Focus Energy Limited

December 17, 2018

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long term fund based limits-Term loans	177.50	160.13	Downgraded from [ICRA]BBB- to [ICRA]BB Outlook revised to Negative from Stable
Long term fund based limits	78.00	78.00	Downgraded from [ICRA]BBB- to [ICRA]BB Outlook revised to Negative from Stable
Short term non-fund based limits	93.00	93.00	Downgraded from [ICRA]A3 to [ICRA]A4+
Total	**348.50**	**331.13**	

*Instrument details are provided in Annexure-1

Rationale

The rating downgrade factors in the delay in commencement of gas sales from the subsequent phases of development of the Rajasthan block (RJ-ON/6) to GAIL /Rajasthan Rajya Vidyut Utpadan Nigam Ltd (RRVUNL) and through the national grid and the higher than expected debt funded capex which has stretched the debt metrics of the company. The company is yet to sign a gas supply contract for a new 160 MW power plant of RRVUNL which has been delayed and is expected to commence operations in January 2020. Besides, the plans for laying a pipeline connecting the RJ-ON/6 block to the national grid, which will diversify its customer base, have also been delayed and sales through pipeline are now expected to commence from January 2021. During FY2017 and FY2018 the capex incurred in RJ-ON/6 was about Rs 107 crore for establishing the reserves and finalisation of field development plan (FDP) of the non-SGL areas of the block. The capex was largely debt funded and has resulted in stretching the capitalisation and debt coverage indicators of the company as reflected by total debt/OPBDITA at 16.8 times as at FY2018 end (total debt (excluding promoters debt)/OPBIDTA is 6.3x in FY2018). Though ICRA continues to take comfort from the large loans extended by the promoter group to Focus Energy nevertheless the debt metrics even on an external debt basis are expected to remain stretched till the commencement of subsequent phases of gas sales. That apart, the rating continues to be constrained by the geological risks inherent in exploration and production (E&P) activities; residual project implementation risks in the development of discovered RJ-ON/6 block to ramp up production volume for next phases of production though the decade long experience of the company in exploration and production of the Rajasthan block partly mitigates the aforementioned risk; risks involved in timely commissioning of pipeline projects to connect the field to the national grid; dependence on group companies for subordinated debt requirements and elevated leverage levels due to debt-funded capital expenditure (capex) plans. The rating continues to draw comfort from the discovered gas reserves of Focus Energy Limited' RJ-ON/6 block; revenue visibility due to gas sale agreement with GAIL (India) Limited; support extended by group and parent companies and increase in the 2P reserves of the Rajasthan block post approval of FDP by DGH.

ICRA notes that during the FY2018, the GoI approved the relinquishment of 30% Participating Interest (PI) of ONGC in SGL Field with future interest in block RJON/6 to Focus Energy Limited (Operator), on the condition that the latter will pay towards 100 % past royalty obligation, PEL/ ML fees, other statutory levies (total amount Rs 155.8 crore as on March 31, 2018) and waive off development/production cost payable by ONGC in SGL Field of the block as well as assume all future 100% royalty obligation of ONGC as licensee. However, execution of Farmout Agreement and amendment in Production Sharing Contract (PSC) are in process and are estimated to be completed by Q1 FY2020. ICRA believes that the exit of ONGC would increase the capex, royalty and other statutory obligations of the company, though the company will be entitled to get additional revenue from the block.

Going forward, timely monetisation of the reserves and extent of dependence on debt for capex would remain key monitorables.

Outlook: Negative

The negative outlook reflects ICRA's expectation of weakening of Focus Energy Limited's debt-servicing indicators, amid continuing delays in ramp up of gas sales, large capex plans and high repayment obligations. The outlook may be revised to Stable if the company is able to ramp up gas sales substantially leading to improvement in credit metrics.

Key rating drivers

Credit strengths

- **The discovered gas reserves of RJ-ON/6 block with successful commencement of gas production:** The company entered into oil & gas E&P activities and signed production sharing contract (PSC) with GoI for the block RJ-ON/6 (pre-NELP block) in 1998. The PSC for the block was signed on 30th June, 1998 between Government of India (GoI), Ministry of Petroleum and Natural gas; Focus Energy Limited; and Oil & Natural Gas Corporation (ONGC). Initially, Focus was holding 100% participating interest (PI) in the block. In Jan 2006, Focus assigned 90% of its participating interest in RJ-ON/6 block to its affiliates iSevices Investment Ltd., Mauritius-65% and Newbury Oil Company Ltd., Cyprus -25% while retaining a 10% with Focus. In May 2006, the gas discovery was made in well SGL1, which was declared as "Commercial" by the Management Committee in Jan-2008. Subsequently, in June 2008, as per terms of the PSC, ONGC notified Focus as to its intention to opt for 30% PI option in the SGL field. As ONGC exercised the rights to acquire 30% PI, the revised PI in SGL Field of Focus Energy Ltd (Operator) is 7% while iServices Investments Ltd. has 45.50%, Newbury Oil Company Ltd. 17.50% and ONGC 30%. Thus, iServices Investments and Newbury Oil together hold 63% stakes in SGL Field of RJ-ON/6 block.

