March 11, 2024

Deepak Nitrite Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long term/Short term fund-based and non-fund based limits	490.00	490.00	[ICRA]AA(Positive)/[CRA]A1+; reaffirmed
Short term – Commercial paper	200.00	200.00	[ICRA]A1+; reaffirmed
Total	**690.00**	**690.00**	

**Instrument details are provided in Annexure-I*

Rationale

While arriving at the ratings, ICRA has taken a consolidated view of Deepak Nitrite Limited (DNL) and its subsidiary Deepak Phenolics Limited {DPL, rated [ICRA]AA (Positive)/[ICRA]A1+}, collectively referred to as the Deepak Group/the Group/the consolidated entity due to their managerial, operational and financial linkages.

The reaffirmation of the ratings considers the healthy consolidated financial profile of the company, supported by stable performance across segments, although there has been some moderation in the revenue and profitability in the current fiscal because of subdued realisations and elevated input costs. ICRA notes that with further prepayment of the term debt in Q3 FY2024, the consolidated entity continues to be net debt-free as on December 31, 2023, leading to healthy capital structure and coverage indicators.

The ratings continue to take into account the long operating track record of the company in the chemical industry, its diversified product mix and exposure to diversified end-user industries. ICRA notes the company's leading market position in most of its product segments across the domestic and global markets. The ratings also continue to factor in the group's multi-purpose manufacturing facility with significant backward and forward integration with flexibility to change the product mix as per the market requirements. ICRA also notes the Group's 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 the volatility in raw material prices, though the risk is lower for certain products because of formula-linked price contracts. The ratings will also be impacted by the vulnerability of DPL's profitability to volatile crack spreads, which in turn is linked to the volatility in the price of feedstock and finished products.

ICRA notes that recently the wholly-owned subsidiary of DNL – Deepak Chem Tech Limited (DCTL) - has signed a Rs. 9,000-crore memorandum of understanding (MoU) with the Government of Gujarat on January 31, 2024, adding to the previous MoU worth Rs. 5,000 crore as on May 23, 2023, for capacity expansion of some existing products, new product addition, backward and forward integration and cost saving measures. However, the capex comprises several smaller projects (under rated entities/subsidiaries/JV), with the execution phased over the next several years, which will mitigate the risk to some extent. Also, the Group is executing projects worth around Rs. 2,000 crore (part of existing MoU worth Rs. 5000 crore), of which majority will get commissioned by December 2024. The large size of the capex exposes the Group to project implementation risks over the next couple of years. ICRA notes that the company is yet to finalise the phasing of the execution for a major part of the capex. ICRA will continue to monitor the developments on this front and it will remain a key monitorable, going forward.

The Positive outlook reflects ICRA's expectation that the consolidated entity's credit profile will continue to benefit from the improvement in financial performance in the near to medium term, driven by the strong market position of the Group in the global chemical industry, backward integration, the cost-saving measures and incremental project commercialisation.

Key rating drivers and their description

Credit strengths

Long operating history and established position in global chemical intermediates industry - DNL has been operating in the chemical industry for nearly five decades. Over the years, the company has become a market leader in the domestic market for inorganic intermediates (sodium nitrite and sodium nitrate), nitro toluenes and fuel additives. DNL is among the top five global players in xylidines, cumidines, colour intermediates and oximes. DNL is present in over 30 countries, including the US, the European Union, the East European nations, Japan, ASEAN countries, South Korea and South America.

DPL, a 100% subsidiary of DNL, commissioned its phenol and acetone plant in November 2018. Since the commissioning of its IPA plant in April 2020, DPL has witnessed a significant improvement in scale and profitability. Further, the total capacity of IPA has doubled after the commissioning of the brownfield expansion in December 2021. The company also undertook debottlenecking of the phenol capacity in H1 FY2024, which will support incremental cash generation for DPL. The domestic demand for phenol and acetone far exceeds domestic production at present. Moreover, with limited domestic competition, DPL has been able to garner a significant market share in the Indian market.

