ONGC Mangalore Petrochemicals Limited

January 23, 2019

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund Based - Working Capital Facilities (Cash Credit)	750	750	[ICRA]AA+&; Reaffirmed
Fund Based - Working Capital Facilities	3,500	3,500	[ICRA]A1+&; Reaffirmed
Non-fund Based - Working Capital Facilities	250	250	[ICRA]A1+&; Reaffirmed
Commercial Paper	3,500	3,500	[ICRA]A1+&; Reaffirmed
Total	**8,000**	**8,000**	

*Instrument details are provided in Annexure-1; &: Under rating watch with developing implications

Rationale

The reaffirmation of ratings takes into account the financial flexibility available with the company owing to the presence of strong sponsors, viz. Oil and Natural Gas Corporation Limited (ONGC; [ICRA]A1+) and Mangalore Refinery and Petrochemicals Limited (MRPL; [ICRA]AAA (Stable) / [ICRA]A1+). The ratings are under 'rating watch with developing implications' on account of the on-going merger of OMPL with MRPL which is expected to benefit both the entities given the synergies between their operations. The key feedstock (i.e. naphtha and aromatics streams) for the operations of OMPL is sourced from MRPL, which would be met captively post the amalgamation. It would also provide flexibility to the management in sourcing of crude so as to maximise the yield depending upon the market dynamics and crack spread available for the respective products. With the amalgamation, the plants of MRPL and OMPL can be operated at optimum utilisation to allow for optimisation of Gross Refining Margin (GRM) and maximisation of combined margins. The merger witnessed significant delays due to pending regulatory approvals though the No Objection Certificate (NOC) was eventually received from the Ministry of Petroleum and Natural Gas (MoPNG) in April 2018. The timeliness in concluding the merger process, going forward, would remain important from a credit perspective.

The ratings continue to favourably factor in the low feedstock supply risks owing to the adjacent operating refinery of MRPL and the healthy demand indicators globally for the company's key products, i.e. paraxylene and benzene. The company's operating profits are expected to witness meaningful increase in the current fiscal owing to the improvement in the paraxylene-naphtha crack spreads following a tight supply market, though the crack spreads are expected to witness a correction over the medium term as considerable paraxylene capacities are expected to come onstream in Asia. The company is planning to implement various measures such as restriction on costlier imported naphtha, higher processing of aromatic rich FCC naphtha from MRPL, replacement of costlier liquid fuels with cheaper natural gas, opening up additional revenue streams from existing product profile, etc. to enhance operating profitability in the near-to-medium term. The company also benefits from its presence in Mangalore SEZ which would result in lower taxation in initial years of operations apart from other fiscal incentives.

The ratings are, however, constrained by the exposure of the company's profitability to the movement in the crack spreads between naphtha/aromatic streams and the finished products which are highly volatile and cyclical in nature, as well as to import duty differentials between finished products and feedstock, and exchange rate movements. Owing to depressed crack spreads prior to FY2019 as global capacity additions had been outpacing demand growth, coupled with inadequate feedstock from MRPL which was in the midst of its own capacity expansion, OMPL reported sizeable losses in its initial years of operations. While the losses have reduced subsequently, the company has been unable to maintain full plant utilisation levels over a sustained period. However, after the upgradation of MRPL's Continuous Catalytic Reforming (CCR) unit in September 2018, the feedstock supply from MRPL to OMPL is expected to be regular and adequately suited to OMPL's requirement which would allow OMPL to optimise its plant utilisation levels. The company's cost structure is elevated because of usage of liquid hydrocarbons as a fuel for process requirement and power generation instead of natural gas which was envisaged at the time of conceiving of the project. Moreover, the company has taken steps to reduce its cost burden through renegotiation of pricing terms for certain key feedstock with MRPL and aims to deleverage its balance sheet through issue of fresh equity and equity-like instruments in the near term. Going forward, the ability of the company to improve plant capacity utilisation levels as well as conclude its capital restructuring plan would remain important.

Key rating drivers

Credit strengths

Financial flexibility arising from presence of strong sponsors - OMPL enjoys healthy financial flexibility arising from its strong parentage comprising of ONGC (49%) and MRPL (51%). Currently, the Board of Directors of OMPL includes four members from ONGC and two from MRPL including their respective Managing Directors. The Chairman of ONGC is also serving as the Chairman of OMPL. Owing to the presence of its strong sponsors, the company has been able to access the debt markets and raise loans at competitive rates in recent years. While the company has sizeable debt repayments due by FY2020 as its NCDs of Rs. 2,500 crore would be due for redemption, it is expected to be able to refinance the same.

