December 13, 2019

Haldia Petrochemicals Limited: Ratings placed on watch with negative implications

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long Term Limits- Term Loans	3,031.30	3,031.30	[ICRA]AA@; placed on watch with negative implications
Long-term Limits-Fund-based	319.00	319.00	[ICRA]AA@; placed on watch with negative implications
Short-term Limits- Non-fund Based Limits	3,687.00	3,687.00	[ICRA]A1+@; placed on watch with negative implications
Long-term/Short-term Unallocated	3,020.70	3,020.70	[ICRA]AA@ /[ICRA]A1+@; placed on watch with negative implications
Proposed NCD Programme	1,000.00	1,000.00	[ICRA]AA@; placed on watch with negative implications
Issuer Rating[1]	-	-	[ICRA]AA@; placed on watch with negative implications
Short Term – Commercial Paper programme	100.00	100.00	[ICRA]A1+@; placed on watch with negative implications
Total	**11,158.00**	**11,158.00**	

**Instrument details are provided in Annexure-1*
@ denotes rating watch with negative implications

Rationale

ICRA has placed the long term rating of [ICRA]AA (pronounced ICRA double A) and short term rating of [ICRA]A1+ outstanding on the various debt programmes of HPL under 'rating watch with negative implications'. The rating watch follows the funding support proposed to be extended by Haldia Petrochemicals Limited to its group company TCG Advisory Services Private Limited to fund the acquisitions of 100% equity stake in the Religare Finvest limited (RFL) from Religare Enterprises Limited (REL) for a consideration of Rs 330 crore. The Board of HPL has approved extending funding support in the form of optionally convertible debenture up to Rs 700 crore to TCG Advisory Services Private Limited to fund the acquisition, though, initially HPL will be extending Rs 330 crore. HPL has been investing in subsidiaries and extending short term loans and advances to group companies, with the current total exposure at Rs. 1325 crore. Of this, the company has invested about $175 million in HPL Global, its trading subsidiary at Singapore to enable paper and physical trade with large counterparties and better commodity risk management; however, of this amount about $90 million has been extended to group companies as security deposit and loans and advances. The proposed transaction, if undertaken will further increase HPL's investments and loans and advances to its group companies leading to depletion of its cash reserves even as the petrochemical cycle is weakening leading to lower tolling margins and cash accruals. Accordingly, any material increase in loans and advances to group companies remains a key rating sensitivity.

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[1] *With effect from September 1, 2017, ICRA has aligned the symbols and the definitions of ratings pertaining to the Issuer Rating Scale with that of the Long-Term Rating Scale. The change in the symbol is not to be construed as a change in the credit rating. Please refer to ICRA's website for more details*

The ratings of the company are also constrained owing to weaker than expected performance in FY2019 which has continued in YTD FY2020; and subdued industry outlook owing to which tolling margins are expected to remain weak over the near to medium term. The capacity utilisation of the company's plant declined in FY2019 due to a turnaround spanning May-June 2018 besides some technical issues, which led to a brief shutdown in October 2018 and lower throughput for a few days in February 2019. Further, company undertook plant shutdown of almost 15 days owing to fire incident at Haldia plant's naphtha cracker unit. Accordingly, the operating profits declined to Rs 1660.0 crore in FY2019 from Rs. 2239.2 crore in FY2018. Going forward, ethylene over capacity and downcycle in margins are projected through 2023; propylene market is tighter than ethylene but new 'on-purpose capacity' could lead to mild downcycle through 2023. Accordingly tolling margins are projected to remain subdued over the near to medium term.

ICRA notes that the company has fulfilled its entire export obligations and the bank guarantees provided to DGFT for the same are expected to be released soon after the necessary formalities.

ICRA notes that the company has signed non-binding MoUs with the state governments of Andhra Pradesh and Odisha for setting up a refinery-cum-petrochemical complex. Though the investments in any of the aforementioned projects would be large however these plans are as yet preliminary and accordingly, ICRA has not factored in any large long term acquisitions/investments by HPL, which would be a key rating sensitivity. In this context, the company has indicated that while it's pursuing several growth opportunities, cash outlay on these ventures would be made keeping in mind the overall liquidity requirement of HPL and also spread over a long tenor, leading to healthy free cash flow generation. ICRA will review the rating if the company was to embark on large debt funded projects that impacts its financial profile.

