August 16, 2017

Gujarat Narmada Valley Fertilizers & Chemicals Limited

Summary of rated instruments

Instrument*	Rated Amount (in crore)	Rating Action
Term Loans	Reduced to Rs 792 crore from Rs 1263 crore	Upgraded to [ICRA]AA(Stable) from [ICRA]AA-
Fund Based facilities	Rs 1500 crore	Upgraded to [ICRA]AA(Stable) from [ICRA]AA-
Non Fund Based facilities	Rs 900 crore	[ICRA]A1+ reaffirmed
Commercial Paper Programme	Rs 1000 crore	[ICRA]A1+ reaffirmed

*Instrument details are provided in Annexure-1

Rating action

ICRA has upgraded the long term rating to [ICRA]AA (pronounced as ICRA double A) from [ICRA]AA- (pronounced as ICRA double A minus) for the Rs 792 crore term loans (reduced from Rs 1263 crore) and the Rs 1500 crore fund based limits of GNFC; the outlook on the long-term rating is Stable†. ICRA has also reaffirmed the [ICRA]A1+ (pronounced ICRA A one plus) rating to the Rs 900 crore non fund based limits and the Rs 1000 crore commercial paper programme of GNFC.

Rationale

The rating upgrade factors in an improvement in the financial risk profile of the company supported by healthy performance of the chemical division, driven largely by healthy capacity utilization and healthy contribution margins from Chemicals and turnaround of the TDI (Toluene Di-isocyanate) segment over the last 6-9 months, which ICRA expects to be sustained in the near term. Supported by the healthy internal accruals, the company has also pre-paid some of its long term debt and is expected to get de-leveraged further in FY2018.

The ratings continue to factor in established market position in the fertilisers business (with its fertilizer brand - Narmada being well entrenched within the farmer community especially in Gujarat), market leadership in chemicals business for products including Acetic acid, Aniline and TDI, diverse chemicals product portfolio with vertical integration benefits and the stable demand outlook for key chemicals. The ratings also take into account the successful stabilisation of production from the TDI-Dahej plant following a gas leak related accident in November 2016 which had resulted in the plant remaining shut for 3-4 months. Further, improvement in realisation for TDI due to higher global prices should result in improved profitability in FY 2018. ICRA notes that the implementation of gas pooling mechanism has ensured un-interrupted gas supply and reduced the uncertainty on working capital management. Further, the company is receiving the capital subsidy on its ammonia feedstock conversion project and this will further ease the liquidity position going forward. The ratings also take into account the company's high financial flexibility characterised by an improvement in coverage metrics and capital structure owing to lower debt levels.

However, the ratings remain constrained by the continuing losses in the fertiliser business. The ratings are further constrained by the vulnerability of fertiliser division's profitability to regulatory policies and agro-climatic risks, commodity price risk associated with its chemicals business and the vulnerability of its

cost structure due to fluctuation in prices of gas which is consumed in chemicals and non-urea fertilisers business. ICRA also notes that the company has achieved lower than the projected energy efficiency levels post the ASGP project, however the company has been receiving a significant part of the expected subsidy. Going forward, the ability of the company to continue to maintain high capacity utilization and meaningful returns from the Dahej TDI capacity as well as the ability to tie up the future gas requirements for its chemicals business at cost competitive rates would remain key rating sensitivities. Also, while the company has shelved plans for Urea expansion, the company has other relatively smaller chemicals / efficiency improvement projects in the pipeline which would entail funding, execution and market risks. Going forward, ICRA expects the profitability of GNFC to improve in the near term on account of the improvement in contribution levels from TDI segment. Some chemical segments are facing temporary pricing pressures, however, over the long term, as prices of chemicals revive, margins should improve on account of the competitive advantage that GNFC holds in the domestic market. Given that there are no immediate large capex plans, with the anticipated cash generation and capital subsidy reimbursement, the company's key debt protection metrics are expected to remain comfortable. However, timely receipt of capital subsidy against the feedstock conversion project will continue to be crucial for managing the cash flows. Any large debt funded capex, including for the Urea energy saving project, will be a key rating sensitivity.

