Deep Industries Limited

December 06, 2021

Ratings

Facilities	**Amount (Rs. crore)**	**Rating[1]**	**Rating Action**
Long Term Bank Facilities	26.79 (Reduced from 92.96)	CARE A; Stable (Single A; Outlook: Stable)	Reaffirmed@
Long Term / Short Term Bank Facilities	56.89 (Reduced from 77.50)	CARE A; Stable / CARE A1 (Single A; Outlook: Stable / A One)	Reaffirmed@
Short Term Bank Facilities	0.00	-	Withdrawn@
Total Facilities	**83.68 (Rs. Eighty-Three Crore and Sixty-Eight Lakhs Only)**		

Details of instruments/facilities in Annexure-1
@Part of the bank facilities have been withdrawn based on the no dues received from the banker.

Detailed Rationale and Key Rating Drivers

The ratings assigned to the bank facilities of Deep Industries Limited (DIL) continue to derive strength from its established position in the domestic gas compression service business, increasing presence in the workover & drilling rigs service business, strong clientele and its healthy profitability. The ratings also factor comfortable capital structure and debt coverage indicators and its strong liquidity backed by build-up of healthy liquid investment and cash and bank balance.
The ratings are, however, constrained on account of DIL's moderate scale of operations, intense competition in the rigs service business which is also susceptible to volatile day rates due to its linkages with crude oil prices, moderate order book, inherent risk associated with renewal of contracts arising from client concentration risk and its elongated debtors days.

Rating Sensitivities

Positive Factors - Factors that could lead to positive rating action/upgrade:

- Growth in scale of operations marked by total operating income (TOI) of more than Rs.400 crore while maintaining PBILDT margin above 40% on consolidated basis on a sustained basis.
- Faster realization of its debtors with avg. collection period less than 90 days with maintaining healthy cash and bank balance and liquid investment.
- Greater share of income from gas compression, air compression and gas dehydration works along with greater customer diversification.

Negative Factors - Factors that could lead to negative rating action/downgrade

- Decline in its scale of operations marked by TOI of less than Rs.250 crore on a sustained basis.
- Reduction in its profit before interest, lease, depreciation and tax (PBILDT) margin to less than 35% on consolidated level a sustained basis.
- Elongation in its operating cycle beyond 180 days affecting its liquidity.
- Any large size debt funded capex leading to moderation in its overall gearing beyond 0.50 times.
- Extension of significant direct / indirect financial support for the exploration & production (E & P) activities in Deep Energy Resources Ltd. (DERL) or undertaking any such activity in the company itself.

Detailed description of the key rating drivers

Key Rating Strengths

Established position in gas compression and workover and drilling rigs related services business

DIL has been serving the oil and gas service industry for more than two decades and has varied service offerings including gas compression, work-over rigs & drilling rigs and gas dehydration units in its portfolio. It has a leading position in providing third party gas compressing services with a dominant domestic market share and is increasing its presence in the workover and drilling rigs related service business. It has strong asset base of rigs and gas compressor units which are almost debt free providing it the flexibility to target higher day rate contracts also its asset base is relatively newer with average age of Rigs and gas compressor was 7 years and 12 years respectively. DIL has also ventured into overseas market for providing oil & gas services through its subsidiary Deep international DMCC (Deep DMCC) in the Middle-East and has also set-up manufacturing unit of CNG Booster Compressors under its subsidiary Raas Equipment Private Limited (REPL) to diversify its operations. REPL started operation from Q4FY21.

