Gujarat Alkalies and Chemicals Limited

May 07, 2021

Ratings

Facilities	Amount (Rs. crore)	Ratings[1]	Rating Action
Long term Bank Facilities	795.63 (enhanced from Rs.334.30)	**CARE AA+; Stable (Double A Plus; Outlook: Stable)**	**Reaffirmed**
Short term Bank Facilities	45.00	**CARE A1+ (A One Plus)**	**Reaffirmed**
Total	**840.63 (Rupees Eight Hundred Forty crore and Sixty-Three Lakhs only)**		

Details of facilities 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. CARE also notes that GACL has not availed any moratorium on its debt as a Covid relief measure, in line with Reserve Bank of India (RBI) guidelines, for servicing of its bank facilities which underlines its strong liquidity profile.

The long term rating of GACL, however, continues to be constrained by its presence in an inherently cyclical chlor-alkali industry and competition from imports despite presence of anti-dumping duty whose impact is reflected in the moderation in its scale of operations and profitability during FY20 (refers to period from April 1 to March 31) & 9MFY21 due to decline in electro-chemical unit (ECU)[2] realization. The long-term rating of GACL is further tempered on account of implementation and post-implementation salability risks associated with its ongoing large-size projects within the company as well as under its JV which has coincided with the cyclical downturn in the industry; albeit its 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 mitigates this risk to a certain extent. The long-term rating of GACL further continues to remain constrained on account of 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

- Sustained pressure on its profitability marked by PBILDT margin remaining below 20% on a sustained basis along with its adverse impact on its debt coverage indicators
- Heavy dumping of caustic soda products significantly impacting its ECU realization
- Significantly more than envisaged debt funded capex/investments leading to its overall gearing deteriorating to more than 0.50x on sustained basis
- 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

[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*

Detailed description of the key rating drivers

Key Rating Strengths

Dominant position in the domestic caustic soda industry

GACL is amongst the top three players engaged in manufacturing of caustic soda in the country with an installed capacity of 412,500 metric tonne per annum (MTPA) 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 on-going large-size capex within the company as well as 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 protect 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 favorable 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 some 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 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 decreased from Rs.6.67 per unit in FY19 to Rs.5.96 per unit in FY20 mainly on account of decrease in power generation cost from captive power plant (on account of decrease in prices of Natural Gas) as well as decrease in cost of power purchased from Gujarat Urja Vikas Nigam Ltd. (GUVNL). However, during 9MFY21, upon lower generation of power from its wind power plants on the back of low wind speed, average cost of power consumed by GACL has gone up upon drawing higher amount of costlier power from the grid.

Comfortable capital structure and strong debt coverage indicators

Despite moderation in its profitability during FY20 & 9MFY21, GACL's overall gearing continued to remain comfortable and improved marginally from 0.06 times as on March 31, 2019 to 0.04 times as on March 31, 2020. Its leverage has improved further in 9MFY21 with the scheduled repayment of its term loans. Also, its debt coverage indicators stood strong marked by interest coverage of 47.64 times and Total debt/ GCA of 0.39 times during FY20 & 47.11 times and 0.46 times during 9MFY21 respectively.

Liquidity: *Strong*

Liquidity of GACL is marked by strong accruals against negligible debt repayment obligations and presence of liquid investments to the tune of Rs.410 crore as on April 19, 2021. With an overall gearing of 0.04 times as of March 31, 2020, 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. Its' entirely unutilized bank lines are more than adequate to meet its incremental working capital needs over the next one year. The operating cycle also remained stable at 46 days during FY20 and current ratio remained healthy at 2.54x as on March 31, 2020. Also, GACL has 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; albeit stable long-term demand outlook

Profitability of the caustic soda industry had increased significantly during FY18 and FY19 largely driven by better sales realization of caustic soda products due to supply cuts from China and Europe on account of stricter environmental norms which had led to closure of some plants in the said countries. However, the prices softened during FY20 and 9MFY21 due to inherent cyclicality associated with the caustic soda industry which is also reflected from the sharp decline in its ECU realizations during past two years ended March 2021. Further as per data from CMIE, the imports of caustic soda after plunging by 50% in FY19 on y-o-y basis again grew by around 49% on y-o-y basis in FY20. As against 4-7% production growth recorded in the preceding three years ended FY20, growth slowed to about 2% in FY20. Moderation in demand from most user industries during FY20 along with a surge in imports restricted the growth in domestic caustic soda production. This has also led manufacturers to cut prices and hence prices of caustic soda lye and flakes plunged by around 20% in FY20 on y-o-y basis. The growth in caustic soda production further decelerate in FY21 on the back of sluggish demand from most user industries owing to the COVID-19 pandemic. Significant imports are from countries having surplus capacities like China, Iran, Turkey, US, Russia, etc. In order to help domestic manufacturers, Alkalies Manufacturers Association of India (AMAI) has 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. Further, extension of anti-dumping duty on caustic soda from certain countries may help in limiting the imports thereby benefitting the domestic players. In the long-term, once there is restoration of demand from end-use industries upon stabilization of economy post Covid-19 pandemic, there is an expectation of normal demand with better realization for caustic soda as it is a basic chemical in most of its user industries. The outlook for the domestic chlor-alkali industry is likely to remain stable in the long-term, mainly on account of expectation of gradual recovery in demand from its key end-use industries like pharmaceuticals, agrochemicals, alumina, organic chemicals, etc.

