Essar Oil Limited (Revised)

March 07, 2018

Rating

Facilities	Amount (Rs. crore)	Rating[1]	Remarks
Long term Bank Facilities	15,334	**CARE AA-; Stable (Double A Minus; outlook: Stable)**	**Revised from CARE A (Single A) and removed from credit watch**
Short term Bank Facilities	10,900	**CARE A1+ (A One Plus)**	**Revised from CARE A1 (A One) and removed from credit watch**
Total	26,234 (Rupees Twenty Six Thousand Two Hundred and Thirty Four Crore only)		

Details of instruments/facilities in Annexure-1

Detailed Rationale

The change in rating of Essar Oil Limited positively factors in change in ownership of the company to PJSC Rosneft Oil Company (49.13%) and investment consortium of Trafigura and United Capital Partners (UCP; combined 49.13%) and their strong market position in the industry and subsequent realization of funds given to erstwhile Essar group companies and settlement of past dues as per agreed payment schedule with NIOC. The ratings further derive strength from its strong operational profile being India's second largest single location refinery, relatively higher Gross Refining Margins (GRM's) than peers in the industry, continuous 100% refinery throughput and strategic location of its refinery along with captive port terminal and power plant albeit a single asset facility. The ratings also take into adequate debt coverage metrics.

However, the aforementioned rating strengths are partially tempered by its exposure to volatility of crude prices, crack spreads and foreign exchange rates and competitive industry scenario in the Indian Oil Refining segment.

Any large debt funded capital expenditure adversely impacting financial risk profile and/or any substantial drop in GRM or PBILDT margin adversely impacting operational risk profile is the key rating sensitivity.

Detailed description of the key rating drivers

Key Rating Strengths

Strong operating profile: The refinery has one of the highest complexities across refineries in India with a high complexity. The refinery has a capacity of 20 MMTPA which constitutes around 9% of the Indian Refinery Capacity. It can process crude oil with a blend of 23-30 API (API/American Petroleum Institute gravity is a measure of how heavy or light petroleum liquid is compared with water). It can process wide variety of crude oil ranging from ultra-heavy, high sulphur, sour crude (i.e. low API) to low sulphur light crude (i.e. high API) and has the flexibility to achieve the product slate based on expected demand. It has consistently achieved a crude throughput more than its rated capacity of 20 MMT. It achieved its highest crude throughput of 20.94 MMT in FY17 (vis-à-vis 19.1 MMT in FY16 due to refinery shut down of 25-30 days [normalized throughput of 20.8 MMT] and 20.5 MMT in FY15). The company has 4,175 operational outlets and another 2,806 retail outlets are under various stages of implementation as on December 31, 2017. Furthermore it plans to expand the number of retail outlets to 7,000 by March 2021.

Advantageous location along with captive port terminal and power plant: EOL refinery is located at Vadinar, Gujarat which is strategically located to cater the demand of domestic and export markets.

Port facilities: VOTL (subsidiary of EOL) operates a captive all weather port with a natural 32 meter draft (deepest in India allowing 365 day intake) in an 8 Km distance with an intake capacity of 27 mmtpa of crude via Single Buoy Mooring (SBM). Its SBM, which is capable of handling crude Very Large Crude Carriers (VLCC), is located in the Gulf of Kutch which also houses SBMs of Indian Oil Corporation, RIL, etc., forming gateway to about 70% of total crude imports by India. The port is equipped with 2 Jetties capable of handling vessels up to size of 100,000 deadweight tonnage for total product off-take of 14 mmtpa.

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[1]*Complete definitions of the ratings assigned are available at www.careratings.com and in other CARE publications.*

Power Plant: VPCL operates a captive power plant within refinery premises which is equipped with oil, gas, liquid and coal fired boilers and turbines capable of generating a total of 1010 MW of co-generative thermal power. VPCL only utilizes its coal based 510MW unit to power its refinery and keeps remaining units as backup. VPCL is proposed to be merged into EOL.

