The Andhra Petrochemicals Limited

December 29, 2017

Summary of rated instruments

Instrument	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund Based – TermLoans	58.90	32.83	Upgraded to [ICRA]BBB- from [ICRA]BB; Outlook revised from Positive to Stable
Fund Based – Cash Credit	35.00	35.00	Upgraded to [ICRA]BBB- from [ICRA]BB; Outlook revised from Positive to Stable
Unallocated	18.65	44.72	Upgraded to [ICRA]BBB- from [ICRA]BB; Outlook revised from Positive to Stable
Non-fund based	2.00	2.00	Upgraded to [ICRA]A3 from [ICRA]A4+
Total	**114.55**	**114.55**	

Rating action

ICRA has upgraded the long-term rating outstanding on the Rs. 32.83 crore[1] term loan facilities (revised from Rs. 58.90 crore), the Rs. 35.00 crore cash credit facility and the Rs. 44.72 crore long-term unallocated facilities (revised from Rs. 18.65 crore) of The Andhra Petrochemicals Limited (APL or the company)[2] from [ICRA]BB (pronounced ICRA double B) to [ICRA]BBB- (pronounced ICRA triple B minus). ICRA has also upgraded the short term rating outstanding on Rs. 2.0 crore non-fund based facilities of APL from [ICRA]A4+ (pronounced ICRA A four plus) to [ICRA]A3 (pronounced ICRA A three). The outlook on the long-term rating has been revised from Positive to Stable.

Rationale

The rating upgrade considers the continued improvement in financial performance of the company during the current fiscal (till date) aided by a healthy spread between global product prices and raw material on the back of supply correction. ICRA notes the continued healthy demand in the domestic market and benefits from the implementation of goods and service tax (GST) from the month of July in the form of input tax credits on naphtha (a key raw material) and LSHS (a fuel), which were earlier not available. The company witnessed ~100% YoY revenue growth during H1 FY2018, aided by improvement in product prices and capacity utilisation of ~109% (~70% in H1 FY2017), with Q2 FY2018 witnessing sequential growth of 27.9%. The OPM and NPM also improved from 2.0% and -6.4% during H1 FY2017 to 13.4% and 7.6%, respectively, during H1 FY2018 leading to positive cash accrual of ~Rs. 24.3 crore during the latter period. The healthy cash accruals helped the company in reducing external long-term debt from ~Rs. 58.4 crore as on March 31, 2017 to ~Rs. 37.4 crore as on September 30, 2017, which included prepayments of some loans. Further, the healthy profitability trend is expected to continue during Q3 FY2018 as well, although there may be some moderation during Q4 FY2018 because of steep increase in raw material prices on the back of increase in crude prices. Due to lack of integration benefits and being a standalone petrochemical producer, the company’s margins are susceptible to spreads between oxo-alcohols and feedstock, import duty differentials and foreign exchange rates, leading to volatility and

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[1] *100 lakh = 1 crore = 10 million*

[2] *For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications*

cyclicality of profitability. The imposition of anti-dumping duty (ADD) on import of 2 Ethyle Hexanol/ N Butanoal (2-EH/NBA) on March/April 2016 was meant to address the impact of high imports. However, the company continued to witness adverse impact of cheaper imports during the last fiscal from countries that are currently not covered under the ruling and further impacted by increase in direct imports of DOP. Nonetheless, the benefits of trade protection initiatives are visible in current fiscal with marked decline in imports, even though company's efforts to get ADD imposed on additional countries and substitute products did not materialise. ICRA also notes that investigation against DOP imports for imposition of ADD are currently under progress, based on the complaint of domestic DOP manufacturers, and potential ADD imposition will be positive for APL. ICRA expects the improvement in financial performance and credit metrics to continue in the current fiscal, backed by GST benefits, cost control and efficiency improvement measures being undertaken by the company. However, the pace and quantum of improvement in financial performance and timeliness of additional trade protection measures remain key sensitivities and monitorables.

ICRA also notes the prudent steps taken by the company to mitigate liquidity pressure and prevent any default in the last few years since the HPCL accident by getting the repayments rescheduled for the existing loans. A significant part of these loans had been prepaid prior to the accident. The company had also tied up working capital term loans/corporate loans with a moratorium period to tide over the pressure during the stabilisation phase. Further, the liquidity position was also aided by continued support from the parent, Andhra Sugar Limited (rated [ICRA]A+/stable/[ICRA]A1+), in the form of interest bearing unsecured loans; partial receipt of insurance claims and funds raised from partial divestment of investments (in FY2017). While a slower pace of margin recovery post stabilisation of raw material supply during FY2016 and FY2017 had eroded the comfort provided by these steps to some extent, the healthy cash accruals and resultant debt repayments (including prepayments) till date in current fiscal has reduced the liquidity pressure. As a result, the company should be able to meet its repayment obligation for the full year. Going forward, the availability of GST benefits, trade protection measures and healthy capacity utilisation levels have improved its ability to withstand the impact of volatility in spreads, compared to the past few years. Nevertheless, in case of any shortfall in cash accruals over the next two years, continued support from the Andhra Sugar group and undrawn working capital limits are expected to support the liquidity profile.