The rating continues to factor in HPL's demonstrated track record in the petrochemicals business, the strength of its promoter, and its leading market position in the eastern Indian market for polymers and its quality of products including chemicals. Its locational advantages in servicing eastern India and Asian exports demand, along with a favourable outlook for polymers demand in India over the long-term from several end-users are other rating comforts. The ratings also consider the cyclicality inherent in the petrochemicals business and the vulnerability of its profitability to the changes in import duty levels and the Rupee–Dollar movement. However, the pricing of HPL's key raw materials and finished products is largely based on import parity, limiting the impact of forex fluctuations on its overall profits. The ratings also factor in the operational risks emanating from the low draft conditions at Haldia port, through which it imports naphtha and the ability of the company to run its plant without significant disruptions.

While it has completed Butene-1 project at a cost of Rs 300 crore, which has been transferred to another SPV viz Advance Performance Material Private Limited, HPL has initiated a project to change the fuel of its power plant's boilers from carbon black feed stock (CBFS) to coal. The capex for the project is estimated at Rs 360 crore. The project is estimated to be completed by the Q4 of CY2020 and would have a short payback period owing to the substantial savings in steam and power cost that would accrue to the company. While the capex plans would entail project execution risks, nevertheless they will be largely mitigated by the HPL's experience in executing large and complex projects.

Going forward, ICRA expects the company to report healthy cash accruals in the near-to-medium term though these are expected to be lower than the past few years owing to the supply overhang caused by ethylene overcapacity and downcycle in margins globally. Though the company has sizable debt repayments, its debt servicing ability is expected to remain healthy over the medium term with healthy cash flows from operations and long maturity of the long-term debt.

Key rating drivers and their description

Credit strengths

Demonstrated track record in the petrochemicals business, with established customers - The domestic polyolefins market has major participants—namely, Reliance Industries Ltd., HPL, Indian Oil Corporation Limited, GAIL India, OPAL, HPCL Mittal Energy Limited, Mangalore Refinery and Petrochemicals Limited wherein, HPL has maintained its niche position through its high-quality focus.

Dominant market position in eastern India and logistical advantage in exporting to East Asian region - HPL has enjoyed a strong market position in eastern and northern India and sells most of its products in the high netback regions of these markets. Additionally, owing to the location of its Haldia Plant, the company enjoys logistical advantage in exporting to the East Asian geography.

Favourable outlook for polyolefins demand in India - The domestic per capita consumption as well as absolute consumption of commodity polymers are expected to show secular growth due to various economic and demographic factors such as increase in urban population and rise in per capita income. Notwithstanding increasing concerns over single -use plastics, which will curtail growth rate for polymers, ICRA expects the domestic consumption of commodity polymers to grow at a CAGR of 7-8% over the long term.

Value-added projects to improve returns from the business over the long-term - Pursuant to the SPA signed between the West Bengal government and TCG Group and upon payment of the first tranche of Rs 653 crore in December 31, 2015 to West Bengal Industrial Development Corporation, the change of management was effectuated. Under the new management, HPL set up a Butene-1 plant (under its subsidiary) with a capex of about Rs 300 crore and a pygas de-sulfurisation project at a capex of about Rs. 105 crore. Commercial production from the Butene-1 plant commenced from March 2019 and from the Pygas de-sulfurisation plant in September 2019. In addition to the aforementioned projects, the company has planned a project to change the fuel of two boilers from CBFS to coal. The capex for the project is estimated at Rs 360 crore. The project is estimated to be completed by the Q4 of CY2020 and would have short payback period owing to the substantial savings in power cost that would accrue to the company. While the capex plans would entail project execution risks, nevertheless these are largely mitigated by the experience of the company in executing large and complex projects