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

Diversified revenue stream coupled with strong clientele and healthy operating profitability
Till FY18, DIL earned majority of its income from Gas Dehydration Units (GDU) and gas compression business. However, since than DIL has diversified its revenue stream. During FY21, DIL derived 54% of its TOI form Workover and rigs, 30% from gas compression, 11% from integrated project management service (IPMS) and 5% from GDU reflecting its diversified revenue stream. Proportion of gas compression has come down in FY21 due to lower inflow of new but same has improved in H1FY22. Going forward, management expects several new orders which will result in higher deployment of unutilized assets (GC) which will support its growth in operation. ONGC (rated, CARE AAA; Stable / CARE A1+) has remained one of the key client for DIL over the years and DIL has been regularly receiving various orders across its business segments.
On a standalone level, DIL continued to have healthy profitability marked by PBILDT margin of 44.70% during FY21 as compared with 46.83% during FY20. Moderation in the PBILDT margin during FY21 was due to increased proportion of the revenue from the Rigs business. On a consolidated basis, PBILDT margin continued to remain healthy at 42.40% during FY21 as compared with 48.46% during FY20. PBILDT margin moderated to 36.10% during H1FY22 (H1FY21: 46.17%) due to increasing proportion of income from REPL and Deep DMCC which have comparatively lower margin. Its PAT margin stood low at 11.75% during FY20 mainly due to amortization of goodwill (Rs.641 crore of Goodwill created upon demerger of its Services business) over a period of 10 years from FY18. However, with implementation of the IND AS accounting standard the same has been discontinued from FY22 leading to reversal of majority of deferred tax liability and improvement in the PAT margin to 32.93% during FY21. GCA remained strong at Rs.77.51 crore during FY21 as compared with Rs.115.33 crore during FY20.

Comfortable capital structure and debt coverage indicators
The overall gearing of DIL remained comfortable and further improved from 0.16x as on March 31, 2020 to 0.06x as on March 31, 2021 and 0.05x as on September 30, 2021. Improvement in the capital structure was on account of part prepayment of its term loan and low reliance on external debt on account of healthy accretion of profits with strong cash accruals. Total debt declined from Rs.85.31 crore as March 31, 2020 to Rs.40.89 crore as March 31, 2021 and Rs.33.34 crore as on September 30, 2021. DIL operates in the capital-intensive industry. It is net debt free as on September 30, 2021 which provides enough headroom for any incremental capex requirements. Tangible net-worth remained strong at Rs.676.82 crore as on March 31, 2021 (excluding goodwill created on account of demerger).
With low debt levels and strong cash accruals, its debt coverage indicators also stood comfortable marked by PBILDT interest coverage and TDGCA of 8.91x and 0.49x respectively during FY21 as compared with 12.03x and 0.74x respectively during FY20.

Revised hydrocarbon licensing and exploration policy to expedite E&P activities which entail good business prospects for oil & gas service providers
Government of India aims at reducing the country's dependence on oil imports from around 84% at present to 50% by 2030. Thus, to increase the pace of activities in the exploration and production (E&P) segment, it has formulated revised licensing policy, viz. 'Hydrocarbon Exploration and Licensing Policy (HELP)' to replace New Exploration and Licensing Policy (NELP). HELP is focused on uniform licensing for all hydrocarbons, bidding on revenue sharing basis rather than profit sharing basis which hitherto was requiring estimation of costs, Open Acreage Licensing Policy' wherein a bidder may apply to the government seeking exploration of any block and pricing freedom for gas produced in high risk / high pressure areas and reduced royalty rates to address issues such as licensing requirements, cost finalization and gas pricing which presently beleaguer the E&P industry. Furthermore, the government in 2016 also launched the 'Discovered Small Field' policy (DSF policy) to auction idle fields of Oil and Natural gas Corporation Limited (ONGC) and Oil India Ltd in order to expedite production from these small fields and recently launched its third round of bidding. These are likely to increase the pace of E&P activities which may also augur well for oil and gas field service providers like DIL through additional business opportunities.

Liquidity: Strong
DIL has strong liquidity characterized by strong cash accruals vis-à-vis its very low debt repayment obligations and healthy liquid investment and cash & bank balance. DIL is expected to earn gross cash accruals (GCA) of Rs.100-120 crore in FY22 as against debt repayment obligation of ~Rs.32 crore out of which It has already paid Rs.26.87 crore as on October 05, 2021. Cash flow from operation remained healthy at Rs.84.44 crore during FY21. Its liquidity is also supported by liquid investment and free cash and bank balance of Rs.106.43 crore as on September 30, 2021 (including margin money). Healthy cash accruals and liquid investment provide adequate headroom to DIL for future expansion. Average utilization of its fund based working capital limits stood low at ~15.61% for the last 12 months ended August 2021. Average utilization of its non-fund based working capital limits stood moderate at 58.55% during the last 12 months ended August 2021. Furthermore, it has also reduced its sanctioned fund based and non-fund based working capital limits from December 2020 month. Current ratio and quick ratio remained strong at 3.67x and 3.13x respectively as on March 31, 2021.