Strong market position of consortium promoters: EOL's consortium promoters comprise of PJSC Rosneft Oil Company (Rosneft, holding 49.13% stake) along with investment consortium of Trafigura Pte. Ltd. (Trafigura) and United Capital Partners (UCP) together acquired 49.13%).

About Rosneft

Rosneft is the leader of Russia's petroleum industry and the world's largest publicly traded petroleum company. It is one of the leading global players in Oil Exploration industry owning 13 refineries in Russia and 5 refineries outside Russia. Its main activities include prospecting and exploration of hydrocarbon exploration and appraisal, production of oil, gas and gas-condensate production, upstream offshore projects, processing, as well as oil, gas, and product marketing in Russia and abroad.

About Trafigura

Trafigura is one of the largest physical commodities trading groups in the world which deals in a range of raw materials (including oil and refined products and metals and minerals) to clients around the world. The trading business is supported by industrial and financial assets, including global oil products storage and distribution company, Puma Energy (49.6% stake); global terminals, warehousing and logistics operator, Impala Terminals; Trafigura's Mining Group, DT Group (50% stake) which specializes in logistics and trading, and Galena Asset Management.

About UCP

Based out of Moscow, Russia, UCP is an independent, private investment group established in 2006 to manage the assets of its partners and co-investors. UCP provides commercial financial services specializing in investments in the growth stage, middle market and emerging markets.

Adequate debt credit metrics: One-offs like inventory gains as well as foreign exchange gains have led to an improvement in PBILDT margin to 13.62% in FY17 (vis-à-vis 10.98% in FY16) which may not be sustainable in FY18. During H1FY18, PBILDT normalized to 9.69%.

EOL's financial profile is marked by moderate capital structure and adequate debt credit metrics. Its capital structure continues to be moderate but improved to 1.39x as on March 31, 2017 vis-à-vis 1.66x as on March 31, 2016 due to scheduled repayment of debt. It further improved to 1.19x as on September 30, 2017 with repayment/prepayment of long term and short term debt as explained above.

Interest coverage improved to 3.73x during FY17 (vis-à-vis 2.22x during FY16) due to increase in operational profits aided by one offs as discussed above. Subsequently total debt to GCA also improved to 4.54x as on March 31, 2017 (vis-à-vis 7.19x as on March 31, 2016). Going forward, financial profile is expected to remain moderate with EOL proposing to raise further debt due to conversion of customer advances into long term borrowing contracts, addition of debt post-merger of VPCL, etc.

Furthermore, post-closing of equity stake sale, EOL is currently in midst of refinancing its existing long term and short term loans to secure better terms such as loans at lower interest rate as well as extended repayment tenure, etc. which may lead to improvement in cash-flows. Successful completion of the refinancing activity would be a credit positive.

Realization of funds given to erstwhile Essar group companies and subsequent payment to NIOC: EOL had given loans and advances and certain amount was lying as trade receivables to Essar Group entities operating in sectors of Steel, Power, Shipping and EPC. Consequent to change in ownership of EOL, it realized an aggregate value of the dues to the tune of Rs.22,983 crore during H1FY18. The same was partially utilized to repay/prepay certain loans and remaining the company has as cash on hand (to the tune of Rs.14,475 crore as on September 30, 2017) which is proposed to be utilized to repay o/s National Iranian Oil Company (NIOC) liability of Euro 2,425 Million (Rs.18500 crore @ INR 76.29/Euro; as on December 26, 2017; additional amount for making payment would be raised via working capital lines and short term debt, if required). EOL made repayment to NIOC to the tune of Euro 998 Million in two tranches (Rs.7625 crore @ INR 76.41/Euro; on January 03, 2018 and January 04, 2018). Furthermore, another tranche of Euro 900 Million is expected to be remitted before March 31, 2018 and the balance payment will be in four equal installments, with final installment latest by September 30, 2018.

