Gujarat Alkalies and Chemicals Limited (Revised)

July 06, 2021

Ratings

Facilities / Instruments	Amount (Rs. crore)	Ratings[1]	Rating Action
Long term Bank Facilities	764.04 (Reduced from Rs.795.63)	**CARE AA+; Stable (Double A Plus; Outlook: Stable)**	**Reaffirmed**
Short term Bank Facilities	45.00	**CARE A1+ (A One Plus)**	**Reaffirmed**
Total	**809.04 (Rupees Eight Hundred Nine crore and Four lakh only)**		
Commercial Paper Issue	100.00	**CARE A1+ (A One Plus)**	**Reaffirmed**
Total	**100.00 (Rupees One hundred crore only)**		

Details of facilities/instrument in Annexure-1

Detailed Rationale & Key Rating Drivers

The ratings for the bank facilities of Gujarat Alkalies and Chemicals Ltd (GACL) continue to draw strength from its strong position in the domestic chlor-alkali industry along with its integrated operations, state-of-the-art technology, wide product portfolio which finds application across diversified end-use industries, captive power generation to meet part of its energy requirement along with its comfortable leverage & debt coverage indicators and strong liquidity. The ratings also take note of the fact that GACL has infused its entire equity requirement in its joint venture (JV) with National Aluminium Company Ltd (NALCO) towards setting-up a greenfield project for manufacturing caustic soda and presence of an off-take agreement with NALCO, a leading player in the domestic aluminium industry, for part of the envisaged production of caustic soda in the JV.

The long-term rating of GACL, however, continues to be constrained by its presence in an inherently cyclical chlor-alkali industry whose impact is reflected in the moderation in its scale of operations and profitability during FY20 (FY refers to period from April 1 to March 31) & FY21 due to decline in its electro-chemical unit (ECU)[2] realization; albeit the ECU realization is envisaged to improve in FY22 on the back of pick-up in demand from its diversified end-use industries which is likely to result in improvement in its operating profitability margin during the year. The long-term rating of GACL is further tempered on account of implementation and post-implementation salability risks associated with its own ongoing large-size projects as well as under its JV which has coincided with the cyclical downturn in the industry. The long-term rating of GACL further continues to remain constrained on account of competition from imports, susceptibility of its profitability to adverse movement in market price of gas and power cost which constitutes a significant part of its cost structure and the risk related to adverse movement in foreign exchange rates.

Rating Sensitivities

Positive factors

- Diversification of its operations to other chemical products thereby insulating itself from inherent cyclicality of the chlor-alkali industry; along with significant growth in its scale of operations marked by total operating income (TOI) of more than Rs.5,000 crore.
- Gaining significant market leadership position in the caustic soda industry while securing significant portion of its power requirement (its major cost component) through captive low-cost sources; along with greater share of value-added products in its sales mix so as to consistently earn high PBILDT margin with greater resilience despite impact of inherent cyclicality in the chlor-alkali industry and competition from imports.
- Improvement in its RoCE to more than 25% on a sustained basis

Negative factors

- Pressure on its operating profitability resulting in its PBILDT margin remaining below 20% on a sustained basis along with its adverse impact on its debt coverage indicators leading to deterioration in Total debt / PBILDT beyond 2.75x on a sustained basis.
- Heavy dumping of caustic soda products significantly impacting its ECU realization.

[1]*Complete definitions of the ratings assigned are available at www.careratings.com and in other CARE publications.*
[2]*Caustic soda, chlorine and hydrogen are co-products and hence ECU refers to weighted average realizations of the above co-products*

- Any tightening of prevailing pollution control/ environmental norms and/or regulatory ban on production & sales of certain major products thereby significantly impacting its business and profitability

Detailed description of the key rating drivers

Key Rating Strengths

Dominant position in the domestic caustic soda industry

GACL is the second largest player of caustic soda in the country with an installed capacity (for caustic soda lye and caustic soda flakes combined) of ~1,750 metric tonne per day (MTPD) as on March 31, 2021 at its plants in Vadodara and Dahej in Gujarat. GACL has gradually built its strong position in the industry through continuous expansion of production capacities to cater to the growing demand for its products over the last four decades. Once its own on-going large-size capex as well as the one under its JV with NALCO gets commissioned over next couple of years, GACL is expected to further consolidate its position in the chlor-alkali industry in India.

Over the years, it has also introduced new chlorine derivatives (downstream products) for captive utilization of chlorine, an essential by-product generated during manufacturing of caustic soda. GACL has more than 36 products in its product basket. This has equipped the company to leverage upon its large production capacity and protects its profitability from the effects of volatility in chlorine prices to some extent.

