March 26, 2021

Deepak Nitrite Limited: Rating upgraded to [ICRA]AA/A1+; outlook revised to Stable

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term Loans	277.00	150.00	[ICRA]AA; upgraded from [ICRA]AA-; outlook revised to Stable from Positive
Fund-based Limits	300.00	300.00	[ICRA]AA; upgraded from [ICRA]AA-; outlook revised to Stable from Positive
Non-fund Based Limits	170.00	170.00	[ICRA]A1+; reaffirmed
Fund-based and Non-fund Based Limits	200.00	200.00	[ICRA]AA/A1+; upgraded from [ICRA]AA-/A1+; outlook revised to Stable from positive
Unallocated Limits	0.00	127.00	[ICRA]AA/A1+; upgraded from [ICRA]AA-/A1+; outlook revised to Stable from positive
Commercial Paper	200.00	200.00	[ICRA]A1+; reaffirmed
Total	**1,147.00**	**1,147.00**	

**Instrument details are provided in Annexure-1*

Rationale

The rating upgrade and revision in outlook to Stable for Deepak Nitrite Limited (DNL) takes into account the continued improvement in the consolidated financial profile of the company during FY2021 despite the slowdown in demand and production loss due to Covid-19 in Q1 FY2021. ICRA notes that, given the healthy cash accruals, the company has reduced its debt levels by pre-paying ~Rs 200 crore debt at its subsidiary, Deepak Phenolics Limited (DPL), during 9M FY2021. Coupled with improved profit margins, this has resulted in sharp improvement in the leverage and coverage indicators of the company.

The rating action also considers the improvement in DNL's business profile, supported by healthy performance of its phenolics and isopropyl alcohol (IPA) businesses housed under its wholly-owned subsidiary, DPL, as well as the sustained growth in the performance of its fine and speciality chemicals (FNS) segment even as the performance of its basic chemicals (BC) segment remained subdued. ICRA also notes that the sales of performance products (PP) dropped sharply in FY2021 with decline in realisations to erstwhile levels, in line with expectations. ICRA expects the recovery in sales of the BC and PP segments to drive the near-term growth of the company.

The rating continues to take into account the long operating track record of the company in the chemical industry, its diversified product mix as well as exposure to diversified end-user industries. ICRA notes the leading market position enjoyed by the company in most of its product segments across domestic as well as global markets. The rating continues to factor DNL's multi-purpose manufacturing facility with significant backward and forward integration linkages that provide flexibility over the product mix to suit changing market requirements. ICRA also notes DNL's technical expertise to handle complex and hazardous chemical processes like nitration, hydrogenation and diazotisation.

The rating is, however, constrained by the exposure of the company's profitability to volatility in the raw material prices, though the same is reduced in certain products through formula-linked price contracts. The rating is also constrained by the high dependence of DPL's profitability on the volatile crack-spreads, which in turn is linked to the volatility in the price of feedstock and finished products. The rating also factors in execution and market risks associated with capex of Rs. 950-1,000 crore planned to be incurred over FY2022-FY2023 towards expansion projects in the BC and FNS segments and addition of downstream products in the phenolics segment.

Key rating drivers and their description

Credit strengths

Long operating history and established track record in the global chemical intermediates industry - DNL has been operating in the chemical industry for nearly five decades. Over the years, the company has grown to become a market leader in the domestic market for inorganic intermediates (sodium nitrite and sodium nitrate), nitro toluenes and fuel additives. It is also among the top three global players for xylidines, cumidines and oximes.

Diversified product profile mitigating risk associated with cyclicality in different product segments - While the company started with a limited portfolio of low-value bulk chemicals, it has grown its product portfolio to include high-value speciality chemicals for multiple end-user applications. Currently, it has a product portfolio of over 100 products (including its derivatives). The company has also added pharma intermediaries and more agro-chemical products to its portfolio over the years. The regular introduction of new products has helped DNL to mitigate the cyclicality risk related to a particular product segment.

