

August 16, 2017

Zuari Fertilisers & Chemicals Limited

Summary of rated instruments

Instrument*	Rated Amount (Rs. crore)	Rating Action
Term loan	30	[ICRA]BBB-reaffirmed; Outlook revised to Stable from Negative
Fund based long term facilities	17	[ICRA]BBB-reaffirmed; Outlook revised to Stable from Negative
Non-fund based, short term facilities	3	[ICRA]A3 reaffirmed
Total	50	

*Instrument details are provided in Annexure-1

Rating action

ICRA has reaffirmed the ratings of [ICRA]BBB- (pronounced ICRA triple B minus) and [ICRA]A3 (pronounced ICRA A three) for Rs. 50 crore¹ bank facilities of Zuari Fertilisers & Chemicals Limited (ZFCL)². The outlook on the long-term rating is has been revised to 'Stable' from 'Negative'.

Rationale

The ratings of ZFCL are primarily based on the parental support of Zuari Agro Chemicals Limited (ZACL, rated [ICRA]BBB+(Stable)/[ICRA]A2+). The revision in outlook factors improvement in performance of ZACL in H2 FY2017 which helped the company in offsetting the large losses incurred in H1 FY2017 due to price intervention by GoI for DAP, NPK and MOP leading to large inventory losses. The revision in outlook also takes into account the expectation of improvement in financial performance of ZACL in the near term owing to lower raw material prices and favourable policy measure taken by GoI. The GoI in March 2017 increased the realisations on production beyond re-assessed capacity (RAC) to IPP +\$30/MT from IPP+\$15/MT earlier which will improve ZACL's profitability from urea production beyond RAC. The rating reaffirmation takes into account the improvement in profitability of ZACL in FY2017 given improvement in urea as well as non-urea operations during the year, though on an absolute basis, the performance of the company remains weak. ICRA notes that the company will be undertaking significant debt funded capex to meet energy efficiency requirements under NUP-2015 applicable from FY2019. ICRA also notes that the company has been planning to infuse equity to strengthen the balance sheet but was unable to do so in FY2017.

The ratings primarily factor in the strong parentage of the company and the associated financial flexibility. ZFCL is promoted by the Adventz Group (erstwhile K.K. Birla Group) and is a subsidiary of the group flagship Zuari Agro Chemicals Limited (ZACL) (rated [ICRA]BBB+(Stable)/[ICRA]A2+), which is a leading player in the domestic fertiliser industry. Besides, the group has several other companies in the fertiliser segment, including Paradeep Phosphates Limited (PPL – rated [ICRA]BBB+(Positive)/[ICRA]A2+) and Zuari Specialty Fertilizers Limited. The ratings also factor in the strategic importance of ZFCL to ZACL, as the latter has invested in various growth avenues through ZFCL – investment in the greenfield single super phosphate (SSP) project, acquisition of majority

¹ 100 lakh = 1 crore = 10 million

² For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications

shareholding of Mangalore Chemicals & Fertilisers Limited (MCF) and investment in the proposed di-ammonium phosphate (DAP) plant in Ras Al Khaimah Maritime City in UAE have been through ZFCL. MCF is now a subsidiary of ZFCL, although the loans availed by ZFCL from banks and financial institutions and from ZACL for the acquisition of MCF shares have resulted in large losses for the company in FY2017 and would continue to strain its financial profile over the near-to-medium term due to high interest costs.

The ratings also factor in the favourable demand outlook for the SSP industry in India driven by low availability of phosphate nutrient in the soil and the marketing push by leading players (including ZACL and PPL), which may lead to an increase in demand of SSP in the long run. Besides, demand risks for the marketing of the company's products are low as the SSP produced by ZFCL will be sold through the marketing network of ZACL and PPL. The capacity utilisation for ZFCL remained low in FY2017 at 28% and is expected to improve going forward.

The ratings are constrained by the volatility of profitability to fluctuations in the prices of key raw materials (rock phosphate, sulphuric acid), and the company's ability to raise retail prices in a timely manner. Besides, the profitability is vulnerable to currency fluctuations, agro-climatic conditions and regulatory developments. Working capital requirements could be influenced by timely receipt of subsidy from the GoI. The company's standalone financial position is weak due to high losses, negative net worth, high debt levels (for the SSP project and MCF investment) and associated interest costs. Going forward, the ability of the company to achieve healthy production levels and cost structure and its ability to generate sufficient cash flows through its own operations to service the debt liabilities for the SSP project would remain to be seen. Besides, any adverse impact of the investments in MCF or RAK Maritime City DAP project on the company's standalone profile and material weakening in the credit profile of ZACL will also be a rating sensitivity.