Diversified product profile mitigates cyclicality risks in different segments - While the company started with a limited portfolio of low-value bulk chemicals, it has grown its product portfolio to include high-value speciality chemicals for multiple end-user applications. At present, it has a product portfolio of over 100 products (including its derivatives). The company has also added pharma intermediaries and more agro-chemical products to its portfolio over the years. The regular introduction of new products has helped DNL mitigate the cyclicality risk related to a particular product segment.

Multi-purpose manufacturing facility, with significant backward and forward integration - The company's production facilities include processes that allow vertical integration for most products, leading to significant cost savings. Also, its facilities have the flexibility to change the product mix to suit the market requirements.

Healthy financial profile – On a consolidated basis, DNL reported a YoY revenue growth of around 17% in FY2023 at Rs. 7,992.1 crore (P.Y. Rs. 6,821.3 crore), driven by higher realisations and capacity utilisation across the phenolics and advanced intermediate segments. However, the profitability was impacted by the high base effect on account of the higher realisations for some products in the prior period combined with a sharp rise in input prices as well as utility costs and also on account of a reduction in crack spreads in the phenolics division. In 9M FY2024, on a consolidated basis, DNL reported an operating income of Rs. 5,555.6 crore, a YoY growth decline of ~8%, as the realisations moderated, though this was partly offset by the volume growth across all segments.

Healthy cash accruals enabled the company to prepay its debt, leading to an improvement in the overall credit and coverage metrics. In FY2023, on a consolidated basis, the interest coverage and DSCR stood at 49.2 and 10.9 times, respectively, compared to 44.7 and 14.9 times, respectively, in FY2022. The total debt/OPBITDA declined to 0.04 times as on March 31, 2023, compared to 0.18 times as on March 31, 2022, while the net debt/OPBITDA remained negative as on March 31, 2023. Going forward, the financial risk profile is expected to witness slight moderation as the Group executes significant capex plans under DCTL.

Healthy operations at DPL – DPL's phenol-acetone plant showed healthy capacity utilisation in FY2023 and 9M FY2024, resulting in steady revenue and cash flow generation for DNL on a consolidated basis. In FY2023, the segment delivered a strong topline performance with a revenue growth of 16%. However, the profitability moderated due to increase in the prices of key raw materials such as propylene and benzene combined with the high prices of coal, which reduced the crack spreads.

In 9M FY2024, the performance remained strong on the back of improving plant efficiency and healthy sales volume, which resulted in record production of phenol and cumene in Q3 FY2024. This elevated the average utilisation levels despite a planned shutdown in Q1 FY2024 for a debottlenecking exercise. Also, after the operationalisation of its IPA plant in April 2020, DPL was able to reap the benefits of the sharp increase in demand for IPA during the pandemic. With IPA 2 getting commissioned in December 2021, the total capacity of IPA has been doubled to 60,000 MTPA. With the timely commissioning, DPL has been able to sell its products in the domestic and global markets while generating healthy cash flows.

Credit challenges

Profitability exposed to volatility in raw material prices; formula-linked price contracts mitigate risk in some segments – The prices of a few key products are linked to the movement in crude oil prices. The change in the price levels, however, varies across product categories and is not commensurate with the change in crude price due to formula-linked pricing. Also, the prices of certain key products, such as sodium nitrite, trifluoromethyl acetophenone (TFMAP), optical brightening agents (OBA) and DASDA are delinked from the movement in crude oil prices. In the phenolics segment, the prices of phenol and acetone are cyclical and volatile and the profitability of the project is exposed to the movement in crack spreads between the final products and the feedstock. The movements in the spread are partly governed by crude oil prices and partly by the global demand-supply balance of phenol and acetone.

