April 14, 2020

Deepak Fertilisers & Petrochemicals Corporation Limited: Ratings re-affirmed; Rating for Non-Convertible debenture withdrawn

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible debenture	500.0	-	[ICRA]A+ (Stable) withdrawn
Term Loan	431.0	631.0	[ICRA]A+ (Stable); Reaffirmed
Cash Credit	975.0	400.0	[ICRA]A+ (Stable); Reaffirmed
Non-fund based limits	1,200.0	925.0	[ICRA]A1; Reaffirmed
Total	**3,106.0**	**1,956.0**	

*Instrument details are provided in Annexure-1

Rationale

The re-affirmation of ratings takes into account the stable financial performance expected in FY2020 of Deepak Fertilisers & Petrochemicals Corporation Limited (DFPCL) on a consolidated basis owing to improvement in demand and margins of isopropyl alcohol (IPA) and Ammonium Nitro Phosphate(ANP) and healthy demand of Technical Ammonium Nitrate (TAN). The sales volumes and margins of IPA had dipped during 9M FY2020 owing to a water cut by MIDC leading to plant shutdown and dumping by China. However, with the outbreak of COVID-19 the demand and margins of IPA have surged because of its use in the manufacture of sanitizers. Similarly, the contribution levels of ANP have also increased to Rs 5396/MT in 9M FY2020 as against Rs 3521/MT in FY2019 besides which the sales of Smartek brand of NPK fertilisers have more than doubled in FY2020 vis-à-vis FY2019. The company has stopped the manufacture of plain vanilla NPK fertilisers and is focussing on the Smartek brand of NPK fertilisers which commands a healthy premium over the former. Additionally, sales volumes of TAN which had declined in 9M FY2020 owing to extended monsoons have recovered even as contribution margins though lower than FY2019 levels remain healthy. The company commissioned additional capacities of Nitric acid at its Dahej plant in April 2019 but utilisation remained low in 9M FY2020 owing to technical issues with the plant and a shutdown order by Gujarat Pollution Control board (GPCB) however capacity utilisation levels have improved from Q4 onwards after resolution of issues with GPCB and stabilisation of plant. Going forward, the increase in sales volumes of nitric acid (post stabilisation of enhanced capacities), Smartchem fertilisers (due to healthy traction in the market) and IPA (due to the surge in demand for sanitisers) are expected to add to the revenues and profits of the company. Further DFPCL has decided to put on hold its Propylene based IPA expansion project and implement its TAN project only post equity funding is tied up. As of now the company is implementing only its ammonia plant under Performance Chemiserve Limited (a subsidiary of Smartchem Technologies Limited) for which the funding tie up are in progress. As a part of fund raising plans the company has divested one of its unused plots of industrial land in Dahej for a total transaction value of ~Rs 100 crore and sold its 75% holding in Desai Fruits and Vegetables for Rs 28.2 crore. Additionally, warrants of Rs. 200 crore were issued to the promoters at a price of Rs. 308.79/share, out of which Rs. 50 crore were infused in October 2018, Rs. 25 crore in October 2019, and balance Rs. 125 crore would be infused in April 2020. Following infusion by promoters, IFC in October 2019, has subscribed to $15 million as Foreign Currency Convertible Bonds in DFPCL and $15 million as compulsory convertible debentures in Smartchem Technologies Limited (STL) and is expected to subscribe to the second tranche of an equal amount in April 2020 post the Rs 125 crore infusion by the promoters. Despite infusion of funds and scaling down of capex, the credit metrics are expected to weaken as the company implements its Ammonia project besides which the exposure to project execution risk remains owing to the initial stage of the project.

The ratings are also constrained by the regulatory risk in the fertilisers business and the vulnerability of the chemicals division's profitability to inherent price cyclicality. Furthermore, the company's profitability remains sensitive to any large fluctuation in spot/term R-LNG prices. The ratings continue to take into account the moderate debt coverage metrics and return indicators of the company. For its ammonia project, the company's ability to tie-up its gas requirements and achieve the design parameters, post-commissioning, would be important.

The ratings, however, continue to take into account the company's diversified business product portfolio comprising of fertilisers and industrial chemicals and the strong market position held in the industrial chemicals business with leadership in ammonium nitrate (TAN), nitric acid and IPA. The ratings also factor in the company's high financial flexibility as evident from the competitive cost of debt and healthy refinancing ability demonstrated in the past. The company has reduced its short-term borrowings in the current fiscal by reducing its trading business in chemicals which was working capital intensive.

The stable outlook takes into account established position in both the chemicals and fertilisers segments and the stable demand outlook for both the sectors in the long term.

