January 27, 2020

Gujarat Narmada Valley Fertilizers and Chemicals Limited: Update on receipt of demand notice from Department of Telecommunication

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based Facilities	1,425.00	1,425.00	[ICRA]AA+(Stable); outstanding
Long-term/Short-term Fund-based	75.00	75.00	[ICRA]AA+(Stable)/[ICRA]A1+; outstanding
Non-fund Based Facilities	825.00	825.00	[ICRA]A1+; outstanding
Long-term/Short-term Non-fund Based	75.00	75.00	[ICRA]AA+(Stable)/[ICRA]A1+; outstanding
Commercial Paper Programme	1,000.00	1,000.00	[ICRA]A1+; outstanding
Total	**3,400.00**	**3,400.00**	

**Instrument details are provided in Annexure-1*

Rationale

On December 27, 2019, Gujarat Narmada Valley Fertilisers and Chemicals Limited (GNFC) received a demand notice from the Department of Telecommunication (DoT) for payment of Rs. 15,020 crore of statutory dues by January 23, 2020 in connection with V-SAT & ISP Licenses held by the Company in respect of financial years from FY2006 to FY2019. The notice follows the Supreme Court Judgement dated October 24, 2019 with respect to the definition of Adjusted Gross Revenue (AGR) for telecommunications companies. However, GNFC was not a party to this litigation and has represented to the DoT about non-applicability of the Supreme Court Judgement to GNFC. As on date, there is uncertainty as to the amount and timing of any potential payment by GNFC.

ICRA notes that until the resolution of this dispute, given the significant nature of the dues demanded, there remains an overhang on the company's ratings and demand for payment by DoT if materialises would be a credit negative for the company. ICRA will continue to monitor the developments in this regard and in case GNFC has to pay the dues, it would have to raise additional capital to fund the payment since GNFC does not have sufficient liquidity to pay the disputed amount. The amount demanded by the DoT is about 24x the company's projected EBITDA for FY2020 and about 4.6x its latest market capitalization. This would result in significantly high leveraging and would immediately put pressure on its ratings.

The ratings continue to factor in the established market position of GNFC in the fertiliser business (with its brand, Narmada, being well entrenched within the farmer community, especially in Gujarat) and its market leadership in the chemical business for products including acetic acid, aniline and toluene diisocyanate (TDI). Further, the ratings consider the diversified chemical product portfolio with vertical integration benefits, and the stable demand outlook for its key chemicals. The ratings also take into account the company’s robust financial risk profile characterised by comfortable coverage indicators and capital structure, in the absence of term debt. ICRA also notes the company’s healthy financial flexibility by virtue of its sovereign ownership and access to debt markets at competitive rates as well as its unutilised working capital limits and surplus cash, strengthening the liquidity profile.

However, the ratings remain constrained by the continuing losses in the fertiliser business, partly due to one-time reversal of subsidy income. The ratings are further constrained by the vulnerability of the fertiliser division’s profitability to regulatory policies and agro-climatic risks, the commodity price risk associated with its chemical business, and the vulnerability of its cost structure to fluctuations in the prices of gas, which is consumed in its chemical and non-urea fertiliser businesses. ICRA notes that the company has achieved lower-than-projected energy efficiency levels, post Ammonia Syngas Generation Project (ASGP); however it is receiving a significant part of the expected subsidy. The company has moderate-sized chemical and efficiency improvement projects in pipeline, which would entail funding, execution and market risks. ICRA also notes that certain chemical segments are facing pricing pressures; however, over the long term, as prices of the chemicals revive, the margins would improve on account of GNFC's competitive advantage in the domestic market.

The Stable outlook on the [ICRA]AA+ rating reflects ICRA's opinion that GNFC's operations will remain steady driven by its strong portfolio of chemicals, sovereign ownership and healthy demand indicators.

Key rating drivers and their description

Credit strengths

Healthy financial risk profile characterised by robust accruals, low gearing and comfortable coverage indicators - Despite a moderation in the chemical segment's profitability, cash accruals remained healthy at Rs. 831 crore in FY2019 with no term debt outstanding for repayment. The outstanding debt of Rs. 208 crore as on March 2019 end comprised only working capital borrowings, against which the company had a surplus cash of Rs. 235 crore. Accordingly, GNFC's gearing remained low at 0.04 time, while its coverage metrics remained robust in FY2019 with OPBDIT/I&F of 146 times, NCA/Debt of 400% and Total Debt/OPBDIT of 0.22 time.