Key rating drivers

Credit strengths

Improvement in the financial risk profile supported by healthy performance of the Chemical division: GNFC's non urea operations (chemical and IT division) registered a health growth ~15% during FY2017, largely driven by higher realisations and healthy capacity utilization levels at its TDI plant in Dahej. Overall growth was however offset due to onetime reversal of operating income to the tune of Rs.189 crore on account of change in estimation of urea subsidy receivable from the DOF. Additionally, lower gas prices and downward revision of NBS rates resulted in lower revenue from the fertiliser segment during FY2017. Chemicals registered a PBIT of Rs 818 crore as compared to a PBIT of Rs 270 crore in FY 2016 while the other products division registered a PBIT of Rs. 44 crore in FY2017 vis-à-vis Rs.26 crore in FY2016. On the hand, the urea segment registered PBIT of Rs 6 crore in FY2017 as compared to a PBIT of Rs.88 crore in FY 2016. Healthy cash accruals driven by improvement in profitability coupled with on-going disbursement of capital subsidy has helped in prepaying part of the long term debt in FY2017 resulting in a drop in overall debt levels as on March 31, 2017 to Rs.1959 crore vis-à-vis Rs.3101 crore as on March 31, 2016. Accordingly gearing has come down to 0.52 time while coverage metric for GNFC have improved in FY2017 with OPBDIT/I&F at 3.9 times (2.2 times in FY2016), NCA/Debt at 39% (14% in FY2016) and Total Debt/OPBDIT at 2.48 times (4.65 times in FY2016).

- **Established track record in both fertilisers and chemicals businesses:** GNFC has a long track record in the manufacturing of fertilisers such as urea, Ammonium Nitro Phosphate (ANP) and industrial chemicals such as TDI, methanol, acetic acid, formic acid and nitric acids. Besides manufacture and marketing of the above products, GNFC also trades in fertilisers such as Di-ammonium Phosphate (DAP) (both imported as well as indigenous), Muriate of Potash (MOP) and ammonium sulphate, industrial chemicals such as methanol and acetic acid. The contribution of fertilisers to total revenue was around 34% of the overall sales, while chemicals contributed around 62% of sales in FY2017. The company also operates an IT products division that contributed 4% to total operating income in FY2017.

- **Strong brand equity in the fertiliser business; market leadership in the chemicals business:** GNFC sells its fertilisers under the brand Narmada through a number of co-operative societies, dealers and sub-dealers. The company's marketing network is on a par with that of industry leaders and is relatively

stronger in its home state of Gujarat. With a strong brand equity built over the years, the company has been able to sell its entire production while also increasing its share of sales in Gujarat. GNFC sells urea primarily in Gujarat, Madhya Pradesh, Maharashtra, Rajasthan and Uttar Pradesh.

- **Product diversity and vertical integration benefits have helped the company in maintaining profitable operations in times of extreme price volatilities for a particular product segment:** The operations of GNFC are characterised by a high level of vertical integration across its fertilisers and chemicals, thereby allowing high value addition and diversification. The strength of the company lies in its product diversity and ability to switch between product streams in tune with market conditions.

- **Continuing receipt of capital subsidy towards the ASGP project, which has eased the liquidity position to some extent:** In order to reduce subsidy outgo, GoI announced mandatory conversion of all liquid fuel (naphtha/FO/LSHS) based urea units. Due to the large capital expenditure required for conversion for LSHS based units (Rs. 1,215 crore for GNFC), the GoI announced a provision for special fixed cost reimbursement per tonne of urea for five years which along with energy savings was targeted to ensure a 12% post tax equity return for the project. The company announced COD for the project w.e.f from October 1, 2013 and has managed to maintain high urea production levels. ICRA however notes that notification of normative energy levels post conversion, as represented by GNFC, will be critical for the company to recover its entire capex with returns.