According to the provisional results in FY2017, ZFCL posted a net loss of Rs 111 crore on an operating income of Rs 49 crore, as against a loss of Rs 89 crore on an operating income of Rs 45 crore in FY2016 primarily on account of large interest charges. Owing to large losses the net worth of the company is negative.

Key rating drivers

Credit strengths

- **Part of Adventz group having interest in fertiliser and agri-businesses:** ZFCL is promoted by ZACL, which is a major player in the Indian fertiliser industry. Besides, the Adventz Group (erstwhile K.K. Birla Group), of which the company is a part, includes other major fertiliser players such as Paradeep Phosphates Limited and Zuari Specialty Fertilisers Limited.
- **Financial flexibility on account of parentage:** ZFCL derives support from its parent in the form of finer interest rates from the banking system. ICRA notes that the Adventz Group is also looking to consolidate its fertiliser operations by the integration of different departments of ZACL and group company Paradeep Phosphates Limited to derive operational and financial synergies, which may be favourable for the companies in the medium to long term.
- **Strategic importance to ZACL and Adventz group:** In May 2015, ZFCL has acquired a majority shareholding in Mangalore Chemicals & Fertilisers Limited (MCF), which is a major Karnataka-based fertiliser player, through an open offer. Investments in MCF and RAK Maritime DAP project have been made through ZFCL, reflecting the strategic importance of ZFCL to ZACL.

- **Favourable demand outlook for the domestic SSP industry:** There has been a push by domestic players in promoting SSP as a source of phosphates for the soil. As a result the outlook for SSP remains positive driven by low availability of phosphate nutrient in the soil and the marketing push by leading players.
- **Low demand risks as marketing of products to be done through ZACL and PPL's marketing network:** ZFCL's products are marketed through the network of ZACL and PPL which results in low demand risks as positive impact of the strong brand equity of these players helps in sale of ZFCL's products as well.

Credit weaknesses

- **Vulnerability of profitability to fluctuations in prices of key raw materials (rock phosphate, sulphuric acid) and ability to raise MRPs in an adequate manner:** Profitability of SSP players depends largely on their ability to pass on any increase in raw material costs through increase in MRP.
- **Vulnerability of profitability to the currency fluctuations, agro-climatic conditions and regulatory developments:** : Agriculture sector in India remains vulnerable to the vagaries of monsoon as the area under irrigation remains low which exposes fertiliser sector to volatility as well. The sector being highly regulated also remains vulnerable to changes in the regulations by GoI.
- **Achieving optimum capacity utilisation levels may take some time:** ZFCL's operations started in FY2016 and the company has been able to achieve capacity utilisation of 25% in FY2016 and 28% in FY2017. Accordingly achieving optimum is expected to take some more time.
- **Working capital requirements could be influenced by the timely receipt of subsidy from the Government of India (GoI):** As the subsidy receivables from GoI continue to remain outstanding for as long as 4-5 months working capital borrowings to fund the receivables keep the borrowing levels elevated. The high receivable days also lead to high working capital intensity for the business and high interest costs for the company impacting profitability.
- **Weak standalone financial position with negative net worth:** Standalone financial risk profile of the company remains weak as significant losses have resulted in negative networth. High debt levels due to debt funded acquisition of MCF have resulted in high interest costs which have resulted in net losses for the company.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below.

Links to applicable criteria:

[Corporate Credit Rating Methodology](#)

[Rating Methodology for fertiliser industry](#)

About the company:

Zuari Fertilisers & Chemicals Limited (ZFCL) is a wholly owned subsidiary of Zuari Agro Chemicals Limited (ZACL) and is a part of the Adventz Group of companies – the erstwhile K.K. Birla Group. The company was incorporated in August 2009 with a view to set up a project to manufacture Single Super Phosphate (SSP). The company's plant is located at Mahad (Maharashtra) with a capacity to manufacture 2 lakh metric tonnes per annum (MTPA) of granulated and powdered SSP. The plant commissioning activities have been completed in YTD FY16 and commercial production has started. Rock phosphate for the project is imported, while sulphuric acid is procured from domestic sources. The product is sold through the marketing network of ZACL, for which ZACL has an informal arrangement with ZFCL.

