Mangalore Chemicals And Fertilisers Limited

March 21, 2023

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Long-term bank facilities	465.50 (Reduced from 483.50)	CARE A-; Stable	Revised from CARE BBB+; Stable
Long-term / Short-term bank facilities	2,534.50 (Enhanced from 1,951.50)	CARE A-; Stable / CARE A2+	Revised from CARE BBB+; Stable / CARE A3+

Details of instruments/facilities in Annexure-1.

Rationale and key rating drivers

The revision in the ratings on the bank facilities of Mangalore Chemicals & Fertilizers Ltd (MCFL) factors expectation of sustainable improvement in the operating efficiencies of the company resulting in higher generation of gross cash accruals (GCAs).

The implementation of energy improvement programme (EIP) and its commissioning from September 2022 onwards led to decrease in MCFL's actual energy consumption to 5.8 Gcal/MT which earlier stood at 6.3 Gcal/MT. Energy consumption is expected to further improve to 5.5Gcal/MT in the next fiscal year. Furthermore, FY22 was the first fiscal year since when MCFL operated on Natural Gas as feedstock after receiving gas in December 2020 and the subsequent conversion of the urea manufacturing process by the company from naptha-based feedstock to natural gas. The allowable consumption norms for the company from December 2020 till December 2025 is 7.356Gcal/MT as per the New Urea Policy 2015.

The improved operating efficiencies driven by the above factors resulted in significant improved operating profitability since Q3FY23. The company is expected to derive significant benefits in FY23 leading to higher operating profitability in current fiscal over FY22 resultantly leading to improvement in gross cash accruals (GCAs) in FY23 despite plant shutdown undertaken in Q2FY23 for improvement of EIP. Normalized operations at current pooled gas prices from the next fiscal onwards is expected to generate incremental profitability and GCA.

The ratings also consider in the faster release of subsidy by the government in last couple of years leading to reduction in the outstanding subsidy receivables of the company and thereby reducing its reliance on the working capital borrowings. The ratings continue to derive strength from MCFL's established position in the Southern states of India with wide customer base, its long track record of operations in fertilizer industry and diversified product range. The ratings also take cognizance of the company being part of Adventz group with diversified business & operational synergies with other companies of the group in the fertilizer business. These rating strengths are, however, partially offset by its leveraged capital structure, high dependence on timely fertilizer subsidy receivable from the government and highly regulated nature of the fertilizer industry.

Rating sensitivities: Factors likely to lead to rating actions

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

- Improvement in its liquidity position along with healthy profitability and lower working capital borrowings and sustained improvement in credit metrics leading to net debt to PBILDT below 2.5x
- Substantial positive impact of any regulatory/policy change

Negative factors – Factors that could lead to negative rating action/downgrade:

- Any increase in the collection period leading to elongation in the operating cycle of more than 200 days on a sustained basis.
- Major debt-funded capex or increase in working capital borrowings to fund large subsidy receivables leading to Net debt to PBILDT deteriorating above 3.5x on sustained basis beyond FY23.
- Any adverse changes in the regulations governing the fertiliser industry

Analytical approach: Standalone

[1]Complete definition of the ratings assigned are available at www.careedge.in and other CARE Ratings Ltd.'s publications

Outlook: Stable

The rating outlook "Stable" indicates sustained improvement in the operating performance over the medium term leading to strengthening of the GCA deriving majorly from the recently executed EIP. Furthermore, the company's capital structure is expected to gradually ease over the medium term supported by expectation of incremental GCA.