Significant improvement in the liquidity position following robust cash accruals from operations since it restarted from January 2015 - After restarting its operations in January 2015, the company has performed significantly well. However, the operating profitability declined in FY2019 due to turnaround/maintenance shutdown impacting the capacity utilisation of the plant and lower tolling margins. Accordingly, the operating margin declined to 15.5% in FY2019 from 22.9% in FY2018. The net loss of the company was Rs 309.5 crore in FY2019 as against a net profit of Rs 102.4 crore in FY2018. The net cash accruals declined to Rs 1418.4 crore in FY2019 from Rs 1920.3 crore in FY2018. ICRA also notes that HPL booked accrued income of Rs 393.5 crore in FY2019 basis the West Bengal Incentive scheme and as agreed between TCG and WBIDC under share purchase agreement in 2015, however, the recovery of the same might be delayed given the tenuous fiscal position of the latter. The cash and cash equivalents declined from Rs 4673.3 crore as at FY2018 end to Rs 2620.2 crore as at FY2019 end owing to increase in net working capital intensity, capex undertaken, prepayment of debt in FY2019 and investments in group companies. The company has been prepaying its debt. Owing to healthy profitability and cash accruals the NCA/TD was 39.3% in FY2019 and Total Debt/OPBDITA was 2.2x in FY2019.

Credit challenges

Olefin cycle expected to remain weak in the near to medium term - The global operating rates of ethylene plants had peaked in CY2017; however, the industry is now passing through a phase of capacity investment. Owing to supply overhang, ethylene over capacity and downcycle in margins are projected through 2023. Nonetheless, the propylene market is tighter than ethylene but new 'on-purpose capacity' could lead to a mild downcycle through 2023. Accordingly, tolling margins for all types of crackers are expected to remain subdued and below their last 10-year averages over the medium term owing to a supply overhang, demand slowdown and more intense competition.

Vulnerability of profitability to cyclicality inherent in the business, import duty levels and exchange fluctuations - Despite the current healthy cash accruals of the company, the profitability remains vulnerable to cyclicality inherent in the petrochemical business, import duty levels and exchange fluctuations.

Operational risks emanating from draft levels at Haldia port, through which HPL imports naphtha; sustainability of cost structure will also be sensitive to the ability of the company to run its plant without significant downturns -The company is dependent on the draft at the Haldia port, owing to which HPL unloads cargo from the mother vessel to a daughter vessel at the Vizag port and both the mother and daughter vessels with relatively lower weight are unloaded at the Haldia port. However, with the draft level stabilising off late, the risk emanating from receding draft has been offset to some extent. While the high capacity utilisation has resulted in cost efficiencies in manufacturing expenses and better fixed cost absorption in the past, any material decline in the capacity utilisation would adversely impact the cost structure of the company.

Liquidity position: Strong

The company has developed large cash reserves of Rs 2620.2 crore as on March 31, 2019 (excluding loans extended to group companies of Rs 377.4 crore) aided by healthy tolling margins and high capacity utilisation of its plant in the last few years. Accordingly, the liquidity position of the company is expected to remain healthy supported by healthy cash accruals and cash and liquid investments, which would be sufficient to meet the annual debt repayment obligations of Rs 354.2 crore and capex of about Rs 200 crore in FY2020.

Rating sensitivities

Positive triggers: – With the ratings on watch with negative implications now, an upgrade in ratings is unlikely.

Negative triggers: – Negative pressure on HPL's ratings could arise if, tolling margins remain below $175/MT on a sustained basis, or the company undertakes any large debt funded capex/acquisitions or total debt/OPBIDTA exceeds 2.5 times. Additionally, any material funding support to group companies could also be a scenario for downgrade.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Chemical Industry
Parent/Group Support	NA
Consolidation/Standalone	The rating is based on consolidated financial statements of the rated entity.

About the company

Haldia Petrochemicals Limited (HPL) was set up as a joint venture (JV) between the Dr Purnendu Chatterjee-led Chatterjee Petrochem (Mauritius) and the Government of West Bengal (GoWB), With the sale of the first tranche of shares by GoWB in December 2015, the majority shareholding as well as the management control of the JV is now with the Chatterjee Group (TCG). HPL manufactures commodity polymers like high-density polyethylene (HDPE), linear low-density polyethylene (LLDPE), and polypropylene (PP), as well as chemicals/fuels like benzene and butadiene with intermediates sourced from a naphtha cracker (capacity: 700 KTA of ethylene) at Haldia, West Bengal. The company is the fourth largest player in the domestic polyolefins market after Reliance Industries Limited Indian Oil Corporation and ONGC Petro Additions Limited.

