

May 05, 2020

Mangalore Refinery and Petrochemicals Limited: Ratings reaffirmed; outlook revised to negative

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
NCDs	3,000.0	3,000.0	Reaffirmed at [ICRA]AAA; Outlook revised to Negative from Stable
Fund Based Limits	6,000.0	6,000.0	Reaffirmed at [ICRA]AAA; Outlook revised to Negative from Stable
Term Loan	1,371.4	1,371.4	Reaffirmed at [ICRA]AAA; Outlook revised to Negative from Stable
Non-Fund Based Limits	6,600.0	6,600.0	[ICRA]A1+; reaffirmed
Commercial Paper	900.0	900.0	[ICRA]A1+; reaffirmed
Issuer Rating	-	-	Reaffirmed at [ICRA]AAA; Outlook revised to Negative from Stable
Total	17,871.4	17,871.4	

*Instrument details are provided in Annexure-1

For arriving at the ratings, ICRA has considered the consolidated financials of the Oil and Natural Gas Corporation Limited (ONGC), including ONGC Videsh Limited (OVL), Mangalore Refinery and Petrochemicals Limited (MRPL), Hindustan Petroleum Corporation Limited (HPCL) and some of the SPVs undertaking forward integration projects, to the extent of any financial commitments made to the stakeholders. ICRA has reaffirmed the rating(s) of ONGC at [ICRA]A1+ along with its subsidiaries OVL at [ICRA]AAA/[ICRA]A1+, ONGC Petro additions Limited (OPaL) at [ICRA]AAA(CE)/[ICRA]AA/[ICRA]A1+ and MRPL at [ICRA]AAA/[ICRA]A1+; however, the outlook on the long term rating has been revised to Negative from Stable for OVL, MRPL and OPaL.

Rationale

The revision in the outlook of the long-term rating is on account of ICRA's view that the global demand destruction of crude oil owing to the Covid-19 pandemic is unprecedented and is likely to lead to depressed crude oil prices for several quarters. The Covid-19 pandemic is creating a severe and extensive credit shock across many sectors, regions and markets – but its impact on oil markets is particularly severe because quarantines and lockdowns stop the movement of people and goods, thereby directly impacting the demand for transportation fuels. Accordingly, Brent prices have crashed from the levels of ~\$68/bbl in December 2019 end to ~\$21/bbl in April 2020-end amid demand destruction of ~25-30 million barrels/day in April. Additionally, as oil consumption declines, producers and traders have been resorting to storing oil, leading to build-up of inventories on land storage and offshore vessels, at multi-year highs. Accordingly, the elevated inventory levels of crude oil and petroleum products are expected to weigh on the prices of crude oil going forward even when demand starts recovering besides which lack of storage space has heightened the volatility in prices. Though the OPEC and Russia have agreed to reduce production by 9.7 mbd and the oil producers of G-20 nations will also contribute with their own output reduction to reach a total of 15 mbd cut in production, in the absence of lockdowns being lifted, the response by the oil producers is expected to be overwhelmed by the demand destruction.

On the demand side, the global economic growth is expected to turn sharply negative in 2020 as the world bears the worst economic fallout since the Great Depression. The timing of the recovery in the global economy is uncertain and

expected to be prolonged, due to which the demand growth of crude oil is expected to remain muted over the medium term, which will weigh on prices.

The domestic gas price, notified at \$2.39/mmbtu (GCV basis) for H1 FY2021, a sharp decline of 26.0% from the price of \$3.23/mmbtu (GCV basis) applicable for H2 FY2020, is the lowest since the institution of the modified Rangarajan formula. Accordingly, the realisations on gas sales of ONGC would also decrease even as gas production remains either a break even or a loss-making proposition for most fields, notwithstanding some decline in oilfield services/equipment cost. Going forward, unless the price formula is changed, the global gas supply glut is expected to keep prices of domestic gas low in the near to medium term, leading to poor returns.

On a consolidated basis ONGC posted a net profit of Rs 17,913.0 crore in 9M FY2020 as against Rs 27,610.2 crore in 9M FY2019 owing to the impact of weaker crude oil realisations (\$62.08/bbl in 9M FY2020 vis-à-vis \$70.29/bbl in 9M FY2019 on ONGC standalone basis) lower sales volumes and lower GRMs. Because of the much larger decline in realisations on both crude oil and natural gas, ONGC's net cash accruals in FY2021 would be significantly lower than previously estimated. With a much sharper decline in crude oil realisations in FY2021 net profits and cash accruals are expected to decline significantly though some support would be provided by the sharp depreciation of INR versus the USD. Also, the downstream and petrochemicals business would not be able to offset the poor earnings of the upstream business due to the weak demand scenario for these products owing to the Covid-19 pandemic. Additionally, its dependence on external debt will increase and debt protection metrics would deteriorate if the crude oil price remains at depressed levels on a sustained basis. Accordingly, the key debt metrics such as total debt/OPBDITA, which stood at 1.3x and NCA/TD, at 53% in FY2019 are expected to weaken materially in FY2021.