- **Financial flexibility arising from unutilized bank limits and access to low cost funds from state government financial institutions:** The company's liquidity position has remained comfortable due to its high financial flexibility and access to unused bank credit limits. The company currently operates with cash credit limits from Rs 1500 crore to further support liquidity. The average fund based working capital utilization for the period April 2016 to April 2017 was at around 43% of sanctioned limits.

- **Implementation of the gas pooling mechanism has ensured un-interrupted gas supply and reduced the uncertainty on working capital management** The gas pooling mechanism came into effect from June 1, 2015. After remaining high till September 2015, the pooled prices fell in the subsequent months particularly after Ras Gas renegotiation. Average pooled gas prices remained lower in FY2017 in comparison to the previous fiscal at ~Rs.460-480 per MMBTU. The major impact on GNFC of the decrease in pooled gas prices is in the form of decrease in subsidy receivables and working capital requirements thereby leading to a decrease in interest cost. It has also favourably impacted the profitability of the company for production above the cut-off quantity for urea.

- **Stabilization of operations at the new TDI project at Dahej; healthy volumes and uptick in realisations has driven improvement in overall financial risk profile in FY2017:** GNFC's profitability for TDI is dependent upon the spreads between prices of TDI and Toluene, among others. International TDI prices followed a declining trend during FY2015, going as low as $1800-1900/MT. FY2016 remained the worst year in a decade with prices further dropping to ~$1500/MT. Prices fell partly due to capacity expansions in Europe and China. TDI prices however staged a healthy recovery in FY2017 and went as high as ~$4000 and remaining ~ $3000-3500 in Q1FY2018. Improvement in contribution margin on TDI in FY 2017 has helped in posting healthy improvement in profitability. The company operated the plant intermittently at 50-60% utilization levels in FY 2015 and FY 2016 while it operated the plant at 100% for most part of FY2017; however operations were disrupted from November 2016 to February 2017 after a gas leak accident. Besides this, GNFC took a one-time impairment loss of Rs 330 crore in FY2015 to account for the lower TDI prices which was however reversed in FY2017 to the tune of Rs.292 crore.

Credit weaknesses

- **Fertilisers continue to remain an un-profitable segment for the company; the fertiliser business remains exposed to regulatory and monsoon related risks:** With the notification of New Urea Policy 2015, urea units in the country are categorized into three groups on the basis of their energy efficiency. Of the three groupings, GNFC's unit falls under Group-II (Pre-set norms between 6 GCal/MT and 7 GCal/MT). GNFC has made losses/small profit in the past few years due to various under recoveries in subsidy mechanism relating to conversion costs and fixed costs. As a result, despite being the largest product in the revenue mix (18% in FY2017 vis-à-vis 28% in FY2016), urea has had a low share in the overall profits of GNFC, dragging down the performance of the entire fertiliser division.

- **Working capital intensity remains high due to high subsidy receivable; although short term funding availed under the SBA facility and fall in gas prices eased the burden in FY2017:** GNFC's working capital intensity (NWC/OI) remained high in the past primarily due to high debtor days resulting from delay in subsidy receipts by GoI. In general, there is a delay in subsidy reimbursement towards the end of the year due to the exhaustion of subsidy limits set in the Union Budget, pushing up the working capital requirements for the fertiliser players. The overall subsidy burden was lower during FY2017, supported to a large extent by the short-term funding availed under the SBA facility and fall in gas prices, resulting in lower outstanding subsidy.

- **High dependence on the chemical division's profitability for the overall net cash accruals still continues*:*** As the fertiliser business continues to be a drag in terms of profitability, the company's chemicals division continues to account for majority of the profitability, which though has remained robust over the years.

- **Vulnerability of chemical divisions' profitability to the fluctuations in natural gas prices, cyclicality, fall in import duty levels and exchange fluctuations:** GNFC's profitability is vulnerable to cyclicality in prices of industrial chemicals and fluctuations in natural gas prices. The reduction in duty differential for imported chemicals could impact the company's profitability. Moreover, because of the import parity pricing of these products for domestic sales, GNFC's profit margins remain exposed to adverse fluctuations in INR-US dollar exchange rates.

