Nayara Energy Limited (formerly known as Essar Oil Limited)

July 25, 2018

Ratings

Facilities	Amount (Rs. Crore)	Rating[1]	Remarks
Proposed Non-Convertible Debentures	3,000	CARE AA; Stable (Double A; Outlook: Stable)	Assigned

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The rating assigned to NCD issue of Nayara Energy Limited (Nayara Energy, formerly known as Essar Oil Ltd) derives strengths from change in ownership of the company and strong market position of its shareholders i.e. PJSC Rosneft Oil Company (holding 49.13%) and investment consortium of Trafigura and United Capital Partners (UCP; combined holding 49.13%), in the industry and Nayara Energy's 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 rating also positively factors in realization of funds given to erstwhile Essar group companies and subsequent settlement of past dues as per agreed payment schedule with NIOC and successful completion of refinancing process as per planned structure. The ratings also factors in 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, competitive industry scenario and government regulation risk in the Indian Oil & Gas 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. It continues to post steady and relatively higher GRM's than its peers in the industry at $ 8.95/bbl in FY18 vis-à-vis $ 9.14/bbl in FY17 and $10.81/bbl in FY16. 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. 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 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 crude throughput of 20.7 MMT in FY18 compared to 20.94 MMT in FY17.

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

<u>*Port facilities:*</u> VOTL (subsidiary of Nayara Energy) 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.

<u>*Power Plant:*</u> 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 MWe of co-generative thermal power. VPCL only utilizes

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

its coal based 510 MWe unit to power its refinery and keeps remaining units as backup. VPCL is proposed to be merged into Nayara Energy.

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

As a part of $12.9 billion deal, Nayara Energy acquired 97.63% stake in Vadinar Oil Terminal Limited (VOTL; owns and operates the port and storage facilities of Nayara Energy) and acquired balance 86.99% stake in Vadinar Power Company Limited (VPCL; owns and operates the 1010 MWe multi-fuel power plant of Nayara Energy) to make it a 100% subsidiary. Transaction includes sale of refinery, retail assets and power plant (US$10.9bn) together with Vadinar Port and related infrastructure assets (US$2.0bn).

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. Further, USA and EU placed sanctions on Russia's (post its claim on Crimea in March 2014) state finances, energy and arms sectors as well as major state oil firms: Rosneft (along with chairman Mr. Igor Sechin), Transneft and Gazprom Neft, thereby making it difficult for Russian firms and banks to access the US and EU markets and limits any new E&P activities by Russian Oil companies in the Arctic Ocean.

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.

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 led to an improvement in PBILDT to Rs.9,129 crore in FY17 vis-à-vis 5,954 crore in FY16 leading to improved PBILDT margin of 13.62% in FY17. However, these gains were not there in FY18 (Provisional), hence PBILDT declined to Rs.7,984 crore leading to lower PBILDT margin of 11.1%.

Nayara Energy's financial profile is marked by adequate capital structure and debt credit metrics. Its capital structure (overall gearing) continues to be moderate and marginally worsened to 1.69x in FY18 (Provisional) compared to 1.39x in FY17 largely due to increase in long term debt. The interest coverage in FY18 (Provisional) declined to 2.37x compared to 3.73x in FY17, mainly due to higher PBILDT during FY17 on account of one-time non-cash interest expense on operational lease to Nayara Energy's subsidiary companies VOTL (Rs.1084 crore) and VPCL (Rs.240 crore). Further, total debt to PBILDT declined to 3.92x in FY18 (Provisional) compared to 2.93X in FY17 due to lower PBILDT and one time forex loss, and also due to increase in debt on account of consolidation of VOTL and VPCL.

***Realization of funds given to erstwhile Essar group companies and subsequent payment to NIOC**:* Nayara Energy 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 Nayara Energy (formerly known as Essar Oil Limited), it realized an aggregate value of the dues to the tune of Rs.22,983 crore during FY18. The same was partially utilized to repay/prepay certain loans and remaining has been utilized to repay o/s National Iranian Oil Company (NIOC) liability of Euro 2,425 Million (additional amount for making payment would be raised via working capital lines and short term debt, if required). Nayara Energy made repayment to NIOC to the tune of Euro 998 Million in two tranches (in January 2018). Furthermore, another tranche of Euro 900 Million was paid in the month of March 2018 and the balance payment of Euro 527 million will be paid 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. Nayara Energy 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).

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 43% 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 expected to be followed in line with policy.

Analytical approach:

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

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, Nayara Energy Limited (formerly known as Essar Oil Limited) 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. The company also has a presence in oil retailing with 7,212 majorly franchisee owned outlets (constituting 4,629 operational outlets and 2,583 under various stages of implementation) in various parts of India as on June 30, 2018. Furthermore it plans to expand the number of operational retail outlets to 7,000 by March 2021. Post deregulation of Motor Spirit (MS) in October 2010 and especially High Speed Diesel (HSD) in October 2014, the company has been ramping up its retail outlets.

Brief Financials (Rs. Crore)	FY17 (A) – Standalone	FY18 (Provisional) – Consolidated
Total operating income	61,670	71,996
PBILDT	9,129	7,984
PAT	-980	577
Overall gearing (times)	1.39	1.69
PBILDT Interest coverage (times)	3.73	2.37

A: Audited

Status of non-cooperation with previous CRA: NA

Any other information: NA

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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****For detailed Rationale Report and subscription information, please contact us at www.careratings.com**

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
Debentures-Non Convertible Debentures	-	-	-	3000.00	CARE AA; Stable

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 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017	Date(s) & Rating(s) assigned in 2015-2016
1.	Non-fund-based - ST-BG/LC	ST	12249.00	CARE A1+	1)CARE A1+ (25-May-18)	1)CARE A1+ (07-Mar-18)	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)
2.	Fund-based - LT-Cash Credit	LT	2000.00	CARE AA; Stable	1)CARE AA; Stable (25-May-18)	1)CARE AA-; Stable (07-Mar-18)	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)
3.	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)
4.	Term Loan-Long Term	LT	4870.42	CARE AA; Stable	1)CARE AA; Stable (25-May-18)	1)CARE AA-; Stable (07-Mar-18)	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)
5.	Term Loan-Long Term	LT	10143.58	CARE AA; Stable	1)CARE AA; Stable (25-May-18)	1)CARE AA-; Stable (07-Mar-18)	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)
6.	Fund-based - ST-Bills discounting/ Bills purchasing	ST	2000.00	CARE A1+	1)CARE A1+ (25-May-18)	-	-	-
7.	Debentures-Non Convertible Debentures	LT	3000.00	CARE AA; Stable	-	-	-	-

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