% utilisation for first two months of operations) supported by healthy demand indicators for its products.

Wholly-owned subsidiary of Deepak Nitrite Limited – DPL strongly benefits from its parent's extensive experience and well-established position in the domestic and global chemical industry. DNL brings to its subsidiary the best practices in the sector and also a strong brand name. DPL would also benefit from the extensive marketing network available that helped it successfully undertake seed marketing during the pre-commissioning stage.

Healthy demand in the domestic market for the project's products, viz. phenol and acetone – The domestic demand for phenol has grown at a CAGR (compounded annual growth rate) of about 9% between FY2010 and FY2017. The domestic demand far exceeds the domestic production for both the products and ~85% of the total phenol and acetone consumption in India is met via imports. With limited domestic production capacity and favourable demand drivers, the market risks for the company's chemicals are expected to be low. On the supply side, the company is procuring propylene and benzene, the key feedstock for manufacturing the intermediary cumene, from an adjacent petrochemicals plant as well as from PSU refineries.

Process technology taken from reputed suppliers – The company has taken the phenol/acetone technology from KBR Inc. of the USA, which is a leading global player in the EPC business and has an established presence in process and design technologies. For the cumene technology, the company has chosen Honeywell UOP (formerly known as Universal Oil Products), a highly reputed plant technology company, as its supplier.

Credit challenges

Profitability exposed to the movement in the spreads between the products and feedstock – As the prices of phenol and acetone are cyclical and volatile, the profitability of the project is exposed to the movement in the crack spreads between the final products and the feedstock. The spread movements are partly governed by the movement in crude oil prices and partly by the global demand-supply balance of phenol and acetone.

Import competition from established global majors – India is heavily reliant on imports of phenol/acetone and therefore the company would have to compete with global majors that have a ready phenol market in India. However, the company has been able to achieve desired quality of phenol and acetone output leading to higher likelihood of the product gaining acceptance in the domestic market.

Profitability to be exposed to custom duty differential and exchange rates – The current custom duty differential remains favourable for domestic manufacturers of phenol/acetone as the custom duty on phenol and acetone is at 7.5% while that on the key feedstock is at 2.5%; however, any change in the duty differential could impact the profitability of

the project. The company would also be exposed to regulatory risks pertaining to Anti-Dumping Duty (ADD). While ADD is currently applicable on some of the markets that export phenol to India, the company would remain exposed to the revisions in ADD for different countries in the long-term. Since the prices of all products are internationally benchmarked, the project's profitability would also be exposed to movement in forex rates.

Liquidity Position:

The company's liquidity profile is expected to be healthy given healthy generation of cash flows and adequate working capital limits from the bank. Further, the repayment of the company's long-term debt is scheduled to commence from June 2020 thereby allowing the company to build up cash reserves for servicing its debt obligations comfortably.

Analytical approach:

Analytical Approach	Comments
Applicable Rating Methodologies	Rating Methodology for Entities in the Chemical Industry Impact of Parent or Group Support on an Issuer's Credit Rating
Parent/Group Support	We expect DPL's parent, Deepak Nitrite Limited [rated [ICRA]A+ (Positive)/ [ICRA]A1+], to be willing to extend financial support to DPL, should there be a need, given the high strategic importance that DPL holds for DNL for meeting its diversification objectives. Both DPL and DNL also share a common name, which in ICRA's opinion would persuade DNL to provide financial support to DPL to protect its reputation from the consequences of a group entity's distress.
Consolidation / Standalone	The ratings are based on the standalone financial profile of the company.

About the company:

Deepak Phenolics Limited (DPL) is a wholly-owned subsidiary of Deepak Nitrite Limited (DNL) setup for a greenfield project at Dahej (Gujarat) for manufacturing of phenol and acetone. The project, with a manufacturing capacity of 200,000 TPA of phenol and 120,000 TPA of acetone, was commissioned on November 1, 2018. The project also includes a cumene manufacturing facility, which would meet the plant's entire cumene requirement. The technology for the phenol plant has been provided by KBR Inc. of USA and for the Cumene Plant UOP Honeywell. The project cost has been estimated at Rs. 1,400 crore, funded by debt of Rs. 840 crore (60% of project cost) and equity of Rs. 560 crore (40% of project cost).

Key financial indicators (Audited)

	FY2017	FY2018
Operating Income (Rs. crore)	136.6	199.4
PAT (Rs. crore)	-9.7	-4.8
OPBDIT/OI (%)	-5.0%	-2.9%
Total Debt/TNW (times)	0.6	1.1
Total Debt/OPBDIT (times)	-22.1	-90.8
Interest coverage (times)	-1.6	-1.1

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				
Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating Mar 2019	Date & Rating in FY2018	Date & Rating in FY2017	Date & Rating in FY2016	Date & Rating in FY2015	
1	Term Loans	840.00	783.0	[ICRA]A-(Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	
2	Fund Based Limits – Cash Credit	480.00	-	[ICRA]A-(Stable)	[ICRA]BBB (Stable)	-	-	-	
3	Non-Fund Based Limits - Interchangeable	(480.00)	-	[ICRA]A2+	-	-	-	-	
4	Non-Fund Based Limits	0.00	-	-	[ICRA]A3+	-	-	-	

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	FY2017	NA	FY2029	840.00	[ICRA]A- (Stable)
NA	Fund Based Limits - Cash Credit	NA	NA	NA	480.00	[ICRA]A- (Stable)
NA	Non-fund Based Limits - Interchangeable	-	-	-	(480.00)	[ICRA]A2+

Source: Deepak Phenolics Limited

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