ICRA also notes that ONGC's cash and surplus investments have been declining over the past few years due to debt-funded acquisitions, and other shareholder distributions. In FY2018, ONGC acquired GSPC's KG Basin asset as well as the Gol's stake in HPCL, which has depleted its cash reserves. The total consideration for the HPCL acquisition was Rs. 36,915 crore, which was funded by a mix of internal resources and short-term debt.

In FY2019 ONGC has paid final dividend of Rs 1.35/share for FY2018 and paid interim dividends totalling Rs. 6.25/share for FY2019 and bought back 25.29 crore equity shares at a price of Rs. 159/share with a combined cash outgo of about Rs. 15,500 crore. In FY2020 the company paid final dividend of Rs 0.75/share for FY2019 and interim dividend of Rs. 5/share with a cash outgo of about Rs. 7,233 crore, depleting the cash reserves even as the capex requirements of the company remain sizeable at about Rs 30,000 crore annually. The substantial decline in cash reserves of the company erodes its ability to withstand crude price shocks as capex requirements remain high for the E&P business to maintain production in future years. During the last crude oil price decline beginning 2014, ONGC maintained its large capex outlay; however, given its low cash reserves now, maintaining the capex levels would increase its reliance on external debt. Nevertheless, ICRA notes that the company has significant undrawn lines of credit available, strong access to capital markets and equity stake in Indian Oil Corporation Limited (IOCL) and GAIL (India) Limited which is currently valued at ~Rs 13,350 crore (as on April 30, 2020). Besides the company has deposits in the site restoration fund of Rs 18,092.6 crore (as on March 31, 2019), which can be used after paying the applicable taxes. ICRA also notes that ONGC enjoys significant sovereign ownership (62.78% Gol stake as on December 31, 2019) and a dominant and strategically important position in the Indian energy sector as the largest domestic producer of crude oil and natural gas. It plays a significant role in fulfilling the socio-political objectives of the Gol towards control of domestic energy prices. Consequently, it enjoys high financial flexibility.

ICRA is of the opinion that ONGC would continue supporting some of the other Group entities through equity infusions, corporate guarantees, inter corporate deposits and loans and advances, given their strategic importance to the company. Accordingly, the negative outlook on the long-term rating for other Group entities is owing to the weakening of outlook for crude realisations and cash accruals of ONGC.

For **MRPL**, the sharp drop in oil prices in the month of March 2020, is expected to lead to large inventory losses for the quarter ending March 2020 and full year 2020. The company has posted a large net loss of Rs 1,789.1 crore in 9M FY2020 as against a net loss of Rs 147.2 crore in 9M FY2019, owing to the loss of production due to shutdowns due to water shortage and landslide in H1 FY2020 and weak GRMs and is expected to post a large loss for full year 2020. The refineries of MRPL are operating at a reduced capacity utilisation, in line with other refineries in the country, owing to the sharply lower demand. Additionally, in case of a prolonged lockdown and consequent demand destruction, standalone refiners like MRPL are expected to suffer a sharper decline in sales as oil marketing companies (OMC) cut down purchases from the former. Though lower product prices have the potential to invigorate demand, nevertheless the same is expected to be outweighed by the demand slowdown. Accordingly, with the gross refining margins (GRMs) at already low levels, a global demand slowdown is expected to exacerbate crack spreads leading to further pressure on the GRMs, which would be offset partially by lower fuel losses and working capital borrowings. The debt metrics such as Total debt/OPBDITA which stood at 4.5x and NCA/TD, at 6% in FY2019, are expected to weaken in FY2020 and FY2021.

In the case of OPaL, while the plant is operating at a reduced capacity utilisation, owing to logistics issues due to lock down situation and lower demand, the tolling margins are healthy due to several plant shutdowns at the global level. Despite healthy tolling margins, the operations are expected to be loss-making owing to high fuel consumption and reduced yields at lower capacity utilisations. Nevertheless, once plant operations normalise, the tolling margins are expected to remain low, owing to a weak demand environment and global supply overhang due to a spate of new capacity additions. OPaL's capacity utilisation had improved to an average of around 84% during 9M FY2020 (65% during FY2019), driven by increased feedstock availability, however, the same is expected to decline in FY2021, if the lock down continues. Further, the debt metrics continue to remain stretched on account of high debt levels and losses and the same is expected to weaken in FY2021. However, ONGC has infused Rs. 870 crore against share warrants in April 2020, which would support the liquidity profile of OPaL.