Key Rating Weaknesses

Exposure to volatility of crude prices, crack spreads and foreign exchange rates: The oil prices and crack spreads are a function of many dynamic markets and fundamental factors such as global demand-supply dynamics, geo-political stability in countries with oil reserves, OPEC policies, exchange rates, etc. EOL is partly managing the above key price risks through derivative transactions which are primarily undertaken as hedge trades to offset the underlying exposure (as governed by Board of Directors approved Price Risk Management Policy). Furthermore, the company has cushion as it is expected to enjoy higher GRM due to the higher complexity of its refinery, which enables it to maximize value additions by producing light and middle distillates from cheapest heavy and sour crudes. However, the differential between brent (sweet) and arab heavy (sour) has meaningfully narrowed down during the last two years which partly explains why the company posted lower GRMs in FY17 (vis-à-vis FY16). Also the new refineries which have recently come up in India have a high NCI resulting into more demand of sour and heavy crude leading to lower differential. The company imports majority of its crude requirements and also crude oil as well as petroleum products are priced in USD leading to volatility associated with forex movements. Susceptibility to forex fluctuation is mitigated to a large extent as company exports 55% of its products. Even domestic sales to OMC's are linked in USD which further mitigates the risk (the pricing of finished products is based on the import parity pricing. This is arrived based on the 15 day average of rupee prices for HSD and MS, and 30 day average of rupee prices for LPG, Kerosene, Aviation Turbine Fuel etc.). However volatility in forex rates may impact its performance. Hence, sound hedging measures are imperative to mitigate these risks of volatility in forex and crude prices. The Company has board approved Price Risk, Treasury and Market Risk Management Policies which are duly followed.

Analytical approach:
CARE has revised its approach from standalone to consolidated post change in ownership and subsequent acquisition of VOTL and VPCL by EOL which have now become wholly owned subsidiaries of EOL and may be merged into EOL. These companies have substantial operational and financial linkages with EOL.

Applicable Criteria
Criteria on assigning Outlook to Credit Ratings
CARE's Policy on Default Recognition
Criteria for Short Term Instruments
Rating Methodology-Manufacturing Companies
Financial ratios – Non-Financial Sector

About the Company
Incorporated in 1989, Essar Oil Limited (EOL) is an Oil and Gas company engaged into refining and marketing. It owns India's second-largest single location Refinery (at Vadinar, Gujarat) having a capacity of 20 million metric tons per annum (mmtpa; equivalent to 140 million barrels) and high complexity which allows it to process crude oil with a blend of 23-30 API. It can process wide variety of crude oil ranging from ultra-heavy, high sulphur, sour crude (i.e. low API) to low sulphur light crude (i.e. high API) and has the flexibility to achieve the product slate based on expected demand. EOL contributes around 9% of the Indian Refinery Capacity. The company also has a presence in oil retailing with 6,981 franchisee owned outlets (constituting 4,175 operational outlets and 2,806 under various stages of implementation) in various parts of India as on December 31, 2017. Post deregulation of Motor Spirit (MS) in October 2010 and specially High Speed Diesel (HSD) in October 2014, the company has been ramping up its retail outlets.

Change in ownership of the Company
On August 18, 2017, Essar Group successfully concluded the sale of 98.26% of EOL to PJSC Rosneft Oil Company acquired 49.13% along with investment consortium of Trafigura and United Capital Partners (acquired 49.13%). The remaining 1.74% stake continues to be with the retail shareholders.

Acquisition of Vadinar Oil Terminal Limited and Vadinar Power Company Limited
As a part of aforementioned $12.9 billion deal, EOL acquired 97.63% stake in Vadinar Oil Terminal Limited (VOTL; owns and operates the port and storage facilities of EOL) and Vadinar Power Company Limited (VPCL; owns and operates the 1010 MW multi-fuel power plant of EOL). Transaction includes sale of Essar Oil's refinery, retail assets and power plant (US$10.9bn) together with Vadinar Port and related infrastructure assets (US$2.0bn).