Healthy financial flexibility; superior liquidity profile – GNFC's financial flexibility is healthy with access to low-cost funds from the state government financial institutions, given its sovereign ownership. Further, GNFC has a superior liquidity profile due to its unused working credit limits. The company currently operates with cash credit limits of Rs. 1,500 crore to further support liquidity. The average utilisation during the last 12 months ended June 2019 remained negligible.

Established track record in both fertiliser and chemical businesses – GNFC has a long track record in the manufacturing and marketing of fertilisers such as urea and ammonium nitro phosphate (ANP), and industrial chemicals such as TDI, methanol, acetic acid, formic acid and nitric acid. GNFC also trades in fertilisers such as diammonium phosphate (DAP) (both imported as well as indigenous), muriate of potash (MOP) and ammonium sulphate, and industrial chemicals such as methanol and acetic acid. The contribution of fertilisers to the total revenue was around 34% of the overall sales, while chemicals contributed around 64% in FY2019. The company also operates an IT-products division and other small segments, which contributed 2% to the total operating income in FY2019.

Strong brand equity in fertiliser business; market leadership in chemical business – GNFC sells its fertilisers under the brand, Narmada, through a number of cooperative societies, dealers and sub-dealers. The company's marketing network, at par with that of the industry leaders, 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 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 help maintain profitable operations – GNFC's operations are characterised by a high level of vertical integration across its fertilisers and chemicals, thereby allowing high value addition and diversification. The company's strength lies in its product diversity and ability to switch among product streams in tune with the market conditions. Accordingly, even under extreme price volatilities for a particular product segment, GNFC was able to maintain profitable operations over the years.

Credit challenges

High dependence on chemical division's profitability for overall net cash accruals continues – As the fertiliser business remains a drag in terms of profitability, the company's chemical division continues to account for majority of the profitability; although, the same remained robust over the years.

Vulnerability of chemical division's profitability to fluctuations in natural gas prices and exchange rates, cyclicality, and fall in import duty levels – GNFC's profitability is vulnerable to fluctuations in the prices of industrial chemicals and natural gas. 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 the INR-USD exchange rates. Further, GNFC's profitability for TDI is dependent upon the spread between the prices of TDI and toluene, among others. The TDI prices started declining from September 2018 and average realisation remained 30% lower in FY2019 compared to FY2018. This impacted the chemical segment's overall profitability in FY2019 and Q1 FY2020.

Fertiliser business exposed to regulatory and monsoon-related risks – As per the New Urea Policy 2015, urea units in the country are categorised into three groups based on their energy efficiency. Of the three groups, GNFC's unit falls under Group-II (pre-set norms between 6 Gcal/MT and 7 Gcal/MT). GNFC made losses/small profits in the last few years due to various under-recoveries in subsidy mechanism relating to conversion costs and fixed costs. However, post capex, its energy efficiency levels improved to 6.3059 Gcal/MT in FY2019 and are further expected to improve to 6.2 Gcal/MT (pre-set norm for GNFC) by the end of FY2020. With improved efficiency, GNFC plans to reduce the under-recoveries. Moreover, the Indian agriculture sector remains vulnerable to the vagaries of monsoon as the area under irrigation remains low, resulting in volatility in sales and profitability of the fertiliser sector.

Moderate-sized capex plans in pipeline to entail moderate funding, execution and market risks – GNFC is currently considering several medium-scale projects at a total project cost of ~Rs. 1,300 crore, with the execution period likely to be three years from the project commencement. These include ammonia capacity enhancement, TDI reliability improvement, and expansion of formic acid and nitric acid add-on capacities at Bharuch (Gujarat). The other capex plans include scaling up its neem-based FMCG products as well as setting up a 10-MW solar plant.