Merger with MRPL would improve financial profile of the combined entity - OMPL is currently in the process of getting merged with MRPL which would benefit both the companies given the strong synergies in their operations. The merger would provide flexibility to the management in sourcing of crude so as to maximise the yield depending upon the market dynamics and crack spread available for the respective products. The power costs for OMPL's plant are also expected to reduce as it would be able to avail cheaper power from MRPL's captive power plant. The merger would also result in savings arising on account of optimum utilisation of resources due to pooling of management, administrative and technical skills of both companies, better administration and cost reduction. However, the merger process has faced delays in receiving the required regulatory approvals and timeliness in concluding the merger process, going forward, would remain important from a credit perspective.

Healthy demand indicators for the company's products - The company's sales mix is dominated by paraxylene (~65%of overall sales) and benzene (~17%), with the other by-products being used either for captive consumption as a fuel or sold back to MRPL. Paraxylene is converted into either Purified Terephthalic Acid (PTA) or Dimethyl Terephthalate (DMT), though globally its demand is mainly driven by manufacturing of PTA, which in turn is used to produce various polyesters (yarn grade, bottle grade and films grade), along with other fibre intermediate viz. Mono Ethylene Glycol (MEG). Given the importance of paraxylene in the polyester value chain, the demand indicators for paraxylene are expected to remain robust. China, a key consumer of paraxylene is in the process of starting up huge capacities of the product that are expected to come on stream over the next 1-2 years. The same is expected to redirect the trade flows for paraxylene; however, the long-term outlook for paraxylene's demand growth remains stable. The company's other key product, benzene, is largely used in the manufacturing process of styrene and phenol apart from cyclohexane and nitrobenzene. Global demand for benzene has been steady in the past years, which is expected to continue, going forward.

Benefits from presence in Mangalore SEZ - As the project has been setup in Mangalore SEZ, it enjoys certain benefits such as exemption from indirect and local state taxes available on the procurement of equipment and services during construction and exemption from payment of income tax for a pre-specified period from commissioning. The products are also exempted from customs duty if sold in the SEZ itself or exported.

Credit challenges

Sizeable losses incurred since commissioning resulting in significant reduction in net worth – OMPL's plant has been operating at moderate capacity utilisation post-commissioning due to constraints in feedstock availability. In the initial years, MRPL was in the midst of its own expansion programme which limited the feedstock supply to OMPL. Subsequently, OMPL ramped up its plant utilisation levels but could not sustain it on a prolonged basis due to water shortage issues seen in FY2017 and certain plant issues faced by MRPL in FY2018. In addition, the paraxylene-naphtha crack spreads were subdued in recent years as global capacity additions are outpacing demand growth, though the crack spreads witnessed sharp improvement in FY2019 due to temporary plant shutdowns leading to a tight supply position. The sizeable losses incurred since commissioning have led to significant reduction in the company's net worth position, resulting in a highly leveraged capital structure. The company, however, has plans to deleverage its balance sheet through issue of fresh equity and equity-like instruments in the near term. In the current fiscal, it has already received Rs. 300 crore as equity from its sponsors.

Profitability exposed to movement in crack spreads, import duty differentials between finished products and feedstock, and exchange rate movements - Considering the cyclical nature of the petrochemicals industry, the profitability of the company is exposed to the crack spread between the feedstock (naphtha and aromatic streams) and the company's key products, viz. paraxylene and benzene. These crack spreads have been highly volatile in the past years and have been impacted by the supply-demand variations of the downstream products (polyester and its intermediates) as well as price movement of naphtha. In addition to the crack spreads, the profitability of the company also remains exposed to import duty differentials between finished products and feedstock, as well as exchange rate movements as the company would be either exporting or selling products domestically on import parity.

Higher-than-envisaged power and fuel costs – The company had setup a 72 MW captive power plant to ensure reliable power supply to the plant as well as to meet the process steam requirement of the project. The plant had been initially conceptualized to be natural gas-based in anticipation of increase in availability of natural gas. The company had to, however, utilise diesel to operate its captive power plant because of the constrained availability of natural gas in the domestic market. Nonetheless, GAIL (India) Limited's Kochi-Koottanad-Bengaluru-Mangaluru pipeline is under execution which would enable OMPL to procure natural gas from Petronet LNG Limited's LNG terminal in Kochi. Thereafter, the company would start using natural gas to fuel its power plant that would lead to considerable cost savings.