Integrated operations and diversified customer base

The operations of GACL are well-integrated with by-product of one process being used as raw material for another process, enabling the company to optimally utilize its large production capacity. It also protects GACL's profitability to an extent from the effects of inherent cyclicality in the demand for its major products, as adverse demand scenario for one set of products is countered by favourable movement in other products. GACL's products find application in various processes across diverse range of industries including textile, pulp & paper, alumina, soaps & detergents, rayon, fertilizers, petroleum, fertilizers, pharmaceuticals, agrochemicals, water treatment, ink, paint, etc., thereby allowing the company to cater to a diversified customer base and thus help it to counter slowdown in any particular industry or a group of industries.

State-of-the-art technology and captive power generation to meet part of its energy requirements

The cost structure of GACL has remained competitive on account of its membrane cell technology used for electrolysis of salt which consumes one-third less power as compared to the traditional mercury cell technology and is also less polluting. Captive power plant for meeting part of its energy requirements and investment in wind-mills & solar power plants to offset higher cost of power purchased from the market aids its cost structure. Total installed capacity of solar power plant stood at 35 MW apart from wind power generation capacity of 171.45 MW, captive 90 MW gas-based power plant and 40-50 MW participation in a 145 MW group captive gas-based power plant operated by Gujarat Industries Power Company Ltd *(GIPCL; rated CARE AA-; Stable/ CARE A1+)*. Average cost of power consumed by GACL stood at Rs.5.98 per unit in FY21 which was largely similar to that of FY20.

Comfortable capital structure and strong debt coverage indicators

Despite moderation in its profitability during FY20 & FY21, GACL's capital structure remained comfortable with an overall gearing of 0.09 times as on March 31, 2021 mainly on the back of significant amount of other comprehensive income arising from fair valuation of its quoted investments leading to significant expansion in its net-worth base. Also, its debt coverage indicators stood strong marked by interest coverage of 27.48 times while its Total debt/ PBILDT moderated to 1.17x during FY21 as against 0.31x during FY20 owing to reduced profitability combined with availment of debt for its on-going capex during FY21. Although its debt coverage indicators are expected to moderate over medium term owing to expected availment of large amount of term debt to complete its on-going capex, they are expected to be supported by improved profitability on the back of improved demand prospects from end-user industries.

Liquidity*: Strong*

Liquidity of GACL is marked by strong accruals and presence of liquid investments to the tune of Rs.410 crore as on April 19, 2021. With an overall gearing of 0.09 times as of March 31, 2021, it has sufficient gearing headroom to raise additional debt for its capex; although over the past few years the company has largely funded its capex through its healthy internal cash accruals. Nonetheless, the debt required for its on-going capex has already been tied-up by the company. Its' entirely unutilized bank lines are more than adequate to meet its incremental working capital needs over the next one year. Operating cycle also remained stable at 41 days during FY21 and current ratio remained healthy at 1.77x as on March 31, 2021. Also, GACL had not availed any moratorium on its debt obligations during the period from March to August 2020, the option for which was available to it as a Covid-relief measure under RBI's package which underlines its strong liquidity.

Key Rating Weaknesses

Presence in an inherently cyclical caustic soda industry

Caustic soda industry is an inherently cyclical industry wherein sales realization of companies in caustic soda manufacturing had improved significantly during FY18 & FY19 and then it had started softening from FY20. By end FY21, ECU realizations had declined to a decade low level mainly on the back of Covid 19 pandemic whereby demand from end-use industries had been severely impacted. ECU realizations of GACL which were at its peak of Rs.38,505/MT during FY19, declined to Rs.30,007/MT during FY20 and further to Rs.23,013/MT during FY21. However, with the improved demand from end-use industries, ECU realizations have again improved to a level of Rs.27,000 /MT – Rs.28,000/MT in April & May 2021 which augurs well for GACL.

Moderation in TOI & profitability during FY20 & FY21 after witnessing an improving trend during past few years; albeit expected to again improve during FY22

GACL's TOI moderated by ~13% in FY20 and further by ~11% in FY21 on y-o-y basis mainly on account of moderation in realization of caustic soda products especially after H1FY20 due to the inherent cyclical nature of the industry and disruption in businesses caused due to outbreak of Covid-19 pandemic. In line with that, PBILDT and PAT margin also moderated by 675 bps and 516 bps on y-o-y basis and stood at 17.03% and 6.64% respectively during FY21. Also, the prices of salt and potassium chloride (which comprise ~34% of its total cost of materials consumed) remained at an elevated level for past two years ended FY21 further impacting its profitability. The cyclical nature of GACL's business is evident from the fact that prior to the current declining trend in its PBILDT margin, during the 4-year period ended FY19, its PBILDT margin had witnessed an improving trend. Again, with increasing trend in its ECU realizations, its PBILDT margin is envisaged to improve to ~22-24% during FY22.

