May 18, 2020

Mangalore Refinery and Petrochemicals Limited: Rated amount enhanced for commercial paper programme

Summary of rated instruments

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
NCDs	3,000.0	3,000.0	[ICRA]AAA (Negative) outstanding
Fund Based Limits	6,000.0	6,000.0	[ICRA]AAA (Negative) outstanding
Term Loan	1,371.4	1,371.4	[ICRA]AAA (Negative) outstanding
Non-Fund Based Limits	6,600.0	6,600.0	[ICRA]A1+ outstanding
Commercial Paper	900.0	3,000.0	[ICRA]A1+ assigned/outstanding
Issuer Rating	-	-	[ICRA]AAA (Negative) outstanding
Total	**17,871.4**	**19,971.4**	

**Instrument details are provided in Annexure-1*

Rationale

The assigned ratings favorably factor in the majority ownership of Oil and Natural Gas Corporation (ONGC; [ICRA]A1+) in Mangalore Refinery and Petrochemicals Limited (MRPL) and ONGC's continued support to MRPL, which is expected to be sustained given its strategic importance to ONGC's forward integration plans. The capacity utilisation levels at MRPL's refinery were impacted in H1 FY2020 due to loss of planned and unplanned shutdown in different phases of the refinery due to shortage of fresh water in Q1 FY2020 and excessive rainfall in Q2 FY2020. Notwithstanding these disruptions, the operational performance of MRPL's refinery has remained healthy in the past with utilisation levels consistently above 100% and the healthy ramp up of operations at its polypropylene unit that achieved close to full capacity utilisation in FY2019. The ratings also take into account the strong financial flexibility of MRPL due to its strong parentage, coupled by sizeable unutilised working capital limits. The ratings also factor in the location advantage enjoyed by the company being located close to the Mangalore port as well as its diversified crude sourcing.

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. The company's profitability would remain vulnerable to the import duty differential, commodity price cycles and the INR-USD exchange rates. Further, MRPL has sizeable capex outlined in the medium to long-term to enhance refinery capacity to 25 MMTPA and set up a desalination project to safeguard its operations against water shortage. The large-scale projects would entail execution risks, while the timelines and funding mix would remain a rating sensitivity. The company is also exposed to asset concentration risks as its refining presence is limited to Mangalore (Karnataka).

While assigning the ratings, ICRA has noted MRPL's plans to merge its subsidiary, ONGC Mangalore Petrochemicals Limited (OMPL; [ICRA]A1+ / under rating watch with developing implications) with itself. The process is currently underway, but has been delayed by regulatory approvals. OMPL currently operates an aromatic complex adjacent to the refinery complex of MRPL. OMPL reported its first year of profitable operations in FY2019, since its commissioning in FY2015 owing to healthy paraxylene-naphtha spreads, however, the company's performance in FY2020 has been adversely impacted by weak spreads for its key products, Paraxylene and Benzene. In ICRA's view the synergy benefits of the impending merger are expected to remain strong in the long run.

The negative outlook on the long-term rating of MRPL is owing to the weakening of outlook for crude realisations and cash accruals of ONGC.

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] [Corporate Credit Rating Methodology]
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
Consolidation / Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of 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
					18-May-2020	5-May-2020	23-April-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	Long Term	3,000.0	2,560	[ICRA] AAA (Negative)	[ICRA] AAA (Negative)	[ICRA] AAA (Stable)	[ICRA] AAA (Stable)	-	-	-	-	-	-	-
2	Fund Based Limits	Long Term	6,000.0		[ICRA] AAA (Negative)	[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	Long Term	1,371.4	1,371.4	[ICRA] AAA (Negative)	[ICRA] AAA (Negative)	[ICRA] AAA (Stable)	[ICRA] AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA] AAA (Stable)	--	--	--	--
4	Non-fund Based Limits	Short Term	6,600.0		[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA]A1+	[ICRA]A1+	[ICRA] A1+	[ICRA] A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
5	Commercial Paper	Short Term	3,000.0		[ICRA]` A1+	[ICRA]` A1+	[ICRA]` A1+	[ICRA]` A1+	[ICRA]`A1+	[ICRA]A1+	[ICRA] A1+	[ICRA] A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
6	Issuer Rating	Long Term	--		[ICRA] AAA (Negative)	[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
INE103A08027	Non-Convertible Debentures	13-Jan-2020	6.64%	14-Apr-2023	500	[ICRA]AAA (Negative)
INE103A08019		13-Jan-2020	7.40%	12-Apr-2030	1,000	
INE103A08035		29-Jan-2020	7.75%	29-Jan-2030	1,060	
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--	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	3,000.0	[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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