- **Revenue visibility due to gas sale agreement with GAIL (India) Limited with "take or pay" payment guarantees, which provides comfort from debt servicing point of view:** Focus along with other partners entered into Gas Sale Purchase Agreement (GSPA) with GAIL in August 2009. The sale was in two stages with first stage without CO2 removal of 0.2 MMSCMD and second stage of enhanced volume of 0.95 MMSCMD after CO2 removal. The first stage of supply had commenced in July 2010 to the ultimate buyer namely RRVUNL but owing to delays in off take from the second stage of the development project, the company enforced take or pay obligations on GAIL from October 1, 2012. Post commissioning and stabilisation of its 160 MW power plant, RRVUNL is now drawing gas at the rate of about 0.80-0.95 MMSCMD (without CO2) of gas and there has been no take or pay enforcement in FY2017 and FY2018.

- **Financial flexibility from the support extended by group companies and modest investments:** To meet its capex requirements, group companies have provided unsecured loans to Focus Energy Limited of Rs 458.9 crore as on March 31, 2018 as against Rs 417.8 crore as on March 31, 2017. Additionally, investments of Focus in liquid investments totalling about Rs. 65.0 crore as on March 31, 2018 provide financial flexibility to the company.

- **Increase of the proved plus probable (2P) reserves post FDP approval by DGH:** Post the FDP approval by DGH the 2P reserves of the RJ-ON/6 block stand at 1.9 tcf (which upon extraction will be valued at $7 billion considering gas price at $5/mmbtu). At the current rate of gas production of 42 MMSCFD (with CO2) and 1.9 tcf of 2P reserves the reserve life index of the block is healthy indicating significant potential for monetisation.

Credit weaknesses

- **Residual project implementation risks in the development of discovered RJ-ON/6 block to ramp up production volume for the next phases of production:** During the next phase of the development of the RJ-ON/6 block the company plans to supply 0.75 MMSCMD (without CO_2) of gas for another 160 MW power plant of RRVUNL, which is expected to be commissioned by January 2020. Subsequently, in January 2021, the company plans to commence supply of additional 4-5 MMSCMD gas through pipeline to the national grid post which the gas quantity is planned to be scaled up. For the next phases of the development of the RJ-ON/6 block, the company plans to drill additional production wells besides setting up of gas handling facilities such as gas gathering station etc. Though the company is exposed to residual project implementation risks to ramp up production volumes, the decade long experience of the company in exploration and production of the Rajasthan block partly mitigate the same.

- **Successful ramp up of gas volumes will be sensitive to the timely connection of the field with the national grid to diversify the customer base:** In February 2018, the company submitted an Expression of Interest (EOI) for Laying, Building and Operating 580 Km Pipeline from Langtala, Jaisalmer to Bhilwara in Rajasthan to PNGRB. Post the EOI various stakeholders were invited to comment on the proposal for the pipeline and post resolution of comments, the PNGRB has invited bids from eligible entities for development of the proposed pipeline network with a minimum capacity of 5 MMSCMD. The promoters are in discussion with GAIL and others for formation of a JV for bidding for the pipeline. Accordingly, the modalities such as capex and funding are still being finalised. Once completed, this pipeline will enable evacuation of natural gas from RJ-ON/6 block to the Hazira- Vijaypur- Jagdishpur pipeline of GAIL. Successfully connecting to the national grid could open up multiple customers and increase offtake and accordingly timely connection of the field to the grid remains crucial.

- **Geological risks inherent in exploration and production (E&P) activities:** The different stages of exploration and production activities are geological & geophysical survey, exploratory drilling, developmental drilling and finally production. At any of the aforementioned stages the company remains vulnerable to any geological surprises which might adversely impact the exploitation of oil and gas reserves. This risk is mitigated to an extent by the long track record of the company in exploration and production in the Indus basin as well as approval of reserves by DGH.

- **Debt-funded capital expenditure (capex) plans:** The total additional development capex of RJ-ON/6 is expected to be around US$ 2002 million till FY2029 of which Focus is scheduled to incur US$ 140.1 million. Focus has availed term loans of US$ 40 million (current outstanding Rs 160.1 crore in November 2018) and an overdraft limit of Rs 78 crore to meet its share of capex. Other than bank loans, group companies have provided unsecured loans of Rs 458.9 crore as on March 31, 2018 as against Rs 417.7 crore as on March 31, 2017. To part fund the capex the company plans to avail additional term loans of US$ 35 million. Going forward, the debt funded capex planned to be incurred by the company is expected to keep the capitalisation and coverage indicators at elevated levels.