Susceptibility of its profitability to adverse movement in market price of gas & power cost and threat of cheaper imports

GACL's profitability is susceptible to adverse movement in market price of gas and power cost since electrolysis is an energy intensive process and power cost constitutes a significant part of its cost structure. The power cost constituted around 31% of GACL's total operating income in FY21 (32% in FY20). The Indian chlor-alkali industry faces competition from cheap imports of lower power cost countries. Out of India's total imports, more than 90% is contributed by Japan, China, Korea, Qatar and Iran with over 50% imports from Japan alone mainly due to tax treaty and lower logistics cost to cater to the requirement of aluminium manufacturers on the eastern cost of India. Domestic manufacturers have sought a level playing field from the government by way of increase in customs duty on caustic soda imports, a GST structure for electricity taxes and the imposition of export duty on salt so as to effectively compete against imports. Further, there was anti-dumping duty on caustic soda imports from China ranging up to USD 48.39 per MT till November 2020 which helped in limiting the imports thereby benefitting the domestic players. At the request of domestic chlor-alkali manufacturers, Ministry of Commerce in Dec. 2020 has initiated anti-dumping investigation on imports of caustic soda from Japan, Iran, Qatar and Oman.

Risk of adverse movement in foreign exchange rates

GACL is exposed to risk of adverse movement in foreign exchange rates on account of its long-term borrowings denominated in USD, raised for part-funding of its capex plans. Further, as a matter of policy, GACL does not hedge its foreign currency exposure. During FY21, GACL imported raw materials and capital goods worth Rs.263.07 crore mainly from Canada and South Africa and had repayment liabilities of Rs.65.64 crore against which it made exports of Rs.339.97 crore, thus providing a natural hedge to its foreign currency exposure to a large extent. In order to mitigate its forex risk, the company has opened Exchange Earners' Foreign Currency Account (EEFC) USD a/c as per RBI Guidelines to deposit the export earnings in the said account and to utilize the same for making US Dollar repayments towards servicing its foreign currency debt & import pay-outs which mitigates the exchange rate risk to a large extent.

Large-size ongoing own capex plan and in JV along with associated salability risk

GACL has plans to incur capex of around Rs.1,825.80 crore over the next two-years period ending FY23 which is expected to be funded by debt of Rs.1,536.26 crore and the balance through internal accruals / available liquidity. As on March 31, 2021, the company has already incurred capex of around Rs.824.70 crore through term loan of Rs.363.74 crore and balance through internal accruals. The required debt for the project has also been tied up by the company. The progress of the projects has been impacted due to Covid-19 and resultant issue of availability of labour, hence the projects are expected to get completed with delay of about 4-6 months period from their last envisaged completion timelines.

Furthermore, GACL has entered into 60:40 joint venture with NALCO; GACL-NALCO Alkalies & Chemicals Pvt Ltd (GNAL; rated CARE A; Stable) for setting up a chlor-alkali plant for producing 800 MTPD of caustic soda along-with 130 MW of coal-based captive power plant at Dahej, in the vicinity of GACL's existing plant. The cost of the JV project is expected to be Rs.2,300 crore and is being funded through debt and equity in the ratio of 2.33:1. GACL & NALCO have already invested their committed equity contribution for this project in GNAL. In line with anticipated delay in its own capex plans due to Covid-19 pandemic, GNAL project is also expected to be delayed and its SCOD has been revised to November 2021 from earlier estimate of August 2021. Further, both the sponsors have extended undertaking to fund any project cost overrun in their shareholding ratio. Out of the total caustic soda to be produced from the JV plant, at least 300 MTPD is agreed to be sold to NALCO (Odisha plant) at market prices and the remaining would be sold in the open market; the marketing rights of which would vest with GACL. The unit would also contain manufacturing facilities for other downstream products, for utilization of chlorine, an essential by-product generated for manufacturing of caustic soda. Thus, GACL will be exposed to marketing risk as well as risk of chlorine disposal for GNAL. However, GACL's significant experience and presence in the industry along with off-take agreement with NALCO for part of the envisaged production of caustic soda in its JV and its strong financial risk profile is expected to mitigate this risk to a certain extent; also, GACL's market position in the domestic caustic soda industry is likely to further strengthen post commissioning of these projects.