Vadinar Oil Terminal Limited
VOTL operates a captive all weather port with a natural 32 meter draft (deepest in India allowing 365 day intake) with an intake capacity of 27 mmtpa of crude via Single Buoy Mooring (SBM).

Vadinar Power Company Limited
VPCL operates a captive power plant within refinery premises capable of generating a total of 1010 MW of co-generative thermal power.

Brief Financials (Rs. crore) – Consolidated	FY16 (A)	FY17 (A)
Total operating income	52,836	61,670
PBILDT	5,954	9.129
PAT	1,015	-980
Overall gearing (times)	1.66	1.39
PBILDT Interest coverage (times)	2.22	3.73

Note: financials are classified as per CARE's standards

Status of non-cooperation with previous CRA: Nil

Any other information: Nil

Rating History for last three years: Please refer Annexure-2

Note on complexity levels of the rated instrument: *CARE has classified instruments rated by it on the basis of complexity. This classification is available at www.careratings.com. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

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About CARE Ratings:
CARE Ratings commenced operations in April 1993 and over two decades, it has established itself as one of the leading credit rating agencies in India. CARE is registered with the Securities and Exchange Board of India (SEBI) and also recognized as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI). CARE Ratings is proud of its rightful place in the Indian capital market built around investor confidence. CARE Ratings provides the entire spectrum of credit rating that helps the corporates to raise capital for their various requirements and assists the investors to form an informed investment decision based on the credit risk and their own risk-return expectations. Our rating and grading service offerings leverage our domain and analytical expertise backed by the methodologies congruent with the international best practices.

Annexure-1: Details of Instruments/Facilities

Name of the Instrument	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Term Loan-Long Term	-	-	March 2031	3935.42	CARE AA-; Stable
Term Loan-Long Term	-	-	March 2031	10143.58	CARE AA-; Stable
Fund-based - LT-Cash Credit	-	-	-	1255.00	CARE AA-; Stable
Non-fund-based - ST-BG/LC	-	-	-	10900.00	CARE A1+

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017	Date(s) & Rating(s) assigned in 2015-2016	Date(s) & Rating(s) assigned in 2014-2015
1.	Non-fund-based - ST-BG/LC	ST	10900.00	CARE A1+	-	1)CARE A1 (Under Credit watch with Positive Implications) (23-Dec-16) 2)CARE A1 (Under Credit watch with Positive Implications) (06-Dec-16)	1)CARE A1 (13-Jan-16) 2)CARE A1 (03-Sep-15)	1)CARE A2 (28-Jul-14)
2.	Fund-based - LT-Cash Credit	LT	1255.00	CARE AA-; Stable	-	1)CARE A (Under Credit watch with Positive Implications) (23-Dec-16) 2)CARE A (Under Credit watch with Positive Implications) (06-Dec-16)	1)CARE A (13-Jan-16) 2)CARE A (03-Sep-15)	1)CARE A- (28-Jul-14)
3.	Term Loan-Long Term	LT	3935.42	CARE AA-; Stable	-	1)CARE A (Under Credit watch with Positive Implications) (23-Dec-16) 2)CARE A (Under Credit watch with Positive Implications) (06-Dec-16)	1)CARE A (13-Jan-16) 2)CARE A (03-Sep-15)	1)CARE A- (28-Jul-14)
4.	Term Loan-Long Term	LT	10143.58	CARE AA-; Stable	-	1)CARE A (Under Credit watch with Positive Implications) (23-Dec-16) 2)CARE A (Under	1)CARE A (13-Jan-16) 2)CARE A (03-Sep-15)	1)CARE A- (28-Jul-14)

						Credit watch with Positive Implications) (06-Dec-16)		
5.	Fund-based - ST-Bills discounting/ Bills purchasing	ST	-	-	-	1)Withdrawn (04-Jan-17) 2)CARE A1+ (SO) (Under Credit Watch) (06-Dec-16)	1)CARE A1+ (SO) (13-Jan-16) 2)CARE A1+ (SO) (03-Sep-15)	1)CARE A2+ (SO) (28-Jul-14)

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