- **Moderate credit metrics:** The company's operating income in FY2018 at Rs 72.8 crore was lower than FY2017 operating income of Rs 77.3 crore on account of lower gas sales. The operating margin has improved in FY2018 at 57.4% from 53.2% in FY2017. The net profit was higher in FY2018 at Rs 1.0 crore as against Rs 0.9 crore in FY2017. The gearing of the company is stable at 4.8x in FY2018 and 4.7x in FY2017 and was 3.7x at FY2016 end. The RoCE remained low in FY 2018 at 0.5% vis-a-vis 0.3% in FY2017. The debt coverage metrics are weak with total debt/OPBDIT of 16.8x in FY2018 (total debt (excluding promoters debt)/OPBIDTA is 6.3x in FY2018) and 16.5x in FY2017 (total debt (excluding promoters debt)/OPBIDTA is 6.9x in FY2017). The coverage metrics will remain adverse even after excluding the sponsors debt which will be subordinate to the external loans. Accordingly, the company's key credit metrics viz RoCE and coverage indicators are moderate and are expected to remain stretched till the commencement of gas sales from subsequent phases of development.

Liquidity Position:

As of March 31, 2018, the outstanding bank debt was Rs 242.7 crore, out of which Rs 23.1 crore is repayable within FY2019. Additionally, ICRA takes comfort from the support extended by the promoter group which stood at Rs 458.9 crore as at FY2018 end.

Analytical approach:

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Upstream Oil Companies
Parent/Group Support	Group Company: Gynia Holdings Ltd. ICRA expect Focus Energy Limited's group company, Gynia Holdings Ltd., to continue to extend financial support to Focus Energy Limited, given the high strategic importance of the company to the group.
Consolidation / Standalone	For arriving at the ratings, ICRA has considered the standalone financials of Focus Energy Limited.

About the company:

Focus Energy Limited (earlier known as Phoenix Overseas Limited) was earlier involved in exports of shoes and commodities to Russia. The shoe operations of the company have reduced significantly and currently the company is active mainly in the field of oil & gas exploration and production. The company has stakes in five blocks in India viz. RJ-ON/6, GK-ON/4, RJ-ONN-2003/2, RJ-ON/2010/2 and CB-OSN-2004/1. Focus has 7% participating interest in SGL field of RJ-ON/6 block, which has discovered gas reserves. Indus Gas, a group company of Focus Energy, is listed on Alternate Investment Market (AIM), London Stock Exchange and has 63% stake in SGL field of RJ-ON/6 block through its wholly owned subsidiaries.

Key financial indicators (audited)

	FY2017	FY2018
Operating Income (Rs. crore)	77.3	72.8
PAT (Rs. crore)	0.9	1.0
OPBDIT/OI (%)	53.2%	57.4%
RoCE (%)	0.3%	0.5%
Total Debt/TNW (times)	4.7	4.8
Total Debt excluding promoters debt/TNW (times)	1.9	1.8
Total Debt/OPBDIT (times)	16.5	16.8
Total Debt excluding promoters debt /OPBDIT (times)	6.9	6.3
Interest coverage (times)	-	-

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 Dec 2018	Date & Rating in FY2018 Aug, 2017	Date & Rating in FY2017 Dec, 2016	Date & Rating in FY2016 Aug, 2015
1	Fund based limits-Term loans	Long term	160.13	160.13	[ICRA]BB(Negative)	[ICRA]BBB- (Stable)	[ICRA]BBB+ (Stable) suspended	[ICRA]BBB+ (Stable)
2	Fund based limits	Long term	78.00	78.00	[ICRA]BB(Negative)	[ICRA]BBB- (Stable)	[ICRA]BBB+ (Stable) suspended	[ICRA]BBB+ (Stable)
3	Non-fund based limits	Short term	93.00	93.00	[ICRA]A4+	[ICRA]A3	[ICRA]A2 suspended	[ICRA]A2

Complexity level of the rated instrument: Simple

Annexure-1: Instrument Details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
-	Long term fund based limits-Term Loan 1	Feb 12, 2010	3M Libor+4.5%	May 30, 2021	36.19	[ICRA]BB(Negative)
-	Long term fund based limits-Term Loan 2	Mar 15, 2016	3M Libor+4.1%	Jan 25, 2025	61.97	[ICRA]BB(Negative)
-	Long term fund based limits-Term Loan 3	Apr 5, 2016	3M Libor+4.1%	Jan 25, 2025	61.97	[ICRA]BB(Negative)
-	Long term fund based limits	-	-	-	78.00	[ICRA]BB(Negative)
-	Short term non-fund based limits	-	-	-	93.00	[ICRA]A4+

ANALYST CONTACTS

K Ravichandran
+91 44 4596 4301
ravichandran@icraindia.com

Prashant Vasisht
+91 124 4545 322
prashant.vasisht@icraindia.com

Mohit Lohia
+91 124 4545 814
mohit.lohia@icraindia.com

RELATIONSHIP CONTACT

Jayanta Chatterjee
+91 80 4332 6401
jayantac@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries:

+91-124-2866928 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

About ICRA Limited:

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For more information, visit www.icra.in

ICRA Limited

Corporate Office
Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002
Tel: +91 124 4545300
Email: info@icraindia.com
Website: www.icra.in

Registered Office
1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001
Tel: +91 11 23357940-50

Branches

Mumbai	+ (91 22) 24331046/53/62/74/86/87
Chennai	+ (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,
Kolkata	+ (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008,
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