Analytical Approach: Consolidated
CARE has considered 'Consolidated' analytical approach for rating of GACL on account of strong operational and financial linkages of GACL with its JV company i.e. GACL-NALCO Alkalies and Chemicals Limited (GNAL) which is setting-up a caustic soda manufacturing facility at Dahej wherein GACL holds 60% equity stake.

Applicable Criteria:
Criteria on assigning 'Outlook' and 'Credit Watch' to Credit Ratings
CARE's Policy on Default Recognition
Criteria for Short Term Instruments
Liquidity Analysis of Non-Financial Sector Entities
Rating Methodology: Consolidation
Rating Methodology - Manufacturing Companies
Financial ratios – Non-Financial Sector

About the Company
Gujarat Alkalies and Chemicals Limited (GACL) was promoted in 1973 by the Government of Gujarat (GoG) through its industrial investment arm, Gujarat Industrial Investment Corporation Ltd (GIIC). As on March 31, 2021, GoG as the promoter, through its various undertakings, held 46.28% equity in the company, the largest being through Gujarat State Investments Ltd (GSIL) with 20.87% holding. GACL is the second largest player in the domestic caustic chlorine industry with integrated operations. It produces a wide range of products including caustic soda, liquid and gaseous chlorine, hydrogen peroxide, phosphoric acid and aluminium chloride which find application across a diversified group of industries including textile, pulp and paper, aluminium, detergents, soaps, rayon, plastics, pharmaceutical, water treatment and agricultural chemicals. GACL's manufacturing facilities had a combined installed capacity for production of ~1750 Metric Tonne Per Day (MTPD) of caustic soda (caustic soda lye & caustic soda flakes) as on March 31, 2021 along-with large capacities for downstream products. GACL also has an ongoing project for expansion of its caustic soda capacity by 425 MTPD along-with setting-up of 65 MW coal-based power plant at Dahej.
Moreover, in December 2015, GACL entered into a 60:40 joint-venture with National Aluminium Company Ltd. (NALCO); GACL-NALCO Alkalies & Chemicals Pvt Ltd (GNAL; rated CARE A; Stable) to set up 800 MTPD caustic soda plant along with a 130-megawatt (MW) coal based captive power plant at Dahej in the vicinity of GACL's existing plant which is expected to start commercial operations from November 2021.

(Rs. Crore)

Brief Financials (Consolidated)	FY20 (A)	# FY21 (A)
Total operating income (TOI)	2,813	2,495
PBILDT	669	425
PAT	332	166
Overall gearing (times)	0.04	0.09
Interest coverage (times)	47.64	27.48

A: Audited, #: Abridged audited results published on the stock exchange

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

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

Complexity level of various instruments rated for this company: Please refer Annexure-3

Annexure - 1: Details of Facilities/ Instrument

Name of the Instrument/ Bank Facilities	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Term Loan-Long Term	-	-	March 2028	634.04	CARE AA+; Stable
Fund-based - LT-Cash Credit	-	-	-	130.00	CARE AA+; Stable
Non-fund-based - ST-BG/LC	-	-	-	45.00	CARE A1+
Commercial Paper-CP/STD	-	-	7-364 days	100.00	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 2021-2022	Date(s) & Rating(s) assigned in 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019
1.	Term Loan-Long Term	LT	634.04	CARE AA+; Stable	1)CARE AA+; Stable (07-May-21)	1)CARE AA+; Stable (06-Oct-20)	1)CARE AA+; Stable (03-Oct-19)	1)CARE AA+; Stable (08-Oct-18)
2.	Commercial Paper-CP/STD	ST	100.00	CARE A1+	-	1)CARE A1+ (06-Oct-20)	1)CARE A1+ (03-Oct-19)	1)CARE A1+ (08-Oct-18)
3.	Fund-based - LT-Cash Credit	LT	130.00	CARE AA+; Stable	1)CARE AA+; Stable (07-May-21)	1)CARE AA+; Stable (06-Oct-20)	1)CARE AA+; Stable (03-Oct-19)	1)CARE AA+; Stable (08-Oct-18)
4.	Non-fund-based - ST-BG/LC	ST	45.00	CARE A1+	1)CARE A1+ (07-May-21)	1)CARE A1+ (06-Oct-20)	1)CARE A1+ (03-Oct-19)	1)CARE A1+ (08-Oct-18)

Annexure 3: Complexity level of various instruments rated for this company

Sr. No.	Name of the Instrument	Complexity Level
1.	Commercial Paper-CP/STD	Simple
2.	Fund-based - LT-Cash Credit	Simple
3.	Non-fund-based - ST-BG/LC	Simple
4.	Term Loan-Long Term	Simple

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:

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