Key strengths

Improved operating performance on the back of implementation of EIP and Conversion to Gas Based Plant

Since November 2020, the company has started receiving gas supply after successful laying of gas pipeline from Kochi, Kerala to MCFL, Mangalore. After successful testing and commissioning, urea manufacturing with the feedstock of natural gas had started since December 12, 2020. Before the commissioning of pipeline for supply of gas, the company has been receiving subsidy based on the criteria for naphtha-based units i.e. at current Govt. notified specific consumption (SEC) norms of 6.902 GCal/ MT and with the conversion of plant to Gas based plant, the subsidy will be received at 7.356 GCal/ MT (for the next five years from the date of commencement of gas based production, i.e., December 15, 2020). This is expected to result in additional profitability to the company till the time such SEC is allowable or latest by December 2025. The energy norm will be revised at 6.50 Gcal/MT after a period of five years after receipt of natural gas. With the receipt of gas, the company is also eligible for vintage allowance and also makes the company eligible to produce urea beyond Reassessed Capacity (RAC). FY22 was the first full year when MCFL operated on Natural Gas as feedstock after receiving gas in December 2020 and the subsequent conversion of the urea manufacturing process by the company from naptha-based feedstock to natural gas.

MCFL has completed its EIP much in advance in FY23 and its current energy consumption stands at 5.81 G.Cal/MT since Q2FY23 from earlier consumption of 6.3Gcal/MT. This leads to incremental accrual benefits on account of energy savings which is expected to increase from 1.02G.cal/MT in FY22 to 1.55- 1.7G.Cal/MT over next couple of years.

MCFL will produce 50,000 MTPA less Urea than its assessed capacity in FY23c due to loss of production during the interim period when plant shutdown was taken for implementation of EIP. This when compared to FY22 is 1,00,000 MTPA less production. However, despite the lower production, MCFL is estimated to achieve a higher absolute profitability (i.e. PBILDT) in FY23 owing to reduced energy consumption on account of EIP.

At current pooled gas prices and improvement in operating efficiencies, the company's PBILDT margin is estimated to be 9.10%-9.20% in FY23 improving from 7.45% in FY22 leading to estimated rise in GCA to approximately ₹200 crore in FY23. This is despite lower production in FY23 on account of plant shutdown (taken in Q2FY23 for implementation of EIP). These accruals are expected to further improve in the medium term when the plant will operate on a full year with complete production on EIP.

Established position, long track record of operations and wide customer base

MCFL commenced production of Ammonia & Urea in 1976, set up Ammonium bicarbonate plant in 1982, Di-ammonium phosphate and captive power plants in 1986, Sulphonated Naphthalene Formaldehyde plant in 2010 and Specialty Fertilizers plant in 2011.

MCFL is one of the leading companies catering to the fertilizer markets in Southern India. About 72% of the company's products are sold in the state of Karnataka, which meets about 11% of the needs of the farmers in the state. MCFL also maintains good market share in Kerala and a modest share in neighbouring states of Tamil Nadu, Andhra Pradesh, Telangana and Maharashtra. The fertilizers and plant nutrient products are marketed in these regions through a network of more than 4,000 dealers leading to wide customer. The company has been able to operate at a with total operating income estimated at ₹3500 crore in FY23 rising from ₹2896 crore in FY22. The rise in TOI was majorly on account of higher commodity prices which were a complete pass through.

The top 10 customers account for less than 10% of the total operating income signifying its diversified customer profile

Part of diversified group; however, moderation in liquidity and financial profile of the holding company in the past