Multi-purpose manufacturing facility, with significant backward and forward integration linkages - The company's production facilities include processes that allow vertical integration for most products, leading to significant cost savings. Also, its facilities are designed to provide flexibility to change the product mix to suit market requirements.

Healthy improvement in financial profile - DNL reported a significant growth in revenue and operating profitability in FY2020, driven by a sharp turnaround in the PP segment. While the average realisations for the performance products declined to erstwhile levels in 9M FY2021, its impact was partly mitigated by the higher margins available on the FNS segment and the phenolics segment. With healthy cash accruals, the company has reduced its debt levels by pre-paying ~Rs. 200 crore debt at DPL during 9M FY2021. As a result, the Total Debt/OPBITDA improved to less than 1.0 time in 9M FY2021 from 2.8 times in FY2019.

Healthy ramp-up of phenolics and IPA operations at DPL – DPL's phenol-acetone plant showcased over 100% capacity utilisation in 9M FY2021 in spite of the plant shutdown during April 2020 due to the Covid-19 pandemic, resulting in healthy revenue and cash flow generation for DNL on a consolidated basis. DPL also commissioned an IPA plant in April 2020 and its utilisation reached 85% during 9M FY2021. IPA is extensively used as a sanitiser, and with the Covid-19 pandemic, the global demand for IPA peaked in Q1 FY2021. With timely commissioning, DPL has been able to sell its product in the domestic and global markets, while generating healthy cash flows.

Credit challenges

Profitability exposed to volatility in raw material prices, although reduced in certain products through formula-linked price contracts - Prices of a few of the company's key products are linked to the movement of crude oil prices. The change in price levels, however, varies across product categories and is not commensurate with the change in crude price due to formula-linked pricing. Also, the prices of certain key products, such as sodium nitrite, TFMAP, OBA and DASDA, which formed about 40% and 43% of DNL's standalone sales in FY2020 in 9M FY2021, respectively, are delinked from movement in crude oil prices.

Capacity expansion and efficiency improvement capex planned over near term - While DNL had sizeable capex plans for FY2021, it has deferred part of the same to next year, given the Covid-19 uncertainties. The company now has a planned capex of ~Rs. 950-1,000 crore to be incurred over FY2022-FY2023 towards expansion projects in the BC and FNS segments and addition of downstream products in the phenolics segment. Such sizeable capex plans expose the company to execution and market risks, although mitigated to some extent by the track record of the company in completing its past projects, including the phenol-acetone project under DPL, in a successful manner.

Liquidity position: Strong

At a consolidated level, DNL's liquidity position remains **strong** with a healthy annual fund flow from operations of Rs. 583 crore in FY2020 and surplus free cash and liquid investments of ~Rs. 200 crore as on December 31, 2020. DNL also had a sanctioned working capital facility of Rs. 670 crore at a standalone level and Rs. 480 crore at DPL as on December 31, 2020, the average utilisation of which remained moderate at ~40% (largely towards non-fund based usage at DPL) over the past 12 months. Further, DNL has an additional sanctioned loan facility of Rs. 150 crore from Axis Bank, which can be availed for any capex if the need arises. The loan terms are favourable, with an 18-month moratorium period from disbursement and a 10-year ballooning repayment schedule.

Rating sensitivities

Positive factors – Sustenance of healthy revenue growth and profit margins, and improvement in product mix towards speciality chemicals could lead to a rating upgrade.

Negative factors – Downward pressure on the ratings may arise if the company faces material weakening in its profitability or undertakes higher-than-expected capex.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Chemical Industry
Parent/Group Support	Not applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of Deepak Nitrite Limited. As on September 30, 2020, the company had two wholly-owned subsidiaries that are enlisted in Annexure-2.