Key rating drivers

Credit strengths

Strong sponsor profile resulting in high financial flexibility - MRPL has a strong parentage with about 72% of its equity held by ONGC and about 17% by Hindustan Petroleum Corporation Limited ([ICRA]AAA (Stable)/ [ICRA]A1+). MRPL is strategically important to ONGC and is essentially managed by ONGC through its nominee directors and senior management. The chairman of ONGC acts as the chairman of MRPL's board of directors. ONGC had also extended loans to MRPL at favourable terms for part-funding of the large-size capital expenditure undertaken for refinery expansion. The company enjoys high financial flexibility on account of the parentage of ONGC.

Healthy operational profile - MRPL's refinery has been operating at more than 100% capacity utilisation for the last few years. The refinery has witnessed a healthy ramp up in operations since the commissioning of the Phase-III expansion and its polypropylene unit. However, in FY2020 the capacity utilization was lower than past years as there was loss of production owing to plant shutdowns due to water shortage and land slides

Location advantages of being a coastal refinery for sourcing of crude as well as exports - The company's refinery is located on the western coast of the country close to the Mangalore port. The company's location is logistically advantageous for sourcing of crude as well as export of products.

Credit weaknesses

Vulnerability of profits to the import duty differential on the domestic sales, commodity price cycles and forex fluctuations – Given the nature of the business, the company remains exposed to the movement in the commodity price

cycles and the volatility in the crude prices. The company's GRM levels witnessed a considerable decline in 9M FY2020 owing to weak crack spreads for light and middle distillates. Any adverse changes in the import duty on its products would also have an impact on the company's domestic sales. The company's profitability is also exposed to the forex rates (INR-US\$) given the company imports its crude requirement, though it also exports certain proportion of its sales (25%~30%) which provides a natural hedge to some extent.

Execution risks associated with the on-going and future capex – MRPL has completed the capex in FY 2020 for upgrading its refinery to be Bharat Stage (BS)-VI compliant. Estimated capital outlay for the same was ~Rs. 1,810 crore. MRPL plans to expand its refining capacity to 25 MMTPA from the existing 15 MMTPA gradually after the capex for BS-VI compliance is completed. In addition, MRPL plans to setup a desalination plant in the medium term. The sizeable projects of MRPL expose it to high execution risks.

Weak financial performance of its subsidiary, OMPL – OMPL reported healthy revenue growth of 52% YoY in FY2019 largely driven by the increase in product realisations, though the growth in sales volumes remained muted owing to sub-par plant utilisation levels. In 9M FY2020, OMPL recorded a significant decline of 41.5% YoY in operating income driven by both, decline in plant throughput and average realisation. OMPL has been operating with weak profitability levels since commissioning due to – a) inadequate supply of feedstock from MRPL which has resulted in lower-than-estimated plant utilisation levels, and b) relatively subdued crack spreads of its products. The Px-naphtha spreads witnessed sharp improvement in FY2019 following a tight supply situation due to shutdown of certain Px capacities as well as healthy product demand. As a result, the company's operating profits grew 217% YoY in FY2019. However, the spreads underwent a significant correction in FY2020 with sizeable new capacities coming on stream in China leading to operating losses of Rs. 47.1 crore in 9M FY2020 as against operating profit of Rs. 306.4 crore in 9M FY2019. The company also incurred forex losses of ~Rs. 70 crore in 9M FY2020 which along with high depreciation and interest charges led to a net loss of Rs. 660.3 crore for the period.

Liquidity Position: Adequate

The liquidity of MRPL is expected to remain adequate given the its high financial flexibility and adequate buffer in the form of unutilised working capital limits. Even though the company has incurred large cash losses in FY2020 and has large repayment obligations going forward nevertheless these are expected to be met partly from cash flows and partly refinanced. The ability to the company to raise funds from banks and capital markets at fine rates provides comfort from a liquidity perspective.

Rating sensitivities

Positive triggers – The outlook may be revised to Stable, if there is an improvement in the credit profile of the ONGC Group.

Negative triggers – Negative pressure on MRPL's ratings could arise in case the credit profile of the ONGC Group weakens or the linkage between ONGC and MRPL weakens, or if there is a further deterioration in MRPL's performance leading to high losses.

Analytical approach:

Analytical Approach	Comments
Applicable Rating Methodologies	Rating Methodology for Downstream Oil Companies
Parent/Group Support	Parent - Oil and Natural Gas Corporation Limited We expect MRPL's parent, ONGC [rated [ICRA]A1+], to be willing to extend financial support to MRPL, should there be a need, given the high strategic

importance that MRPL holds for ONGC for meeting its diversification objectives
 For arriving at the ratings, ICRA has considered the consolidated financials of
 Consolidation / Standalone Mangalore Refinery and Petrochemicals Limited. As on March 31, 2019, the
 Company had 1 subsidiary and 1 JV, that are enlisted in Annexure-2.

