September 25, 2017

Zuari Agro Chemicals Limited Revised

Summary of rated instruments

Instrument*	Rated Amount (Rs. crore)	Rating Action
Long term fund based limits	1,200 (increased from Rs 1200 crore earlier)	[ICRA]BBB+ (Stable) reaffirmed
Long term fund based-Interchangeable#	75 (increased from nil earlier)	[ICRA]BBB+ (Stable) reaffirmed
Long term un-allocated limits	265 (reduced from Rs. 300 crore earlier)	[ICRA]BBB+ (Stable) reaffirmed
Short term non-fund based limits	2,750 (increased from Rs. 2600 crore earlier)	[ICRA]A2+ reaffirmed
Short-term unallocated	Nil (reduced from Rs. 100 crore earlier)	-
Long Term/Short term unallocated limits	Nil (reduced from Rs. 15 crore earlier)	-

**Instrument details are provided in Annexure-1*
 # Rs 75 crore of long term limit is fully interchangeable with short term non-fund based limits

Rating action

ICRA has reaffirmed the ratings of [ICRA]BBB+ (pronounced ICRA triple B plus) and [ICRA]A2+ for Rs 4,215 crore[1] for the bank facilities of Zuari Agro Chemicals Limited (ZACL)[2]. The outlook on the long-term rating is Stable.

Rationale

The rating reaffirmation factors in the improvement in performance 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 financial performance of the company is expected to remain healthy 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. For arriving at the ratings, ICRA has taken a consolidated view of ZACL and its fully owned subsidiary, Zuari Fertilisers and Chemicals Limited (ZFCL) (rated [ICRA]BBB- (Stable) / [ICRA]A3) as well as Mangalore Chemicals and Fertilizers Limited (MCF) in which ZFCL has a 53.03% stake and Paradeep Phosphates Limited (PPL) (rated [ICRA]BBB+(Positive) / [ICRA]A2+) in which ZACL has a 40.225% stake. This is because all these companies have a common management, considerable operational linkages and the management plans to merge them over the medium term. The rating reaffirmation also 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.

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[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*

The ratings continue to factor in the established position of the company in the fertiliser and other agri-businesses, diversified product portfolio and healthy operating efficiency and its strong marketing network and leading market position in Karnataka and Maharashtra. The ratings also factor in the financial flexibility on account of being part of the Adventz Group (part of the erstwhile K.K. Birla Group). ICRA notes that the Adventz Group is also looking to consolidate its fertiliser operations by the integration of different departments of ZACL and group companies MCFL and PPL derive operational and financial synergies, which may be favourable for the companies in the medium to long term.

The ratings continue to be constrained by the continuing high debt levels due to significant subsidy delays by the Government of India and the resulting weak debt coverage indicators and modest core profitability metrics. The credit metrics of the company are expected to deteriorate in the near term as ZACL undertakes significant debt funded capex to meet the energy requirements under NUP-2015 applicable from FY2019 onwards. The ratings also factor in the decline in gas costs for the company following the implementation of gas pooling for the urea sector by the Government of India, although the company has also lost out on energy savings to some extent. Besides the already high debt levels owing to subsidy delays, Zuari Fertilisers & Chemicals Limited (ZFCL, rated [ICRA]BBB-(Stable)/A3) had also availed a term debt of Rs. 300 crore (now reduced to Rs 210 crore) for the acquisition of the MCF shares. Besides, ZACL has also provided inter corporate deposits to ZFCL for the acquisition. Further, the MCF acquisition may not generate any major returns for ZACL in the medium term, although long-term synergies and growth opportunities exist.

The ratings are also constrained by vulnerability of profitability of the industry to agro-climatic conditions, regulated nature of the industry and seasonality associated with the fertiliser business. The performance of the non-urea sector is relatively more vulnerable to regulatory (subsidy) as well as economic variables (such as supply-demand, commodity prices and currency movements); profitability for the segment can be volatile depending upon ruling international prices of raw materials as well as ability to raise retail prices in an adequate manner. Demand for the segment has also been affected in recent years due to high retail prices of these fertilisers resulting in a price differential with urea.