Moderation in profitability during FY20 & 9MFY21 after witnessing an improving trend during past few years
GACL's TOI moderated by ~13% in FY20 on y-o-y basis mainly on account of moderation in realization of caustic soda products during FY20 (especially after Q1FY20) due to the inherent cyclical nature of the industry. In line with that, PBILDT and PAT margin also moderated by 1,280 bps and 961 bps and stood at 23.78% and 11.80% respectively during FY20. Further, on account of disruption in businesses caused due to outbreak of Covid-19 pandemic and subsequent lockdown, TOI of GACL dipped by ~16% to Rs.1817 crore during 9MFY21 on Y-o-Y basis. Also, on the back of reduced sales realization of caustic soda products, its PBILDT margin and PAT margin further moderated to 17.58% and 7.22% during 9MFY21. The cyclical nature of GACL's business is also 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.

Susceptibility of its profitability to adverse movement in market price of gas and power cost along with competition from 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 32% of GACL's total operating income in FY20 (28% in FY19). The Indian chlor-alkali industry faces competition from cheap imports of lower power cost countries; however, the same is being partly mitigated by presence of anti-dumping duty on imports of caustic soda. Also, reduction in prices of natural gas should help in reducing its power cost in FY22.

Risk of adverse movement in foreign exchange rates; however, export volumes help to provide natural hedge
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 FY20, GACL imported raw materials and capital goods worth Rs.361.27 crore mainly from Canada and South Africa and had repayment liabilities of Rs.59.94 crore against which it made exports of Rs.334.79 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 in the backdrop of cyclical downturn in the caustic soda industry
GACL has plans to incur capex of around Rs.1,826 crore over the next two-years period ending FY23 which is expected to be funded by debt of Rs.1,500 crore and the balance through internal accruals / available liquidity. 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 previously 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 292,000 MTPA of caustic soda at Dahej, in the vicinity of GACL's existing plant. The joint venture would also establish a coal-based power plant (130 MW) to meet the power requirements on a captive basis. The cost of the JV project has been revised to Rs.2,280 crore from its earlier estimates of Rs.2,000 crore and is envisaged to be funded through debt and equity in the ratio of 2.33:1. GACL has already invested its committed equity contribution for this project in GNAL. The JV project achieved financial closure in February 2019 and as indicated by the management, as on July 25, 2020, the caustic soda plant had achieved 87%

physical progress while captive power plant had achieved 72% physical progress. In line with anticipated delay in its own capex plans due to Covid-19 pandemic, the GNAL project is also expected to be delayed. 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, 54,750 MTPA would be provided to NALCO's alumina refinery 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
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 among the top three players 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 412,500 metric tonne (MT) of caustic soda per annum as on March 31, 2021.
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 metric tonne per day (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.

(Rs.Crore)

Brief Financials (Consolidated)	FY19 (A)	FY20 (A)
Total operating income (TOI)	3,223	2,813
PBILDT	1,179	669
PAT	690	332
Overall gearing (times)	0.06	0.04
Interest coverage (times)	56.30	47.64

A: Audited

As per 9MFY21 (Prov.) results, GACL has reported a TOI of Rs.1817 crore with a PAT of Rs.131 crore vis-à-vis TOI of Rs.2175 crore with PAT of Rs.321 crore during 9MFY20 (Prov.).

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

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	665.63	CARE AA+; Stable
Fund-based - LT-Cash Credit	-	-	-	130.00	CARE AA+; Stable
Non-fund-based - ST-BG/LC	-	-	-	45.00	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	665.63	CARE AA+; Stable	-	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 (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+ (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.	Fund-based - LT-Cash Credit	Simple
2.	Non-fund-based - ST-BG/LC	Simple
3.	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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