The ratings, however, continue to favourably consider the sole producer status of APL in the Indian oxo-alcohol market with APL catering to 35-40% of the domestic oxo-alcohol demand (at normalised production level); and the optimistic long-term domestic demand outlook for various end-use sectors of oxo-alcohols. The ratings also consider the healthy capital structure of the company, aided by profits generated in the past and prepayment of term loans (prior to HPCL accident) and low working capital intensity. ICRA also draws comfort from the benefits accruing to APL as part of the Andhra Sugars Group, which has an established track record over the past six decades.

Outlook: Stable

ICRA believes APL will continue to benefit from GST imposition, cost control measures and trade protection measures, which will partly mitigate the impact of volatility in spread between global product prices and raw materials. The outlook may be revised to Positive if substantial growth in revenue and profitability, and better working capital management strengthens the financial risk profile. The outlook may be revised to Negative if cash accrual is substantially lower than expected, or if any major capital expenditure, or stretch in the working capital cycle weakens liquidity.

Key rating drivers

Credit strengths

Sole producer of oxo-alcohols in India; favourable long-term demand outlook for various end-user sectors – APL is the sole producer of oxo-alcohols in India and has been operational for more than three decades. The company can cater to ~35-40% of domestic demand when operating at full capacity, while the remaining demand is met through imports. The company's products are mainly used by domestic manufacturers of DOP, which is used as plasticisers in manufacturing Poly Vinyl Chloride (PVC). The long-term demand potential for PVC in India remains favourable.

Promoted by Andhra Sugars Limited; the Group has around six decades of operating history - APL is part of the Andhra Sugars Group, with the flagship entity Andhra Sugars Limited (rated [ICRA]A+/stable/A1+) having around six decades of operating history and a strong credit profile.

Implementation of GST to provide benefits due to additional input tax credits, which were not available earlier – The company has started getting input tax credits on naphtha (a key raw material) and LSHS under the GST regime, which was not available earlier for the VAT applicable on these commodities as more than 95% of company's sales were interstate sales. The benefit from the additional tax credit is expected to help its profitability and improve its competitiveness.

Credit challenges

Standalone petrochemical producer without integration benefits; margins dependent on spreads between oxo-alcohols and its feedstock, and susceptible to changes in import duties, other trade protection measures and forex rates - APL is a standalone manufacturer without backward integration benefits and additionally, the usage of naphtha compared to natural gas used by other international manufacturers, puts it at a relative cost disadvantage. This exposes the company's sales and margin to volatility in global prices, spread between product and feedstock prices, intense competition from imports, changes in duty structure and import pattern of end user segments and substitute products. While, the imposition of ADD on imports of 2EH/NBA from several large importing countries in March/April 2016, did not lead to sufficient improvement in profit margins during FY2017 on account of factors like increase in imports from countries not covered under ADD ruling issued, increase in import of substitute products and direct import of DOP, the benefits have been visible in the current fiscal with significant moderation in imports, even though company's efforts to get anti dumping duties imposed on additional countries and substitute products did not materialise. This coupled with improvement in pricing and spread during YTD FY2018 on the back of global supply correction, has led to healthy accruals and improvement in credit metrics following reduction in debt levels. However, ICRA notes that there may be moderation in margins during Q4 FY2018 due to steep increase in raw material prices. Further, currently investigation against countries which are not covered under the ADD ruling issued earlier is on and further investigation against DOP imports have also been initiated based on complaint of domestic DOP manufacturers and any potential increase in ADD coverage for these segments should be a positive for APL

High dependence on a single feedstock supplier makes it vulnerable to force majeure event risk leading to a disruption of operations– APL is dependent on a single source, HPCL, for supply of key feedstock propylene. The company's operations were severely impacted in FY2014 and FY2015 due to feedstock supply disruption following a fire at HPCL's refinery. However, the supply has been largely regular since FY2016.

Debt protection metrics had weakened over last few years, but have witnessed improvement in current fiscal; continued Group support also aids liquidity profile - Due to the significant deterioration in financial performance after the HPCL accident and subsequent slow recovery, the company's debt protection metrics had weakened. The liquidity pressure was partly mitigated by steps undertaken by the company after the HPCL incident, including getting the debt repayment rescheduled, support from Andhra Sugars Group, availing additional debt with moratorium period during the expected stabilisation phase, partial receipt of insurance claim and partial divestment of investment (in FY2017). The comfort from these measures had reduced due to slower pace of recovery during FY2016 and FY2017. However, on the back of the healthy improvement in performance witnessed in current fiscal (till date) and debt repayments (including pre payments), the company is expected to meet its debt repayment obligations in the current fiscal; and the availability of GST benefits, trade protection measures and healthy capacity utilisation levels have improved its ability to withstand the impact of volatility in spreads compared to the past few years. Nevertheless, in case of any shortfall in cash accruals, continued support from the Group and undrawn working capital limits are expected to support the liquidity profile.