MCFL is a part of the Adventz group which has interests in agri-inputs, engineering, infrastructure, real estate, consumer durables and services sectors. MCFL was earlier a UB group company, however, in May 2015, Zuari group acquired an additional 36.56% stake in MCFL over and above its earlier 16.47% stake to become the majority stakeholder in the company with 54.03% stake at present. As part of the Adventz group, MCFL is being benefitting from centralized procurement of key raw materials at group level leading to the benefit of economies of scale, a strong marketing and distribution network, resulting in better cost efficiencies, besides the savings in fixed overheads as a result of integrated operations with the other group companies which are in similar line of business. The parent company of MCFL, Zuari Agro Chemicals limited (ZACL), is the flagship company of the group and also acts as a holding company for the other group companies engaged in manufacturing of fertilizers while the non-fertilizers business are under another holding company, Zuari Global Limited (ZGL). ZACL's liquidity position deteriorated considerably in FY19 due to which it faced cash flow mismatches and was not able to timely service its debt repayment obligations. However, the company had been regular in meeting all its debt obligations since the beginning of January 2020 with the unsecured loans provided by the promoters, the release of the subsidy by Government of India (GoI) and collections from the market. Further, ZACL has raised funds by monetization of its assets (Goa Plant) to its Group company Paradeep phosphate Limited. The sale of these assets and the resultant fund raising help ZACL to deleverage its balance sheet. Further, MCFL is not dependent for financial support from its promoters as seen in the past since its acquisition and is an independent operating company and is only being benefitting by leveraging the group operational and business linkages with better reach to market. Furthermore, as on December 31, 2022, the total pledge stood at 63.06% of the promoter shareholding i.e. 38.23% of total outstanding shares.

Key weaknesses

Leveraged capital structure albeit improvement expected with higher accruals going forward

Capital structure of MCFL is leveraged on account of higher working capital borrowings. The net overall gearing (adjusted for acceptances) of the company which improved from 3.22x as on March 31, 2020 to 1.21x as on March 31, 2021 moderated to 1.79x as on March 31, 2022 owing to increased working capital borrowings on account of increased subsidy receivables year on year on the back of higher production in FY22 as MCFL produced beyond its reassessed capacity and also on account of increased commodity prices of Natural Gas and complex fertilizers. Net debt (including acceptances and adjusted for cash balance) which stood at ₹1752 crore at FY20 end and reduced to ₹735 crore at FY21 end, increased again to 1223 crore at FY22 end on account of higher working capital borrowings and also on account of marginal term debt which came due to energy improvement program. Accordingly, the net debt to ebitda levels which improved from 8.47 in FY20 to 3.51x in FY21, moderated to 5.66x in FY22 but is estimated to improve to 4.10x-4.20x by FY23 end and shall improve further to 3.06x on account of enhanced profitability when MCFL will operate the entire year on improved norms and accrue higher operating profits.

MCFL is expected to undertake projects of sulphuric acid and capacity expansion in DAP over next two to three years but are expected to be judicious with the mix of debt and equity/internal accruals to make sure the net debt to ebitda levels are maintained range bound till 3.5x and not moderate significantly. Any debt funded capital expenditure which has a significant impact on its credit profile or leverage indicators shall remain a key monitorable.

Regulated nature of the fertiliser industry and inherent delays associated with the release of the subsidy from the GoI:

The profitability of fertiliser manufacturers is influenced by the regulations governing various types of fertilisers, wherein, the government controls the fertiliser prices and provides subsidies. The quantum of subsidy receivables and delays associated with the receipt of the same inherently impacts the liquidity of the fertiliser industry, albeit differs with the type of fertilizer. During FY22, the fertilizer manufacturers curtailed the production of a few fertilizers, primarily DAP, wherein, few manufacturers incurred losses in FY22 due to the multi-year elevated input prices. However, there has been a sharp upward revision in the subsidy rates for all the nutrients for H1FY23. In the Union Budget for FY23, the GoI had initially provided for a total fertilizer subsidy of ₹1.05 lakh crore, which was subsequently enhanced by another ₹1.10 lakh crore in May 2022 looking at the elevated prices of key raw materials and natural gas, thereby taking the total fertilizer subsidy budget for FY23 to an all-time high of ₹2.15 lakh crore. The shortfall in the subsidy budget amid the volatile raw material prices may lead companies to resort to higher short-term borrowings to fund extended subsidy receivables. Regular intervention by the government to increase the subsidy budget, NPK nutrient rates, and minimum selling prices (MSP) help the sector to work in a regulated manner. The government is also planning to implement the second phase of DBT and is planning to explore the option of directly transferring the subsidy to the farmers' accounts, which can be beneficial for the fertilizer companies. However, it will have a substantial burden on the government finances, and accordingly, the rollout of the second phase of DBT can take some time.