About the company

DNL is the flagship of the Deepak Group, which was incorporated in 1970 by Mr. C.K. Mehta. It began as a fully indigenous sodium nitrite and sodium nitrate manufacturer, before gradually widening its product portfolio over the years. Currently, DNL enjoys a leading market position in most of its products in the domestic as well as global markets. DNL has a portfolio of over 100 products, broadly divided into three segments—BC, FNS and PP. The company has five manufacturing facilities, one each at Nandesari and Dahej in Gujarat, Taloja and Roha in Maharashtra, and at Hyderabad. DNL also has a research and development facility at Nandesari in Gujarat. The company's growth has also been aided by strategic acquisitions of companies with complementary product lines. In November 2018, the company commissioned its phenol and acetone manufacturing plant at Dahej at a project cost of ~Rs. 1,400 crore under its wholly-owned subsidiary, DPL. DNL infused equity of Rs. 560 crore in the project, 50% of which was in the form of non-cumulative optionally convertible redeemable preference shares.

Key financial indicators (audited)

DNL Consolidated	FY2019	FY2020	9M FY2021
Operating Income (Rs. crore)	2,699.9	4,229.7	2,896.5
PAT (Rs. crore)	173.7	611.0	485.7
OPBDIT/OI (%)	15.8%	24.3%	27.4
RoCE (%)	21.7%	38.1%	NA
Total Outside Liabilities/Tangible Net Worth (times)	1.7	1.0	NA
Total Debt/OPBDIT (times)	2.8	1.1	0.6
Interest Coverage (times)	4.9	8.9	13.2

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; ROCE: PBIT/Avg (Total Debt + Tangible Net Worth + Deferred Tax Liability - Capital Work in Progress); DSCR: (PBIT + Mat Credit Entitlements - Fair Value Gains through P&L - Non-cash Extraordinary Gain/Loss)/(Interest + Repayments made during the Year)

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2021)					Chronology of Rating History for the past 3 years			
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of Dec 31, 2020 (Rs. crore)	Date & Rating		Date & Rating in FY2020	Date & Rating in FY2019		Date & Rating in FY2018
					Mar 26, 2021	Jun 17, 2020	Aug 22, 2019	Mar 18, 2019	Oct 1, 2018	Jan 5, 2018
1	Term loans	Long term	150.00	0.0	[ICRA]AA (Stable)	[ICRA]AA- (Positive)	[ICRA]AA- (Stable)	[ICRA]A+ (Positive)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)
2	Fund based limits	Long term	300.00	-	[ICRA]AA (Stable)	[ICRA]AA- (Positive)	[ICRA]AA- (Stable)	[ICRA]A+ (Positive)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)
3	Non-fund based limits	Short term	170.00	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
4	Fund and non-fund based limits	Long term/ Short term	200.00	-	[ICRA]AA (Stable)/ [ICRA]A1+	[ICRA]AA- (Positive)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]A+ (Positive)/ [ICRA]A1+	[ICRA]A+ (Stable)/ [ICRA]A1+	[ICRA]A+ (Stable)/ [ICRA]A1+
5	Unallocated limits	Long term/ Short term	127.00	-	[ICRA]AA (Stable)/ [ICRA]A1+	-	-	-	-	-
6	Commercial papers	Short term	200.00	0.00	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+

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 click here

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 loans	FY2015	NA	FY2026	150.00	[ICRA]AA(Stable)
NA	Fund based limits	-	-	-	300.00	[ICRA]AA(Stable)
NA	Non-fund based limits	-	-	-	170.00	[ICRA]A1+
NA	Fund and non-fund based limits	-	-	-	200.00	[ICRA]AA(Stable)/[ICRA]A1+
NA	Unallocated limits	-	-	-	127.00	[ICRA]AA(Stable)/[ICRA]A1+
Unplaced	Commercial paper	-	-	7-365 days	200.00	[ICRA]A1+

Source: *Company*

Annexure-2: List of entities considered for consolidated analysis

Company Name	DNL Ownership	Consolidation Approach
Deepak Nitrite Limited	100.0% (rated entity)	Full Consolidation
Deepak Phenolics Limited	100.0%	Full consolidation
Deepak Nitrite Corporation Inc., USA	100.0%	Full consolidation

Source: *DNL H1 FY2021 published result*

Note: *ICRA has taken a consolidated view of the parent (DNL) and its subsidiaries while assigning the ratings*

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