Credit strengths

Strong market position in the domestic industrial chemicals business - DFPCL has a strong market position in existing chemical businesses of AN, nitric acids and IPA. DFPCL is one of the leading players of TAN in the domestic market supported by the superior quality product offering in the form of Low Density AN (LDAN), which commands a premium over AN-melt manufactured by domestic players and the imported fertiliser grade AN. The company is also the sole producer of IPA in the domestic market and caters to 75¬80% of the market demand through its manufacturing capacity as well as imports. DFPCL is also the leading manufacturer of concentrated nitric acid (CNA) in the domestic market. The company is expanding its capacities in all its key segments, viz. TAN, IPA and nitric acid, which would allow it to maintain its dominant position over a longer term. The company also got environmental clearance (EC) for enhancing its fertiliser manufacturing to 1.1 million MTPA from 0.6 million MTPA in FY 2020

Diversified product portfolio - DFPCL has a broad-based product mix, derived from two streams using natural gas or ammonia as the primary feedstock. The company's ability to suitably modify its product mix in response to changes in market conditions partially mitigates the risks associated with cyclicality.

Favourable demand prospects - Domestic demand outlook for the company's key products like TAN, IPA, nitric acid remains healthy. The demand for ammonium nitrate will be driven by demand from coal mining and infrastructure sector while demand for nitric acid would be supported by planned addition of capacities in the downstream segments. The IPA market is expected to maintain healthy growth driven by the growing end-user industry, namely the pharma sector apart from dyes and paints. The demand for IPA has also seen a sharp increase for sanitisers following the outbreak of corona virus. The fertiliser business would continue to benefit in the long term from the steady demand for its expanding NPK grade of fertilisers, though demand could be affected in years of poor monsoons.

Healthy financial flexibility - DFPCL's overall liquidity position is supported by availability of unutilised bank limits and high financial flexibility as reflected by its healthy refinancing ability. The Promoters have brought in Rs. 75 crore over FY2019 and FY2020 and are expected to infuse another Rs 125 crore in April 2020. IFC has infused USD 30 million in DFPCL and STL in the form of FCCB and CCD. Furthermore, with reduction in chemical trading activity and refinancing of certain part of short-term debt with longer tenure loans in FY2020, the refinancing risks for the company have reduced.

Credit challenges

Vulnerability of profitability to cyclicality in input prices -The profitability of the company remains exposed to the cyclicality in input prices and the company's ability to pass on the same to the customers. The company's fertiliser business was also impacted by shortage of phosphoric acid as its key supplier had reduced its production. While the company has subsequently diversified its supplier base, it remains exposed to any such shutdowns from its key suppliers.

Exposed to regulatory risks - The company's fertiliser business operates in a regulated environment. The selling prices of its products remain dependent on the subsidy allocated by the GoI to the various nutrients. The company thus remains exposed to any sharp variation in the subsidy amount and delays in receipt of the same, apart from any other regulatory intervention on the product prices. ICRA also notes the regulatory overhang with regard to recovery of unintended benefits initiated by Department of Fertilizers against DFPCL for the usage of cheaper inputs than envisaged by the policy. Quantum of recovery will be a key rating sensitivity.

Large debt-funded capex - The company successfully commissioned its nitric acid plant in April 2019 which was set up at a total estimated cost of ¬Rs. 575 crore. In addition, the company is setting up an Ammonia plant at a total capex of about Rs. 2,920 crore to be funded in a debt to equity ratio of 7:3. The company has achieved financial closure for the proposed ammonia plant (debt of Rs. 2,044 crore tied-up) and plans to commission the project by Q4 FY2022. Further the company has decided to put on hold its Propylene based IPA expansion project and implement its TAN project only post equity funding is tied up. The company has purchased key equipment for the ammonia and TAN project. The large-scale and long gestation period of these projects results in execution risks and any material cost or time overrun would be a key rating sensitivity. The company would be applying for approvals from the Industries department for consent of establishment post allotment of land to PCL. The company also plans to raise additional equity funds to meet part of the equity commitment for the aforementioned projects; timely conclusion of the equity raising programme would be critical from a credit perspective. ICRA expects the off-take risks for these projects to be limited, though the company's ability to achieve the design parameters, post-commissioning, and ramp up operations in a timely manner would remain important.

Liquidity Position: Adequate

The company's liquidity is expected to remain adequate as its steady accrual generation, healthy financial flexibility and release of past subsidies lend support to the overall liquidity position. The company has strong banking relationships and can also raise funds from the debt and equity markets, as demonstrated in the past. With funding tied up for the ammonia project with a comfortable moratorium period and long tenure, the company's cash flows are expected to be adequate to meet the repayment obligations.

Rating sensitivities

Positive triggers – Successful commissioning and stabilisation of Ammonia project within time and cost budgets and healthy cash accruals from the same could lead to a rating upgrade.