During FY2017, owing to improvement in operating profits ZACL (standalone) posted a net profit of Rs. 19.57 crore as against a loss of Rs.15.89 crore in FY2016. With decline working capital borrowings during FY2017 credit metrics showed some improvement, even though they continue to remain subdued owing to modest profitability and low capitalisation vis-a-vis large scale of operations. Gearing of the company moderated to 3.37 times in FY2017 as against 4.26 times in FY2016 while Total Debt/OPBDITA moderated to 12.25 times in FY2017 as against 16.97 times in FY2016. The company is looking at raising equity through various routes to improve the capital structure and fund the equity requirements for the upcoming project capex. During Q1 FY2018, the standalone performance of the company has remained weak on account of lower sales volumes wherein it posted a net profit of Rs 0.27 crore as against a loss of Rs. 41 crore in Q1 FY2017. The credit metrics of the company are expected to remain subdued in the near term on account of large debt funded capex being undertaken by the company. The liquidity position of ZACL is expected to remain moderate in the near-to-medium term due to expectations of continuing high subsidy receivables and short-term debt mobilised for MCF through the subsidiary.

Key rating drivers

Credit strengths

- **Established track record of the company in fertiliser and other agri-businesses:** ZACL has had an established track record in the fertiliser and other agri-business since 1967. ZACL through its subsidiaries and joint ventures is engaged in manufacturing of fertilisers, seeds and other agri-inputs.

- **Diversified product portfolio including urea, DAP and NPK complexes as well as traded products:** ZACL is engaged in manufacturing of urea as well as DAP/NPK fertilisers at its Goa manufacturing facility. It also undertakes trading of various fertilisers to provide wide range of agri products to the farmers. The product portfolio is further diversified by availability of water soluble fertilisers (WSF) manufactured by its subsidiary Zuari Rotem Specialty fertilisers and Single Super Phosphate (SSP) manufactured by another subsidiary Zuari Fertilisers & Chemicals Limited (ZFCL). ZACL also benefits from access to the DAP/NPK fertilisers manufactured by its JV Paradeep Phosphate Limited (PPL).
- **Favourable long-term demand outlook for fertilisers in India due to scarcity of nutrients in the soil:** Indian soil remains deficient in nutrient content which has resulted in lower agri-productivity. With increasing population the demand for food will increase which will make productivity improvement imperative for the agri sector. Thus the demand outlook for fertilisers remains positive in India.
- **High operating efficiency of the plants, although the company has faced certain operational issues in recent years:** Though ZACL's plants had faced operational issues in the past, the operational efficiency has improved over the last few years. Urea as well as DAP/NPL plant has shown healthy capacity utilisation in last few years.
- **Strong marketing network and leading market position in Karnataka and Maharashtra:** ZACL caters to the southern and western part of India and enjoys leading market position in Karnataka and Maharashtra. ZACL along with PPL enjoy a major part of the DAP/NPK market in south –western part of India and a strong marketing network.
- **Gas pooling has significantly reduced gas costs and hence, subsidy receivables:** ZACL used to operate on R-LNG before implementation of gas pooling which resulted in high cost of production of urea for the company. Post implementation of gas pooling the gas costs for production of urea has declined significantly leading to lower subsidy receivables which in turn has resulted in lower working capital borrowings for the company. ZACL's urea production also became competitive against urea imports as the cost of production declined.
- **Financial flexibility on account of being part of the Adventz Group (part of the erstwhile K.K. Birla Group):** ZACL derives financial flexibility on account of being part of the Adventz Group (erstwhile K.K. Birla Group) which was instrumental in the company getting indirect support through purchase of land to counter the losses during FY2014. 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.