- **While the company has shelved plans for Urea expansion, the company has other relatively smaller chemicals / efficiency improvement projects in the pipeline which would entail moderate funding, execution and market risks:** GNFC is currently considering several new medium scale projects. The execution period is likely to be 2-3 years from commencement of the project. The only plan that is moving is the Di-Calcium Phosphate (DCP) plant with a Belgian JV partner Ecophos at Dahej in which GNFC only has about Rs 26 crore (includes land worth Rs 23 crore) commitment over next 3 years towards the Rs 525 crore project. Theother plans include expansion of formic acid and nitric acid add-on capacities at Bharuch which are still at conceptual stage. Further, GNFC's plans of setting up a Urea plant in Iran in partnership with Rashtriya Chemicals & Fertilisers Ltd. have been suspended indefinitely. ICRA has not factored these projects while assessing the credit risk profile of the company.

- **Capex towards Urea energy savings project could depress the return indicators due to long pay back period**: In May 2015, the GoI announced the New Urea Policy 2015 (NUP 2015) for urea manufacturers for the period June 2015 to March 2019. The pre-set norms were tightened which has reduced subsidy outgo for the GoI besides incentivising the industry to compete on the basis of their energy efficiency. Further, for FO / LSHS based units which have completed feedstock conversion projects , the present provisions would continue until they get the capital subsidy recoverable for the projects for a period of five years (till September 2018 for GNFC). From H2 FY2019 onwards, GNFC

will fall under Group-II of NUP-2015, which means it will need to reduce its energy consumption resulting in a significant capex, however the company has represented to DoF to provide exception to the urea plant for the capex. Given such a scenario, ICRA has not factored in any capex on this front and it will remain an event-based risk for GNFC.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below.

Links to applicable criteria
Rating Methodology on Fertilisers
Rating Methodology on Chemicals

About the company:

Promoted jointly by the Government of Gujarat (GoG) and Gujarat State Fertilizers and Chemicals Limited (GSFC), GNFC was incorporated as a public limited company in 1976, with the two promoters cumulatively holding a 41.18% equity stake in it. Subsequently however, the entire shareholding of the GoG was transferred to Gujarat State Investments Limited (GSIL), a GoG undertaking. Based in Bharuch (Gujarat), GNFC is engaged mainly in the manufacture of fertilisers such as urea, Ammonium Nitro Phosphate (ANP) and Calcium Ammonium Nitrate (CAN), and industrial chemicals such as methanol, acetic acid, aniline, Toluene Di Isocyanate (TDI), formic acid, and nitric acid. The company also trades in a few fertilisers and chemicals. The Company also provides IT services and solutions covering Digital Signatures Certificate (DSC), E-procurement, E-Governance projects, Data centres and CCTV surveillance systems etc. under Brand name of (n)code solutions and is the market leader in Digital Certificate business.

For the year ended March 31, 2017, on an operating income of Rs. 4724 crore, GNFC reported a PAT of Rs. 521 crore as against an operating income of Rs 4656 crore and PAT of Rs. 173 crore for the year ended March 31, 2016. For the quarter ended June 30, 2017, on an operating income of Rs.1004, GNFC report a PAT of Rs.67 crore.

Key Financial Indicators (Audited)

	FY2016	FY2017
Operating Income (Rs. crore)	4656	4724
PAT (Rs. crore)	173	521
OPBDIT/ OI (%)	14.3%	16.7%
RoCE (%)	8.5%	14.4%
Total Debt/ TNW (times)	0.95	0.52
Total Debt/ OPBDIT (times)	4.65	2.48
Interest coverage (times)	2.2	3.9
NWC/ OI (%)	42%	33%

OI: Operating Income; 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);
NWC: Net Working Capital

Status of non-cooperation with previous CRA: Not applicable

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Any other information: Not applicable

Rating history for last three years:

Table:

S.No	Name of Instrument	Current Rating (2018)			Chronology of Rating History for the past 3 years		
		Type	Rated amount (Rs. Crore)	Date & Rating	Date & Rating in FY2017	Date & Rating in FY2017	Date & Rating in FY2016
				August 2017	November 2016	July 2016	January 2016
1	Term Loans	Long Term	792	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	-
2	Fund Based facilities	Short Term	1500	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	-
3	Non Fund Based facilities	Short Term	900	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	-
4	Commercial Paper Programme	Short Term	1000	[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 www.icra.in