Key financial indicators (audited)

	FY2018	FY2019
Operating Income (Rs. crore)	9761.8	10698.6
PAT (Rs. crore)	102.4	-309.5
OPBDIT/OI (%)	22.9%	15.5%
RoCE (%)	3.3%	-0.5%
Total Outside Liabilities/Tangible Net Worth (times)	0.4	0.4
Total Debt/OPBDIT (times)	2.0	2.2
Interest Coverage (times)	3.9	3.7

Status of non-cooperation with previous CRA: None

Any other information: None

Rating history for past three years

	Instrument	Type	Amount Rated	Amount Outstanding	Rating (FY2020)			Rating History for the Past 3 Years							
					Current Rating	Earlier Rating	Earlier Rating	FY2019	FY2018					FY2017	
					13-Dec-2019	16-Sep-2019	12-April-2019	31-Aug-2018	23-Feb-2018	25-Jan-2018	4- Dec-2017	30-June-2017	8-May-2017	15-Sept-2016	24-June-2016
1	Long Term-Proposed NCD Programme	Long Term	1000.0	-	[ICRA]AA@	[ICRA]AA (Negative)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA-(Stable)	-	-	-	-	-	-
2	Long Term Limits-Term Loans	Long Term	4162.15	3,031.30	[ICRA]AA@	[ICRA]AA (Negative)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]A+ (Positive)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A-(Stable)	[ICRA]BBB+(Stable)
3	Long-term Limits-Fund-based	Long Term	313.00	-	[ICRA]AA@	[ICRA]AA (Negative)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]A+ (Positive)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A-(Stable)	[ICRA]BBB+(Stable)
4	Short-term Limits-Non-fund	Short Term	3440.00	-	[ICRA]A1+@	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A-(Stable)	[ICRA]BBB+(Stable)

	Based Limits														
5	Long-term/Short-term Unallocated	Long term/Short Term	2142.85	-	[ICRA]AA@/ [ICRA]A1+@	[ICRA]AA (Negative)/ [ICRA]A1+	[ICRA] AA (Stable)/ [ICRA] A1+	[ICRA] AA (Stable)/ [ICRA] A1+	[ICRA] AA- (Stable)/ [ICRA] A1+	[ICRA] AA- (Stable)/ [ICRA] A1+	[ICRA] A+ (Positive)/ [ICRA] A1+	[ICRA] A+ (Stable) / [ICRA] A1+	[ICRA] A+ (Stable) / [ICRA] A1+	[ICRA] A- (Stable)/ [ICRA] A2+	[ICRA] BBB+ (Stable)/ [ICRA] A2+
6	Issuer Rating		-	-	[ICRA]AA@	[ICRA]AA (Negative)	[ICRA] AA (Stable)	[ICRA] AA (Stable)	[ICRA] AA- (Stable)	[ICRA] AA- (Stable)	[ICRA] A+ (Positive)	[ICRA] A+ (Stable)	[ICRA] A+ (Stable)	[ICRA] A+ (Stable)	[ICRA] A- (Stable)
7	Short Term-Commercial Paper Programme	Short Term	100.00	-	[ICRA]A1+@	[ICRA]A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	-	-	-

@denotes rating watch with negative 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	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Long Term Limits- Proposed NCD programme	-	-	-	1000.00	[ICRA]AA@
NA	Long Term Limits- Term Loans	January 2015	9%	March 2029	3031.30	[ICRA]AA@
NA	Long-term Limits-Fund-based	-	-	-	319.00	[ICRA]AA@
NA	Short-term Limits- Non-fund Based Limits				3687.00	[ICRA]A1+@
NA	Long-term/Short-term Unallocated				3020.70	[ICRA]AA@ /[ICRA]A1+@
NA	Issuer Rating				N.A.	[ICRA]AA@
NA	Short Term – Commercial Paper programme			7-90 days	100.00	[ICRA]A1+@
NA	Long Term Limits- Proposed NCD programme	-	-	-	1000.00	[ICRA]AA@

**only one loan is at 10.5%*

Source: Haldia Petrochemicals Limited

@ denotes rating watch with negative implications

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Haldia Riverside Estates Limited	100.00%	Full consolidation
HPL Go Private Limited	100.00%	Full consolidation
Advanced Performance Material Private Limited	100.00%	Full consolidation
HPL Global Pte limited	100.00%	Full consolidation

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