About the company:

Mangalore Refinery & Petrochemicals Limited (MRPL) was set up as a joint venture (JV) between the AV Birla Group and Hindustan Petroleum Corporation Limited (HPCL). MRPL operates a refinery at Mangalore (Karnataka), with a nameplate capacity of 15 million metric tonne per annum (MMTPA). The refinery project was initially implemented in two phases during a period of administered pricing, where the regulatory framework provided assured returns on capital employed. However, since the deregulation of the refining sector in 1998, the company had been exposed to low and volatile international refining margins, which affected its operating profitability quite significantly. Together with high debt service commitments, this resulted in MRPL posting large losses in the past. Oil and Natural Gas Corporation Limited (ONGC) acquired a 51% stake in MRPL in March 2003, and later increased its stake to 72%. With a change in management, funds infusion by ONGC and upturn in the refining margin cycle, the company made a financial turnaround in the subsequent period. The refining capacity was enhanced to 15 MMTPA from 11.82 MMTPA in March 2012 with the commissioning of Phase-III. It also commissioned a 440 KTPA polypropylene unit. In July 2015, MRPL's board approved the merger of its subsidiary, OMPL, with itself, which is currently in process. MRPL had acquired a controlling stake in OMPL in February 2015 by increasing its stake to 51% from 3%, while the remaining stake was held by ONGC.

Key Financial Indicators - Consolidated (Audited)

	FY2018	FY2019
Operating Income (Rs. crore)	49,055	63,421
PAT (Rs. crore)	1,773	351
OPBDIT/ OI (%)	9.3%	4.4%
RoCE (%)	15.7%	7.1%
Total Debt/ TNW (times)	1.4	1.5
Total Debt/ OPBDIT (times)	3.3	5.6
Interest coverage (times)	5.0	2.6
NWC/ OI (%)	6%	6%

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating History for last three years:

Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. Crore)	Current Rating (FY2020)						Chronology of Rating History for the past 3 years				
				Date & Rating						Date & Rating in FY2019		Date & Rating in FY2018		Date & Rating in FY2017
				05-May-2020	27-Nov-19	24-Jul-19	09-May-19	16-Aug-18	04-Apr-18	02-Nov-17	19-Apr-17	18-Apr-16		
1	NCDs	3,000.0	-	[ICRA] AAA (Negative)	[ICRA] AAA (Stable)	-	-	-	-	-	-	-	-	
2	Fund Based Limits	6,000.0		[ICRA] AAA (Negative)	[ICRA] AAA (Stable)	[ICRA] AAA (Stable)	[ICRA] AAA (Stable)	[ICRA] AAA (Stable)	[ICRA] AAA (Stable)	[ICRA] AAA (Stable)	[ICRA] AAA (Stable)	[ICRA] AAA (Stable)	[ICRA] AAA (Stable)	
3	Term Loan	1,371.4	1,371.4	[ICRA] AAA (Negative)	[ICRA] AAA (Stable)	[ICRA] AAA (Stable)	[ICRA] AAA (Stable)	[ICRA] AAA (Stable)	--	--	--	--	--	
4	Non-fund Based Limits	6,600.0		[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	
5	Commercial Paper	900.0		[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	
6	Issuer Rating	--		[ICRA] AAA (Negative)	[ICRA] AAA (Stable)	[ICRA] AAA (Stable)	[ICRA] AAA (Stable)	[ICRA] AAA (Stable)	[ICRA] AAA (Stable)	[ICRA] AAA (Stable)	[ICRA] AAA (Stable)	[ICRA] AAA (Stable)	[ICRA] AAA (Stable)	

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
--	Non-Convertible Debentures	Yet to be placed	--	--	3,000.0	[ICRA]AAA (Negative)
--	Fund Based Limits	--	--	--	6,000.0	[ICRA]AAA (Negative)
--	Term Loans	FY2019	--	FY2021	1,371.4	[ICRA]AAA (Negative)
--	Non-fund Based Limits	--	--	--	6,600.0	[ICRA]A1+
--	Commercial Paper	--	--	7-365 days	900.0	[ICRA]A1+
--	Issuer Rating	--	--	--	--	[ICRA]AAA (Negative)

Source: Mangalore Refinery and Petrochemicals Limited

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
ONGC Mangalore Petrochemicals Limited	51.00%	Full Consolidation
Shell MRPL Aviation Fuels and Services Limited	50.00%	Limited Consolidation

Source: Mangalore Refinery and Petrochemicals Limited

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