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

Links to applicable criteria:

[Corporate Credit Rating Methodology]

[Rating Methodology for Entities in the Chemical Industry]

About the company:

The Andhra Petrochemicals Limited (APL) was promoted by The Andhra Sugars Limited (ASL) and incorporated on April 18, 1984. It is currently the sole producer of oxo-alcohols in India with a capacity to manufacture 73,000 tonnes per annum (tpa) of oxo-alcohols. The product mix includes 2 ethyl hexanol (2EH), n-butanol (NB) and iso-butanol (IB). APL's oxo-alcohol manufacturing capacity currently caters to about 35-40% of the Indian market, with imports accounting for the rest. Oxo-alcohols are primarily used as one of the raw materials for manufacturing PVC plasticisers. APL commenced operations from February 1994. APL's factory is located adjacent to Hindustan Petroleum Corporation Limited's (HPCL's) Vishakhapatnam refinery and APL has entered into a long-term contract with the latter for procurement of propylene, which is the key raw material in the manufacturing process.

During H1 FY2018, the company reported a net profit of Rs. 19.8 crore on an operating income of Rs. 261.5 crore, as compared to a loss of Rs. 8.3 crore on an operating income of Rs. 130.6 crore during H1 FY2017.

Key financial indicators (audited)

	FY 2016	FY 2017
Operating Income (Rs. crore)	335.7	328.9
PAT (Rs. crore)	-24.1	-7.4
OPBDIT/ OI (%)	-3.5%	3.9%
RoCE (%)	-5.4%	2.0%
Total Debt/ TNW (times)	0.8	1.0
Total Debt/ OPBDIT (times)	-8.2	8.7
Interest coverage (times)	-0.9	0.8
NWC/ OI (%)	8.2%	12.5%

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

		Current Rating (FY2018)						Chronology of Rating History for the past 3 years				
					Date & Rating	Date & Rating	Date & Rating	Date & Rating in FY2016	Date & Rating in FY2015			Date & Rating in FY2014
	Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs crore)	Dec 2017	Sep 2017	July 2017	Mar 2016	Mar 2015	Sep 2014	May 2014	Nov 2013
1	Term Loans	Long Term	32.83	32.83	[ICRA] BBB-(Stable)	[ICRA]BB (Positive)	[ICRA]BB-(Stable)	[ICRA]BB-(Negative)	[ICRA]BB+(Negative)	[ICRA]BB+(Negative)	[ICRA] BBB-(Negative)	[ICRA]BBB+(Negative)
2	Fund Based – Cash Credit	Long Term	35.00	35.00	[ICRA] BBB-(Stable)	[ICRA]BB (Positive)	[ICRA]BB-(Stable)	[ICRA]BB-(Negative)	[ICRA]BB+(Negative)	[ICRABB+(Negative)	[ICRA] BBB-(Negative)	[ICRA]BBB+(Negative)
3	Unallocated	Long Term	44.72	44.72	[ICRA] BBB-(Stable)	[ICRA]BB (Positive)	[ICRA]BB-(Stable)	[ICRA]BB-(Negative)	[ICRA]BB+(Negative)	[ICRA]BB+(Negative)	[ICRA] BBB-(Negative)	[ICRA]BBB+(Negative)
4	Non Fund Based – LC/BG	Short Term	2.00	2.00	[ICRA] A3	[ICRA] A4+	[ICRA] A4	[ICRA] A4	[ICRA]A4+	[ICRA]A4+	[ICRA] A3	[ICRA]A2

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	Consortium Project Term Loan	FY2008 and FY2009*	-	October 2018	6.58	[ICRA]BBB-/stable
NA	Corporate Loan	February 2016	-	March 2018	2.50	[ICRA]BBB-/stable
NA	Consortium Working Capital Term Loans	FY2015^	-	January 2021	23.75	[ICRA]BBB-/stable
NA	Long Term Unallocated				44.72	[ICRA]BBB-/stable
NA	Cash Credit				35.00	[ICRA]BBB-/stable
NA	Non Fund Based				2.00	[ICRA]A3

*Source: APL; Consortium partners sanctioned the loans during FY2015 on different dates of which the longest tenure loan is maturing on January 2021; * Consortium partners sanctioned the loans during FY2008 and FY2009 on different dates*

ANALYST CONTACTS

K.Ravichandran
044 4596 4301
ravichandran@icraindia.com

Sai Krishna
044 4596 4304
sai.krishna@icraindia.com

Prashant Vasisht
0124-4545322
prashant.vasisht@icraindia.com

RELATIONSHIP CONTACT

Jayanta Chatterjee
+91 80 4332 6401
jayantac@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
naznin.prodhani@icraindia.com

Helpline for business queries:

+91-124-2866928 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

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For more information, visit www.icra.in

ICRA Limited

Corporate Office
Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002
Tel: +91 124 4545300
Email: info@icraindia.com
Website: www.icra.in

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

Branches

Mumbai	+ (91 22) 24331046/53/62/74/86/87
Chennai	+ (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,
Kolkata	+ (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008,
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