Annexure-1

Details of Instrument

Name of the instrument	Date of Issuance/Sanction	Coupon rate	Maturity Date	Size of the issue (Rs. Cr)	Current Rating and Outlook
Term Loans	-	-	FY 2022	762	[ICRA]AA (Stable)
Fund Based facilities	-	-	-	1500	[ICRA]AA (Stable)
Non Fund Based facilities	-	-	-	900	[ICRA]A1+
Commercial Paper Programme	-	-	-	1000	[ICRA]A1+

Source: Gujarat Narmada Valley Fertilizers and Chemicals Limited

Name and Contact Details of the Rating Analyst(s):

Analyst Contact
K. Ravichandran
+91 22 6114 3408
ravichandran@icraindia.com

Ankit Patel
+91 79 4027 1509
ankit.patel@icraindia.com

Aashay Choksey
+91 79 4027 1526
aashay.choksey@icraindia.com

Relationship Contact
L. Shivakumar
+91 22 6114 3406
shivakumar@icraindia.com

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Registered Office
ICRA Limited
1105, Kailash Building, 11th Floor, 26, Kasturba Gandhi Marg, New Delhi 110001
Tel: +91-11-23357940-50, Fax: +91-11-23357014

Corporate Office
Mr. Vivek Mathur
Mobile: **+91 9871221122**
Email: vivek@icraindia.com

Building No. 8, 2nd Floor, Tower A, DLF Cyber City, Phase II, Gurgaon 122002
Ph: +91-124-4545310 (D), 4545300 / 4545800 (B) Fax; +91- 124-4050424

Mumbai **Mr. L. Shivakumar** Mobile: **+91 9821086490** Email: shivakumar@icraindia.com 3rd Floor, Electric Mansion Appasaheb Marathe Marg, Prabhadevi Mumbai—400025, Board : +91-22-61796300; Fax: +91-22-24331390	**Kolkata** **Mr. Jayanta Roy** Mobile: **+91 9903394664** Email: jayanta@icraindia.com A-10 & 11, 3rd Floor, FMC Fortuna 234/3A, A.J.C. Bose Road Kolkata—700020 Tel +91-33-22876617/8839 22800008/22831411, Fax +91-33-22870728
Chennai **Mr. Jayanta Chatterjee** Mobile: **+91 9845022459** Email: jayantac@icraindia.com 5th Floor, Karumuttu Centre 634 Anna Salai, Nandanam Chennai—600035 Tel: +91-44-45964300; Fax: +91-44 24343663	**Bangalore** **Mr. Jayanta Chatterjee** Mobile: **+91 9845022459** Email: jayantac@icraindia.com 'The Millenia' Tower B, Unit No. 1004,10th Floor, Level 2 12-14, 1 & 2, Murphy Road, Bangalore 560 008 Tel: +91-80-43326400; Fax: +91-80-43326409
Ahmedabad **Mr. L. Shivakumar** Mobile: **+91 9821086490** Email: shivakumar@icraindia.com 907 & 908 Sakar -II, Ellisbridge, Ahmedabad- 380006 Tel: +91-79-26585049, 26585494, 26584924; Fax: +91-79-25569231	**Pune** **Mr. L. Shivakumar** Mobile: **+91 9821086490** Email: shivakumar@icraindia.com 5A, 5th Floor, Symphony, S.No. 210, CTS 3202, Range Hills Road, Shivajinagar,Pune-411 020 Tel: + 91-20-25561194-25560196; Fax: +91-20-25561231
Hyderabad **Mr. Jayanta Chatterjee** Mobile: **+91 9845022459** Email: jayantac@icraindia.com 4th Floor, Shobhan, 6-3-927/A&B. Somajiguda, Raj Bhavan Road, Hyderabad—500083 Tel:- +91-40-40676500	