Liquidity Position:

OMPL enjoys strong financial flexibility owing to the presence of MRPL and ONGC as its holding companies. This has been clearly demonstrated by its ability to raise debt market instruments (NCDs and CPs) at highly competitive rates. The company also has working capital facilities sanctioned by its banks which are being moderately utilised.

Analytical approach:

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Impact of Parent or Group Support on an Issuer's Credit Rating
Parent/Group Support	We expect OMPL's sponsors, ONGC ([ICRA]A1+) and MRPL ([ICRA]AAA (Stable)/ [ICRA]A1+), to be willing to extend financial support to OMPL, should there be a need, given the high strategic importance that OMPL holds for the ONGC group for meeting its diversification objectives. Both OMPL and ONGC also share a common name, which in ICRA's opinion would persuade ONGC to provide financial support to OMPL 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:

ONGC Mangalore Petrochemicals Limited (OMPL) was originally incorporated as Mangalore Petrochemicals Limited on December 19, 2006. The name of the company was subsequently changed to ONGC Mangalore Petrochemicals Limited on April 30, 2007. OMPL has been promoted by Mangalore Refinery & Petrochemicals Limited (51% equity stake) and Oil and Natural Gas Corporation Limited (49% equity stake). It has set up a project in Mangalore Special Economic Zone (MSEZ) adjacent to the MRPL refinery, to manufacture about 913 KTPA (kilo tonnes per annum) of Paraxylene and about 283 KTPA of Benzene. The project also includes a captive power plant of 72 MW capacity which can utilise natural gas, LSHS (low sulphur heavy stock) or diesel as fuel. The project cost was estimated at about Rs. 5,750 crore which was funded in debt-to-equity ratio of 65:35 though it witnessed cost overruns of about Rs. 1,160 crore. OMPL declared its Commercial Operation Date (COD) as April 1, 2014, though the plant was initially in trial runs and commercial production commenced in October 2014. On July 8, 2015, MRPL announced that its board has approved the Scheme of Amalgamation of OMPL with itself. The No Objection Certificate (NOC) for the merger was received from the MoPNG (Ministry of Petroleum and Natural Gas) in April 2018.

Key financial indicators (audited)

	FY2017	FY2018
Operating Income (Rs. crore)	5,257	5,561
PAT (Rs. crore)	-366	-447
OPBDIT/OI (%)	5.0%	4.2%
RoCE (%)	-0.5%	0.0%
Total Debt/TNW (times)	9.1	22.3
Total Debt/OPBDIT (times)	26.4	29.7
Interest coverage (times)	0.6	0.5

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				
						Date & Rating in FY2018	Date & Rating in FY2017	Date & Rating in FY2016		
	Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating Jan 2019	Dec 2017	Nov 2016	Dec 2015	Jul 2015	Jun 2015
1	Fund Based - Working Capital Facilities (Cash Credit)	Long term	750		[ICRA]AA &	[ICRA]AA+ &	[ICRA]AA+&	[ICRA]A +%	[ICRA]AA-	[ICRA]AA- (Stable)
2	Fund Based - Working Capital Facilities	Short term	3,500		[ICRA]A1+ &	[ICRA]A1+ &	-	-	-	-
3	Non-fund based - Working Capital Facilities	Short term	250		[ICRA]A1+ &	[ICRA]A1+ &	[ICRA]A1+&	[ICRA]A +	[ICRA]A1+	[ICRA]A1+
4	Commercial Paper	Short term	3,500		[ICRA]A1+ &	[ICRA]A1+ &	[ICRA]A1+&	[ICRA]A +	[ICRA]A1+	[ICRA]A1+

&: Under rating watch with developing implications

%: Under rating watch with positive implications

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	Fund Based - Working Capital Facilities (Cash Credit)	-	-	-	750	[ICRA]AA+&
NA	Fund Based - Working Capital Facilities	-	-	-	3,500	[ICRA]A1+&
NA	Non-fund based - Working Capital Facilities	-	-	-	250	[ICRA]A1+&
NA	Commercial Paper	-	-	7-365 days	3,500	[ICRA]A1+&

Source: ONGC Mangalore Petrochemicals Limited

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