Exposure towards fluctuations in raw material prices

MCFL procures Regasified Liquefied Natural Gas (RLNG) for the manufacturing of urea and imports phosphoric acid and ammonia for manufacture of complex fertilizers, and also imports Di-Ammonium Phosphate [DAP] and Muriate of Potash [MOP] besides other variants of complex fertilizers for trading. The raw materials and the traded goods derive their prices from the global crude price while international prices of DAP and MOP etc., are based on the demand and supply, therefore the turnover of the company fluctuates based on the global crude & commodity prices and are also vulnerable to exchange rate movement.

Vulnerability of sales to agro-climatic conditions

Financial health of the fertilizers manufacturers largely depends on the sowing season, vagaries of rainfall, status of subsidy outgo and the existing channel inventory level.

Liquidity: Adequate

The company derives its adequate liquidity from its healthy cash & cash equivalents, moderate cushion between GCA and repayment obligations. MCFL has total working capital limits to the tune of around ₹2,500 crore which are largely utilized in the form of Bills discounting, Letter of credit and buyers credit and is 78% utilized for last 12 months through February 2023.

Free cash and cash equivalents were ₹502 crore as on March 31, 2022 & as on December 31, 2022 was ₹352 crore. MCFL has scheduled repayments of ₹68 crore vis-à-vis estimated GCA of ₹200 crore during FY23. Even over the next two years debt repayments are ₹99 and ₹50 crore respectively which may be comfortable met out of the expected accruals over the medium term.

ESG Profile: Fertiliser manufacturing, particularly urea, has a significant carbon footprint as natural gas is the key raw material for hydrogen which goes into ammonia production and thereafter urea. GoI is expected to provide adequate policy support to the sector if the hydrogen requirement through the green route is mandated by GoI for the sector.
Agro-climatic risk remains a key risk for the sector given the fact that a significant portion of the Indian agriculture sector remains dependent on the monsoons and with changing climate patterns which may impact fertiliser offtake. The sector is also socially important, given its role in ensuring food security and rising concerns related to excessive usage of fertilisers and its impact.
MCFL has been undertaking its part on the environment, social and governance front as follows:

Environment

- As an ISO 14001 certified company, many environmental management programs have been implemented to improve the environmental performance of the Company. The Company has changed its Feedstock and Fuel from Naphtha to cleaner Natural Gas which has significantly reduced Sulphur Dioxide emissions.
- In addition to the existing 64 acres of green belt in manufacturing site, MCFL has planted 2,000 saplings during FY22.
- Online analyser for NOx measurement in Captive Power Plant stacks and main plant Boiler stacks were installed and commissioned during the year 2020-21 as per the Central Pollution Control Board (CPCB) guidelines.
- MCFL was awarded the **"Best Environment Protection Award"** in the Nitrogenous Fertilizer Plants category for the performance in year 2020-21 by Fertilizer Association of India. The award was received in the 57th Annual FAI Seminar held on December 01, 2021 in New Delhi.

Social

- Promotional campaigns like National Safety Day, Fire Service Week and Chemical Disaster Prevention Week were undertaken. Firefighting training is being conducted every Friday regularly to train the employees and also contractors' workman. This year basic firefighting training was imparted to employees through Karnataka State Fire and Emergency services.
- MCFL won 'Unnatha Suraksha Puraskara' - the 1st prize in the state level safety awards instituted by National Safety Council, Karnataka Chapter for the category of industries involved in manufacture of Iron, Steel, Aluminium, Cement & Fertilizers

Governance

- The Company is committed to good corporate governance practices. The Board endeavours to adhere to the standards set out by the Securities and Exchange Board of India (SEBI) on corporate governance practices and accordingly has implemented all the mandatory stipulations.