Key Rating Weaknesses

Moderate scale of operations with high competition in rigs business segment having susceptibility to volatile day rates

TOI of DIL declined from Rs.264.75 crore during FY20 to Rs.196.81 crore during FY21. TOI declined during FY21 on y-o-y basis due to impact of Covid-19 pandemic where in its workover rigs and IPMS segment were majorly impacted due to restricted movement due to nationwide lockdown. However, TOI grew to Rs.164.43 crore during H1FY22 as compared with Rs.93.88 crore during H1FY21. Going forward, with expectation of strong order flow majorly from the gas compression segment and deployment of unutilized assets as well as scaling up of operation in the REPL will support its growth in operation.

DIL's orders are availed through tendering; hence it remains exposed to competition in the industry, particularly in the workover rigs segment. The company also remains exposed to the risk of non-renewal of contracts on their expiry which is, however, inherent in the oil and gas industry as it is linked to the capex and growth plans of the major oil & gas E&P companies. Furthermore, the company also remains exposed to risks associated with volatility in day rates of rigs, which largely move in tandem with crude oil prices and hence are volatile in nature. However, over the years, DIL has been able to renew its orders and during 12 months orders that were renewed, were at same or higher day rates.

Moderate orderbook with client concentration risk

Over the past 3 years, order book of DIL has remained moderate. It has order book of Rs.374.90 crore as on September 30, 2021 as compared with Rs.377.53 crore as on June 30, 2020. Majority of the DIL's orderbook is concentrated from the orders from the ONGC / ONGC-led consortium. However, the same has been moderated with addition of new clients in and diversification of the business in REPL (subsidiary). DIL is executing one project from consortium led by ONGC, Indian Oil Corporation Limited (IOC) and Prabha Energy Private Limited (PEPL0 in the ratio of 55:20:25 for providing IPMS in one of the E&P project wherein PEPL is an operator. DIL has invested Rs.15.81 crore as on March 31, 2021 as optionally convertible preference shares.

On a standalone basis, revenue from ONGC forms ~70% of net sales during FY21 as compared with 35% during FY20 which exposes the company to risks associated with customer concentration. However, ONGC being one of the India's most strategically important central public sector undertaking (PSU) mitigates the risk to a certain extent. Furthermore, DIL has established track record of securing and renewal of contract with ONGC.

Elongated debtors days

Overall operating cycle remained elongated at 259 days during FY21 as compared with 190 days during FY20. DIL has fixed contractual payment terms with its customers. Overall debtors days increased from 214 days during FY20 to 263 days during FY21 due to decline in TOI alongwith collection being impacted by time take in amendment of contracts post its demerger process and name change. However, same has shown an improvement in H1FY22 with debtors remaining at March 2021 levels despite growth in TOI translating into debtors days of 120-140 days. Inventory level has gone up due to higher proportion of rigs and IPMS income whereby it needs to keep sufficient inventory of spares.

Analytical approach: Consolidated

Analytical approach has been revised from Standalone along-with factoring the operations of subsidiaries (whereby there was marginal operations) to Consolidated approach. Also, DIL has extended unconditional and irrevocable corporate guarantee to the bank facilities of Raas Equipment Private Limited (REPL).

Applicable Criteria

Policy on default recognition
Consolidation
Financial Ratios – Non financial Sector
Rating Methodology – Manufacturing Companies
Rating Methodology - Service Sector Companies
Liquidity Analysis of Non-financial sector entities
Rating Outlook and Credit Watch
Short Term Instruments

About the Company

Promoted by Mr Paras Savla and Mr Rupesh Savla in 1991, Ahmedabad based DIL (CIN: L14292GJ2006PLC049371) was engaged in majorly two business viz. firstly E&P of oil, gas, coal bed methane (CBM) and marginal oil fields and secondly in providing services such as Gas compression, Air compression, rigs (both work-over and drilling) and gas dehydration in the oil and gas industry.