Liquidity position: Superior

In FY2019, the gross cash flows declined on account of increased working capital intensity; however, the free cash flows remained healthy at ~Rs. 500 crore with marginal capex and repayments during the year. GNFC's liquidity position is **superior** given an absence of long-term debt and no repayment obligations, healthy cash accruals, and access to unused bank credit limits of Rs. 1,500 crore. GNFC had a surplus cash of Rs. 235 crore as on March 2019 end, further strengthening its liquidity profile. In terms of commitments, GNFC has capex plans of Rs. 1,300 crore over the next three-four years. This would primarily be partly funded through internal accruals and partly through external debt. In addition, the company has a healthy financial flexibility to raise debt at low cost from the state government financial institutions.

Rating sensitivities

Positive triggers – ICRA is unlikely to upgrade the ratings in the near term, given the company's business profile consisting of loss-making fertiliser operations and its high dependence on the cyclical chemical segment.

Negative triggers – Negative pressure on GNFC's ratings could arise if an extended down-cycle in the prices of its key chemical products results in a further moderation in profitability and accruals, or if significant delays in subsidy reimbursement lead to a stretched working capital cycle, or if there is any major debt-funded capex or sizeable investments resulting in significant additional debt, leading to the Total Debt/OPBDIT ratio exceeding 2.0 times.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	[Corporate Credit Rating Methodology] [Rating Methodology on Fertilisers] [Rating Methodology on Chemicals]
Parent/Group Support	Not applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of GNFC. As on March 31, 2019, GNFC had one subsidiary and one associate, which are enlisted in Annexure-2.

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 GoG's entire shareholding was transferred to Gujarat State Investments Limited (GSIL), a GoG undertaking. Based in Bharuch, GNFC mainly manufactures fertilisers such as urea, ANP and calcium ammonium nitrate (CAN), and industrial chemicals such as methanol, acetic acid, aniline, TDI, formic acid and nitric acid. The company also trades in few fertilisers and chemicals. The company further provides IT services and solutions covering digital signature certificates (DSCs), e-procurement, e-governance projects, data centres, CCTV surveillance systems etc under the brand name of (n)Code Solutions, and is the market leader in the digital certificate business.

Key financial indicators (audited)

	FY2018	FY2019
Operating Income (Rs. Crore)	5,919	5,961
PAT (Rs. Crore)	790	741
OPBDIT/ OI (%)	24.9%	15.7%
RoCE (%)	22.2%	15.2%
Total Debt/ TNW (times)	0.07	0.04
Total Debt/ OPBDIT (times)	0.21	0.22
Interest Coverage (times)	14.8	146.2
DSCR	2.5	12.3

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

	Instrument	Current Rating (FY2020)					Chronology of Rating History for the past 3 years			
		Type	Amount Rated (Rs. Crore)	Amount Outstanding (Rs. Crore)	Rating		FY2019	FY2018	FY2017	
					January 27, 2020	September 9, 2019	August 29, 2018	August 16, 2017	November 8, 2016	July 11, 2016
1	Long-term Fund-based	Long Term	1,425	-	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)
2	Long-term/Short-term Fund-based	Long Term/ Short Term	75	-	[ICRA]AA+ (Stable)/ [ICRA]A1+	[ICRA]AA+ (Stable)/ [ICRA]A1+	-	-	-	-
3	Short-term Non-fund Based	Short Term	825	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
4	Long-term/Short-term Non-fund Based	Long Term/ Short Term	75	-	[ICRA]AA+ (Stable)/ [ICRA]A1+	[ICRA]AA+ (Stable)/ [ICRA]A1+	-	-	-	-
5	Commercial Paper	Short Term	1,000	-	[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 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	Cash Credit	NA	NA	-	1,425	[ICRA]AA+(Stable)
NA	Long-term/Short-term Fund-based	NA	NA	-	75	[ICRA]AA+(Stable)/ [ICRA]A1+
NA	Long-term/Short-term Non-fund Based	NA	NA	-	75	[ICRA]AA+(Stable)/ [ICRA]A1+
NA	Non-fund Based	NA	NA	-	825	[ICRA]A1+
NA	Commercial Paper	NA	NA	-*	1,000	[ICRA]A1+

** as on date, nil commercial paper outstanding*

Source: GNFC

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Gujarat Ncode Solutions Ltd	100.00%	Full Consolidation
Gujarat Green Revolution Co. Ltd	46.87%	Equity Method

Source: GNFC

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