Applicable criteria

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

About the company and industry

Industry Classification

Macro Economic Indicator	Sector	Industry	Basic Industry
Commodities	Chemicals	Fertilizers & Agrochemicals	Fertilizers

MCFL is one of the largest manufacturers of chemical fertilizers in the state of Karnataka and around 72% of the company's products are sold in the state of Karnataka, which meets about 11% of the needs of the farmers of the state. MCFL also maintains good market share in Kerala and a modest share in neighbouring states of Tamil Nadu, Andhra Pradesh, Telangana and Maharashtra. Further, the company is also engaged in traded of complex fertilizers. MCFL has an aggregate installed capacity of 6.74 lakh metric tons per annum (MTPA). The company has a wide range of products that include Urea (capacity: 3.79 lakh MTPA), Di-Ammonium Phosphate (along with other phosphate and potassium (P&K) fertilizers – with capacity of 2.56 lakh MTPA) and Muriate of Potash, Granulated Fertilizers, Micronutrients, Soil Conditioners and Specialty Fertilizers. The company sells its product under the brand "Mangala". MCFL is a part of Adventz group with majority shareholding held by the group company Zuari Agro Chemicals limited (ZACL, 54.03% holding as on Dec 31, 2022).

Brief Financials (₹ crore)	March 31, 2021 (A)	March 31, 2022 (A)	9MFY23 (UA)
Total operating income	2,145.36	2,895.58	2478
PBILDT	209.59	215.84	181
PAT	67.10	87.86	67
Overall gearing (times)	1.85	2.53	NA
Interest coverage (times)	2.75	4.43	2.46

A: Audited; UA: Un-Audited; NA: Not available; Note: The above results are latest financial results available

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating history for the last three years: Please refer Annexure-2

Covenants of the rated instruments/facilities: Detailed explanation of the covenants of the rated instruments/facilities is given in Annexure-3

Complexity level of the various instruments rated: Annexure-4

Lender details: Annexure-5

Annexure-1: Details of instruments/facilities

Name of the Instrument	ISIN	Date of Issuance (DD-MM-YYYY)	Coupon Rate (%)	Maturity Date (DD-MM-YYYY)	Size of the Issue (₹ crore)	Rating Assigned along with Rating Outlook
Fund-based - LT-Term Loan		-	-	June 2030	465.50	CARE A-; Stable
Fund-based/Non-fund-based-LT/ST		-	-	-	2534.50	CARE A-; Stable / CARE A2+

Annexure-2: Rating history for the last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating History			
		Type	Amount Outstanding (₹ crore)	Rating	Date(s) and Rating(s) assigned in 2022-2023	Date(s) and Rating(s) assigned in 2021-2022	Date(s) and Rating(s) assigned in 2020-2021	Date(s) and Rating(s) assigned in 2019-2020
1	Fund-based - LT-Term Loan	LT	465.50	CARE A-; Stable	-	1)CARE BBB+; Stable (23-Dec-21)	1)CARE BBB+; Stable (25-Mar-21)	1)CARE BBB; Stable (09-Oct-19)

							2)CARE BBB; Stable (08-Oct-20)	
2	Fund-based/Non-fund-based-LT/ST	LT/ST*	2534.50	CARE A-; Stable / CARE A2+	-	1)CARE BBB+; Stable / CARE A3+ (23-Dec-21)	1)CARE BBB+; Stable / CARE A3+ (25-Mar-21) 2)CARE BBB; Stable / CARE A3 (08-Oct-20)	1)CARE BBB; Stable / CARE A3 (09-Oct-19)

*Long term/Short term.

Annexure-3: Detailed explanation of the covenants of the rated instruments/facilities: Not Applicable

Annexure-4: Complexity level of the various instruments rated

Sr. No.	Name of the Instrument	Complexity Level
1	Fund-based - LT-Term Loan	Simple
2	Fund-based/Non-fund-based-LT/ST	Simple

Annexure-5: Lender details

To view the lender wise details of bank facilities please click here

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

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About us:

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