Large capex planned over the medium term, exposing the Group to project execution risks - On a consolidated basis, the DNL Group incurred ~Rs. 363-crore capex towards capacity expansion of existing products, regular maintenance and the announced capex plans in FY2023. DCTL signed an MoU worth Rs. 9,000 crore with the Government of Gujarat on January 31, 2024, adding to the previous MoU worth Rs. 5,000 crore as of May 23, 2023 for capacity expansion of some existing products, new product addition, backward and forward integration and cost-saving measures. However, ICRA notes that the capex pertains to several smaller projects (under rated entities/subsidiaries/JV), with the execution phased out during an extended period, which will mitigate the risk to some extent.

Also, the Group is currently executing projects worth around Rs. 2,000 crore (part of existing MoU worth Rs. 5000 crore), of which majority will get commissioned by December 2024. Further, the capex is not for a single project but several projects, which will be staggered over this period and each unit will be monetised/commence operation, even while the capex for the others might be ongoing. The Group is also incurring capex for the sodium nitrate plant in Oman. Such sizeable capex plans expose the company to execution and market risks, although this is mitigated to some extent by the track record of the company in completing the projects, including the phenol-acetone project under DPL. Further, majority of the chemicals will serve as backward and forward integration for the Group, which reduces the market risk. The development on this front remains a key monitorable.

Environmental and Social considerations

Environmental considerations: Chemical companies, including specialty and commodity chemical producers, face environmental risks from their exposure to waste, pollution, and toxicity. DNL (consolidated) is exposed to the risks of tightening regulations on environment and safety. As per the disclosures made by the consolidated entity, its operating units comply with all the environmental regulations and various statutory approvals/permits granted by the authorities. Also, there were no pending show cause/legal notices from the CPCB/SPCB at the end of 2022-2023. This indicates that the consolidated entity has mitigated the regulatory risks with its sound operational track record and regulatory compliance. Nonetheless, the consolidated entity remains exposed to the longer term risk of the ongoing shift towards a future that is less dependent on fossil fuels. The consolidated entity's ability to adapt its business model, including diversification into new segments, would be a key rating driver from a long-term credit perspective.

Social considerations: The key social risks for chemical companies are demographics, safety management, and the growing influence of consumer behaviour. Chemical companies face demographic changes from rising population, urbanisation, and greater economic development in many parts of the world. However, for emerging markets like India, such change in consumer behaviour or any other driver of change is expected to be relatively slow paced. Therefore, at present, while the consolidated entity remains exposed to the mentioned social risk, it does not materially affect its credit profile. Further, social perception of chemical products and consumer preferences could pose important long-term risks to the consolidated entity.

Liquidity position: Strong

At a consolidated level, DNL's liquidity position remains strong with healthy annual cash flow from operations at Rs. 649.9 crore in FY2023 and Rs. 534.7 crore in H1 FY2024. The Group's free cash balance and liquid investments were at ~Rs. 538.9 crore as on September 30, 2023. DNL has a sanctioned fund-based working capital facility of Rs. 490 crore as on December 31, 2023 at a standalone level, the average utilisation of which remained negligible over the past 12 months ended December 2023. DPL also has a sanctioned interchangeable working capital limit of Rs. 580 crore as on December 31, 2023, the average utilisation of which was 55% in the form of non-fund based limits in the last 12 months.

The company has no repayment obligations for its existing debt on account of the prepayment in Q3 FY2024. The company has plans for capex/investment in JVs over the next few years, for which ~Rs. 730-750 crore will be incurred in FY2024 and ~Rs. 2,100-2,500 crore over FY2025-FY2026, to be funded through a mix of debt and internal accruals, although the debt funding is expected to be moderate.

Rating sensitivities

Positive factors – The ratings can be upgraded if the company is able to sustain healthy revenue growth and profitability on a consolidated basis, backed by a change in the product mix towards more value-added products.