Negative triggers – i) Material time and cost over runs in new projects or ii) decline in profitability or stretch in working capital position of existing operations leading to deterioration of debt metrics or iii) inability of the company to raise additional funding as envisaged could lead to a downgrade

Analytical approach:

Analytical Approach	Comments
Applicable Rating Methodologies	Rating Methodology for Entities in the Fertiliser Industry Rating Methodology for Entities in the Chemical Industry Corporate Credit Rating Methodology
Parent/Group Support	Not Applicable
Consolidation / Standalone	For arriving at the ratings, ICRA has combined the business and financial risk profiles of Deepak Fertilisers & Petrochemicals Corporation Limited with its subsidiary, Smartchem Technologies Limited as the latter is an integral part of DFPCL's operations. For arriving at the ratings, ICRA has considered the consolidated financials of Deepak Fertilisers & Petrochemicals Corporation Limited. As on March 31, 2019, the Company had 5 subsidiaries, 2 stepdown subsidiaries and 1 JV, that are enlisted in Annexure-2

About the company:

Deepak Fertilisers and Chemicals Corporation Limited (DFPCL) was incorporated in 1979. It is engaged in the manufacturing of Nitro-Phosphate (NP), Nitrogen-Phosphorous-Potassium (NPK), and Bentonite Sulphur fertilisers and industrial chemicals such as technical ammonium nitrate (TAN), methanol, nitric acid and iso propyl alcohol (IPA). Its manufacturing facilities are located at Taloja, Srikakulam and Panipat. It also owns a commercial mall at Pune. DFPCL's promoters (Mr C. K. Mehta and Mr S.C. Mehta) hold 51.48% stake in the company with the rest held by the public and institutional investors. DFPCL's fertilisers and chemicals business verticals have inter-linkages in the form of use of common raw materials and synergies in the manufacturing processes. The capability of the business segments to attract a different set of investors and strategic partners in order to scale up the size and operations is significant and hence, in FY2018, DFPCL demerged its fertilisers and TAN businesses into a wholly-owned subsidiary, Smartchem Technologies Limited (STL) with effect from January 1, 2015. STL further owns ~85% equity in a subsidiary company, Performance Chemiserve Limited (PCL), which was acquired in Q4 FY2018. The group is setting up a 1,500 MTPD ammonia plant under Performance Chemiserve Limited.

Key financial indicators (Consolidated)

	FY2018	FY2019
Operating Income (Rs. crore)	5,995	6,742
PAT (Rs. crore)	167	77
OPBDIT/OI (%)	9.7%	7.2%
RoCE (%)	10.0%	8.5%
Total Outside Liabilities/TNW (times)	2.3	2.3
Total Debt/OPBDIT (times)	6.1	6.2
Interest coverage (times)	3.3	2.1
DSCR	1.0	1.7

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 in FY2020	Date & Rating in FY2019			Date & Rating in FY2018	Date & Rating in FY2017		
					April 14 2020	Mar 29 2019	Oct 25 2018	Sep 17 2018	02-April 2018	03 Mar 2017	08 Jul 2016	21 Jun 2016
1	Term Loan	Long Term	631.0	523	[ICRA] A+ (Stable)	[ICRA] A+ (Stable)	[ICRA] AA- (Negative)	[ICRA] AA- (Negative)	[ICRA] AA- (Stable)	[ICRA] AA- (Negative)	[ICRA] AA- (Negative)	[ICRA] AA- (Negative)
2	Cash Credit	Long Term	400.0		[ICRA] A+ (Stable)	[ICRA] A+ (Stable)	[ICRA] AA- (Negative)	[ICRA] AA- (Negative)	[ICRA] AA- (Stable)	[ICRA] AA- (Negative)	[ICRA] AA- (Negative)	[ICRA] AA- (Negative)
3	Commercial Paper	Short Term				[ICRA] A1; Withdrawn	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+
4	Non-fund based limits	Short Term	925.0		[ICRA] A1	[ICRA] A1	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+
5	Non-convertible debenture	Long Term				[ICRA] A+ (Stable)	[ICRA] AA- (Negative)	-	-	-	-	-

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	Term Loan	Jun-15	NA	Dec-28	631.0	[ICRA]A+(Stable)
NA	Cash Credit	NA	NA	NA	400.0	[ICRA]A+(Stable)
NA	Non-fund based limits	NA	NA	NA	925.0	[ICRA]A1
NA	Non-convertible debenture	Not placed	-	-	500.0	[ICRA]A+(Stable) (Withdrawn)

Source: Deepak Fertilisers & Petrochemicals Corporation Limited

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Smartchem Technologies Limited	100%	Full Consolidation
Deepak Nitrochem Pty Limited	100%	Full Consolidation
Deepak Mining Services Private Limited (DMSPL)	100%	Full Consolidation
RungePincockMinarco India Private Limited (Subsidiary of DMSPL)	51%	Full Consolidation
Desai Fruits and Vegetables Private Limited	5%	Equity method
SCM Fertichem Limited	100%	Full Consolidation
Platinum Blasting Servies Pty Limited (PBS)[Subsidiary of STL]	65%	Full Consolidation
Australian Explosives Pty Limited (AME)[Subsidiary of PBS]	65%	Full Consolidation

*: Company divested stake in company in FY 2020, For FY 2019 audited financials ownership considered was 28.7%

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