Credit weaknesses

- **Vulnerability of profitability to agro-climatic conditions, regulatory risks and seasonality of the fertiliser business:** 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.
- **Performance of non-urea fertilisers is relatively more vulnerable to regulatory and economic variables:** Non-urea fertiliser demand is relatively more volatile as the preference for urea is driven by the price differential. In case of weak monsoon, the impact on non-urea fertiliser demand has been witnessed to be more as against the impact on urea demand. The domestic manufacturers are also impacted by movement in international prices of end products as well as raw material which impact the profitability. Post implementation of Nutrient Based Subsidy (NBS) for P&K fertilisers, the price differential between urea and P&K fertilisers has widened which has adversely impacted demand for P&K fertilisers. The profitability of the companies depends on the movement of international prices of raw material as majority of these are imported. The ability of the company to pass on any increase in raw material prices to end-consumer through revision of retail price also plays a crucial role in protecting profitability which may be constrained by high level of stocks or poor monsoon etc.
- **Imports expose ZACL to forex risk; partly mitigate by the hedging policy of the company:** ZACL imports its entire requirement of phosphoric acid, ammonia and MOP for production of DAP/NPK fertiliser which exposes it to foreign exchange risks. The risk is however partly mitigated by the nearly complete hedging of the foreign exchange exposure the company undertakes.
- **High debt funded capex to meet energy norms under NUP-2015; energy savings decline due to lower gas costs:** ZACL will be undertaking significant debt funded capex to meet energy consumption norms applicable under NUP-2015 from FY2019 onwards. The capex for the project is around Rs 1300 crore and is to be funded in a debt-equity ratio of 70:30. The capex is expected to keep the credit metrics subdued in the near term. As gas prices have declined the energy savings derived from the capex incurred in the past and the expected savings from the upcoming capex will be lower.
- **Subdued capital structure characterised by low capitalisation, high debt and low core profitability:** Capital structure of the company has weakened since demerger from Zuari Industries Limited. Low capitalisation, high debt due to subsidy receivable driven working capital borrowings along with weak core profitability over the past few years has resulted in weak capital structure. Going forward the debt funded capex will keep the capital structure subdued unless equity infusion is done in the company.
- **High working capital intensity due to subsidy delays and high trade receivables resulting in high borrowings:** 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.
- **MCF acquisition leading to cash outflow:** ZACL acquired majority stake in Mangalore Chemicals & Fertilisers Limited through its subsidiary Zuari Fertilisers & Chemicals Limited, resulting in a significant cash outflow; the investment of ~Rs. 510 crore has been significantly funded through debt, which has resulted in further cash outflows in the form of interest and may not yield any major returns in the medium term, although long-term synergies and growth opportunities exist.

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 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+(Stable)/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 and DAP/NPK complex with capacity of 0.86MMTPA, 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	FY2017
Operating Income (Rs. crore)	5,261	3,918
PAT (Rs. crore)	-15.89	19.59
OPBDIT/ OI (%)	3.8%	5.8%
RoCE (%)	7.5%	8.6%
Total Debt/ TNW (times)	3.37	4.26
Total Debt/ OPBDIT (times)	16.97	12.25
Interest coverage (times)	0.66	0.78
NWC/ OI (%)	51%	50%

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		Date & Rating in FY2015
				September 2017	August 2017	December 2016	September 2016	January 2016	September 2015	July 2014
1	Fund based limits	Long term	1,200	[ICRA] BBB+ (Stable)	[ICRA] BBB+ (Stable)	[ICRA] BBB+ (Negative)	[ICRA] BBB+ (Stable)	[ICRA] BBB+ (Stable)	[ICRA] BBB+ (Stable)	[ICRA] BBB+ (Stable)
2	Fund based-interchangeable	Long term	75	[ICRA] BBB+ (Stable)	-	-	-	-	-	-
3	Un-allocated limits	Long term	265	[ICRA] BBB+ (Stable)	[ICRA] BBB+ (Stable)	[ICRA] BBB+ (Negative)	[ICRA] BBB+ (Stable)	[ICRA] BBB+ (Stable)	[ICRA] BBB+ (Stable)	[ICRA] BBB+ (Stable)
4	Non-fund based limits	Short term	2,750	[ICRA] A2+	[ICRA] A2+	[ICRA] A2+	[ICRA] A2+	[ICRA] A2+	[ICRA] A2+	[ICRA] A2+
5	Unallocated	Short term	0	-	[ICRA] A2+	[ICRA] A2+	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+
6	Unallocated limits	Long Term/ Short term	0	-	[ICRA] BBB+ (Stable)/ A2+	[ICRA] BBB+ (Negative)/ A2+	[ICRA] BBB+ (Stable)/ A2+	[ICRA] BBB+ (Stable)/ A2+	[ICRA] BBB+ (Stable)/ A2+	[ICRA] BBB+ (Stable)/ A2+

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
-	Long term, fund based- Cash Credit	-	-	-	1200	[ICRA]BBB+ (Stable)
-	Long term, fund based- interchangeable	-	-	-	75^	[ICRA]BBB+ (Stable)
-	Long term, unallocated	-	-	-	265	[ICRA]BBB+ (Stable)
-	Short term, non fund based	-	-	-	2750	[ICRA]A2+

Source: The company,

^Long term interchangeable limits of Rs. 75 crore are fully interchangeable with short term non-fund based limits.

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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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