In May 2018, DIL's Board of Directors proposed a scheme of demerger wherein it was proposed to segregate oil and gas services business (Services business) into a separate company i.e. Deep CH4 Limited (DCL) w.e.f. appointed date of April 01, 2017 and keeping oil and gas exploration business (E&P business) with DIL. As per scheme of demerger, entire assets & liabilities of erstwhile DIL had been transferred to DCL (which subsequently renamed to DIL) and DIL (which subsequently

renamed to DERL) was left with assets of around Rs.14 crore pertaining to E & P assets with corresponding net-worth. NCLT sanctioned the above-said scheme of demerger vide its order dated March 17, 2020 and the same was approved by registrar of companies (RoC) on August 04, 2020 leading to conclusion of scheme of demerger.
DIL has four subsidiaries namely Deep Onshore Service Private Limited (DOSPL), Raas Equipment Private Limited (REPL), Deep Onshore Drilling Services Private Limited (DODSPL) and Deep International DMCC (DMCC).

Brief Financials--Consolidated (Rs. crore)	FY20 (A)	FY21 (A)	H1FY22 (Published)
Total operating income	264.75	196.81	164.43
PBILDT	128.30	83.45	59.43
PAT	31.10	64.80	38.05
Adj. overall gearing (incl. CG extended) (times)	0.16	0.06	0.05
Interest coverage (times)	12.03	8.91	20.23

A: Audited

Status of non-cooperation with previous CRA: Not Applicable
Any other information: Not Applicable
Rating History for last three years: Please refer Annexure-2
Covenants of rated instruments / facility: Detailed explanation of covenants of the rated instrument//facilities is given in Annexure-4
Complexity level of various instruments rated for this company: Annexure- 5

Annexure-1: Details of Instruments / Facilities

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Fund-based - LT-Term Loan	-	-	January 2023	-	11.79	CARE A; Stable
Fund-based - LT-Cash Credit	-	-	-	-	15.00	CARE A; Stable
Non-fund-based - LT/ ST-Bank Guarantees	-	-	-	-	56.89	CARE A; Stable / CARE A1
Non-fund-based - ST-Credit Exposure Limit	-	-	-	-	-	Withdrawn
Fund-based - ST-Term loan	-	-	-	-	-	Withdrawn

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	Fund-based - LT-Term Loan	LT	11.79	CARE A; Stable	-	1)CARE A; Stable (01-Oct-20)	-	-
2	Fund-based - LT-Cash Credit	LT	15.00	CARE A; Stable	-	1)CARE A; Stable (01-Oct-20)	-	-
3	Non-fund-based - LT/ ST-Bank Guarantees	LT/ST*	56.89	CARE A; Stable / CARE A1	-	1)CARE A; Stable / CARE A1 (01-Oct-20)	-	-
4	Non-fund-based - ST-Credit Exposure Limit	ST	-	-	-	1)CARE A1 (01-Oct-20)	-	-
5	Fund-based - ST-Term loan	ST	-	-	-	1)CARE A1 (01-Oct-20)	-	-

** Long Term / Short Term*

Annexure 3: List of subsidiaries and joint ventures of SIL getting consolidated

Sr. No.	Name of the Entity	% holding by DIL@
1.	Deep International DMCC	100%
2.	Raas Equipment Private Limited	80%
3.	Deep Onshore Drilling Services Private Limited	74%
4.	Deep Onshore Services Private Limited	100%

@as on March 31, 2021

Annexure 4: Detailed explanation of covenants of the rated instrument//facilities

Name of the Instrument	Detailed explanation
A. Financial covenants	
	DIL to maintain followings: Debt to Equity: Not to exceed 1.50 Debt to PBIDT: Not to exceed 3.50 Interest Coverage: > 2 DSCR: > 1.25 Current Ratio: > 1.10
B. Non financial covenants	
	-

Annexure 5: Complexity level of various instruments rated for this company

Sr. No	Name of instrument	Complexity level
1	Fund-based - LT-Cash Credit	Simple
2	Fund-based - LT-Term Loan	Simple
3	Fund-based - ST-Term loan	Simple
4	Non-fund-based - LT/ ST-Bank Guarantees	Simple
5	Non-fund-based - ST-Credit Exposure Limit	Simple

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

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