Negative factors – Pressure on the ratings may arise if the company faces significant decline in its consolidated revenue and profitability on a sustained basis or undertakes higher-than-expected debt-funded capex that will weaken its credit profile. A specific credit metric for downgrade would be net debt/OPBITDA of more than 1.5 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology 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 (please refer to Annexure II for details of the entities consolidated)

About the company

DNL is the flagship of the Deepak Group, which was incorporated in 1970 by Mr. C.K. Mehta. It began as a fully indigenous sodium nitrite and sodium nitrate manufacturer, before gradually widening its product portfolio over the years. At present, DNL has a leading market position in most of its products in the domestic and global markets. DNL has a portfolio of over 100 products, broadly divided into two segments— advanced intermediates and phenolics. The company has five manufacturing facilities, one each at Nandesari and Dahej in Gujarat, Taloja and Roha in Maharashtra, and in Hyderabad in Telangana. DNL also has a research and development facility at Nandesari, Gujarat. The company's growth has also been aided by the strategic acquisition of companies with complementary product lines. In November 2018, the company commissioned its phenol and acetone manufacturing plant at Dahej under its wholly-owned subsidiary, DPL.

In FY2023, DNL, on a consolidated basis, reported a net profit of Rs. 852.0 crore on an operating income of Rs. 7,992.1 crore compared with a net profit of Rs. 1,066.6 crore on an operating income of Rs. 6,821.3 crore in FY2022.

Key financial indicators (audited)

	FY2022	FY2023	9MFY24
Operating income	**6821.3**	**7992.1**	**5555.6**
PAT	**1066.6**	**852.0**	**557.0**
OPBDIT/OI	23.8%	16.4%	14.8%
PAT/OI	15.6%	10.7%	10.0%
Total outside liabilities/Tangible net worth (times)	0.3	0.3	-
Total debt/OPBDIT (times)	0.2	0.0	-
Interest coverage (times)	44.7	49.2	110.8

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument		Current rating (FY2024)			Chronology of rating history for the past 3 years					
		Type	Amount rated (Rs. crore)	Amount outstanding as on Dec 31, 2023 (Rs. crore)	Date & rating in FY2024	Date & rating in FY2023		Date & rating in FY2022		Date & rating in FY2021
					Mar 11, 2024	Mar 31, 2023	Jun 13, 2022	Mar 25, 2022	Mar 26, 2021	Jun 17, 2020
1	Term loans	Long-term	-	-	-	-	-	-	[ICRA]AA (Stable)	[ICRA]AA- (Positive)
2	Fund-based limits	Long-term	-	-	-	-	[ICRA]AA (Positive)	[ICRA]AA (Positive)	[ICRA]AA (Stable)	[ICRA]AA- (Positive)
3	Non-fund based limits	Short term	-	-	-	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
4	Fund and non-fund based limits	Long term/ Short term	490.00	-	[ICRA]AA (Positive)/ [ICRA]A1+	[ICRA]AA (Positive)/ [ICRA]A1+	[ICRA]AA (Positive)/ [ICRA]A1+	[ICRA]AA (Positive)/ [ICRA]A1+	[ICRA]AA (Stable)/ [ICRA]A1+	[ICRA]AA (Positive)/ [ICRA]A1+
5	Unallocated limits	Long term/ Short term	-	-	-	-	-	-	[ICRA]AA (Stable)/ [ICRA]A1+	-
6	Commercial papers	Short term	200.00	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long/Short term fund-based and non-fund based limits	Simple
Short-term – Commercial paper	Very 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 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 I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	**Fund and non-fund based limits**	NA	NA	-	490.00	[ICRA]AA(Positive)/[ICRA]A1+
Unplaced	**Commercial paper**	NA	NA	7-365 days	200.00	[ICRA]A1+

Source: Company

[Please click here to view details of lender-wise facilities rated by ICRA]

Annexure II: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Deepak Nitrite Limited	100.00% (rated entity)	Full Consolidation
Deepak Phenolics Limited	100.0%	Full Consolidation
Deepak Nitrite Corporation Inc., USA	100.0%	Full Consolidation
Deepak Chem Tech Limited	100.0%	Full Consolidation

Source: DNL annual report

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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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