Besides, ZFCL is also the holding company for the investment of the Adventz Group in Mangalore Chemicals & Fertilizers Limited (MCF) – the UB Group company, in which ZFCL has acquired the majority shareholding in May 2015 after an open offer. ZFCL holds a 53.03% stake in MCF and is part of the promoter group of MCF with the UB Group, which holds ~22.95% stake in MCF.

About the parent company:

Zuari Agro Chemicals Limited (erstwhile Zuari Holdings Limited) constitutes the fertiliser operations of the Adventz Group following the demerger of Zuari Industries Limited (ZIL). It is also the holding company for the other agri-business operations of the Adventz Group. The group has interests in agri-inputs, engineering, infrastructure, real estate, consumer durables and services sectors. It was a part of the erstwhile K.K. Birla Group. In April 2011, the Bombay High Court (Goa bench) approved the demerger of ZIL's fertiliser business into Zuari Holdings Limited (later renamed as ZACL), while the residual entity ZIL (later renamed as Zuari Global Limited) retained the non-fertiliser business operations and investments. The demerger scheme was applicable w.e.f July 1, 2012.

The erstwhile ZIL was promoted in 1967 in financial and technical collaboration between the K.K. Birla Group and the U.S. Steel Corporation to manufacture urea, compound nitrogenous fertilisers and phosphates in Goa. In 1985, ZIL promoted Chambal Fertilisers & Chemicals Limited (CFCL) to produce urea using natural gas at Gadepan, Rajasthan. In 2002, ZIL acquired Paradeep Phosphates Ltd (PPL - rated [ICRA]BBB+(Positive)/A2+) through a JV company, as part of the disinvestment process of GoI. PPL manufactures DAP and NPK fertilisers, with its plant located at Paradeep, Orissa. While the equity shareholding of ZIL in PPL is now held by ZACL (~40% of entire shareholding of PPL through the JV company), the 13.3% shareholding of ZIL in CFCL continues to be held by ZGL.

ZACL's plant is located in Goa and comprises of a single stream ammonia plant of 0.22 million metric tonnes per annum (MMTPA) capacity, urea plant of 0.4 MMTPA capacity, complex (NPK) plant of 0.36 MMTPA capacity and DAP-cum-Complex plant of 0.36 MMTPA capacity, which is capable of manufacturing a range of complexes. ZACL completed its feedstock conversion project and is now using gas as a feedstock for manufacturing urea (it was earlier using naphtha). For complexes and DAP, it uses imported ammonia and phosphoric acid. As of end-June 2017, 65.72% of the shareholding of ZACL was held by the promoter group, while the rest is held by domestic and foreign institutional investors and public.

Key Financial Indicators (Audited)

	FY2016
Operating Income (Rs. crore)	44.7
PAT (Rs. crore)	110.7
OPBDIT/ OI (%)	-12.6%
RoCE (%)	
Total Debt/ TNW (times)	NM
Total Debt/ OPBDIT (times)	NM
Interest coverage (times)	NM
NWC/ OI (%)	164%

OI: Operating Income; PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; ROCE: PBIT/Avg (Total Debt + Tangible Net-Worth + Deferred Tax Liability - Capital Work - in Progress); NWC: Net Working Capital

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating history for last three years:

Table:

S. No.	Instrument	Current Rating (FY2018)			Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Date & Rating	Date & Rating in FY2017		Date & Rating in FY2016
				August 2017	December 2016	September 2016	September 2015
1	Term loan	Long term	30	[ICRA]BBB-(Stable)	[ICRA]BBB-(Negative)	[ICRA]BBB-(Stable)	[ICRA]BBB-(Stable)
2	Fund based long term facilities	Long term	17	[ICRA]BBB-(Stable)	[ICRA]BBB-(Negative)	[ICRA]BBB-(Stable)	[ICRA]BBB-(Stable)
3	Non-fund based, short term facilities	Short term	3	[ICRA]A3	[ICRA]A3	[ICRA]A3	[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	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
-	Term loan	December 30, 2013	12.0%	September 30, 2020	30	[ICRA]BBB+ (Stable)
-	Fund based long term facilities	-	-	-	17	[ICRA]BBB+ (Stable)
-	Non-fund based, short term facilities	-	-	-	3	[ICRA]A2+

Source: the company

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