Mangalore Chemicals and Fertilisers Limited

December 23, 2021

Ratings

Facilities/Instruments	Amount (Rs. crore)	Rating[1]	Rating Action
Long Term Bank Facilities	483.50	**CARE BBB+; Stable (Triple B Plus; Outlook: Stable)**	**Reaffirmed**
Long Term / Short Term Bank Facilities	1,951.50 (Enhanced from 1,401.50)	**CARE BBB+; Stable / CARE A3+ (Triple B Plus ; Outlook: Stable/ A Three Plus)**	**Reaffirmed**
Total Bank Facilities	**2,435.00 (Rs. Two Thousand Four Hundred Thirty-Five Crore Only)**		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The reaffirmation of the ratings assigned to the bank facilities of Mangalore Chemicals & Fertilisers Ltd (MCFL) continue to derive strength from its 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 rating also factors in the improvement in profitability of the company in FY21 (refers to period from April 01 to March 31) and H1FY22 (refers to period from April 01 to Sept 30) with the revision in the allowable consumption norms for the company and increased efficiency of operations subsequent to the conversion of the urea manufacturing process by the company from naphtha-based feedstock to natural gas after the receipt of the gas supply in Dec 2020. The ratings also take cognizance of reduction in MCFL's subsidy receivable levels, given the backlog clearance by the government, which improved the liquidity and reduced the reliance on external borrowings and ratings also factor 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 albeit improvement in FY21, high dependence on timely fertilizer subsidy receivable from the government and highly regulated nature of the fertilizer industry. The ratings are also constrained by the stressed liquidity and financial risk profile of the promoters of the company, Zuari Agro Chemicals Limited (ZACL).

Key Rating Sensitivities

Positive Factors (Factors that could lead to positive rating action/upgrade)

- Ability of the company to maintain its PBILDT margins of over 15% on a sustained basis going forward while successfully executing the energy improvement project leading to envisaged energy saving.
- Ability of the company to maintain total debt to PBILDT at 2.5x and below on a sustained basis going forward.

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.
- Any cost or time overruns witnessed in the execution of the planned Energy Improvement Project or further sizeable capex undertaken by the company adversely impacting the capital structure with the overall gearing exceeding 2.5x.
- Any sizeable financial support being extended by the company to its holding company or other group entities adversely impacting its capital structure or leads to any stress on its financial profile.

Detailed description of the key rating drivers

Key Rating Strengths

Established position and wide customer base

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. MCF has a wide customer base and the top 10 customers account for less than 10% of the total operating income.

Long track record of operations in fertilizer industry

MCFL was incorporated in July 1966 as a private limited company under the name Malabar Chemicals & Fertilizers Private Limited and was converted into a public company in 1967 and subsequently in 1971, the name of the company was changed to the present one. The company went public in 1972. MCFL commenced production of Ammonia & Urea in 1976, set up Ammonium bi-carbonate plant in 1982, Di-ammonium phosphate and captive power plants in 1986, Sulphonated Naphthalene Formaldehyde plant in 2010 and Specialty Fertilizers plant in 2011.

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

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%

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

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, 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 is in process of raising funds by monetization of its assets and has entered into certain transactions which are subject to statutory approvals. The sale of these assets and the resultant fund raising will 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.
Further, as on September 30, 2021, the shares are pledged by ZACL, ZACL has pledged 5,85,66,382 out of 6,40,28,382 shares in MCFL which is equivalent to 49.42% of total shareholding of MCFL.

Conversion to Gas Based Plant
As mandated by Department of Fertilizers, GOI, the Company has successfully completed gas conversion project of urea operations in June 2014 at a cost of around Rs.315 crore. The plant can therefore work on dual feed of natural gas and naphtha. The Company has signed a gas supply agreement with GAIL (India) Limited in February 2020 and a Gas Transmission Agreement with GAIL (India) Limited in February 2011. During November 2020, the company has received the gas supply after the successful completion of laying of gas pipeline from Kochi, Kerala to MCFL, Mangalore. After successful testing and commissioning, urea manufacturing with the feedstock of natural gas has started from 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 5 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 for the next 5 years till the time such SEC is allowable. The energy norm will be revised at 6.50 Gcal/MT after a period of five years after receipt of natural gas. Natural gas, being clean energy, increases the efficiency of the operations and will also reduce the maintenance cost of the company, which may lead to the additional savings. 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).

Moderate financial risk profile
During FY21, the total operating income of the company declined by ~21% y-o-y and has largely remained volatile over the past few years. The decline in income in FY21 was primarily on account of lower production & sales as the plant was shut due to change in feedstock from October 5, 2020 to December 12, 2020 on account of the preparations required to be made for the change in the feedstock from Naptha to Natural gas.
Profitability of fertilizer division has been range bound as the major fertilizer i.e. urea is totally regulated. In FY21 despite the drop in topline which happened due to production loss the EBITDA was at similar FY20 levels on account of feedstock changing to natural gas and hence higher efficiencies flowed in Q4FY21.
The total debt of the company decreased from Rs. 1506 cr as on March 31, 2020 to Rs. 884 crore as on March 31, 2021 owing to lower working capital requirements of the company due to release of subsidy backlog from the government. With significant reduction in the debt levels, the interest coverage indicators have improved and the same stood at 3.07x as on March 31, 2021 from 2.07x as on March 31, 2020 and the same is expected to improve going forward.
The company achieved a total operating income of Rs. 1427 crore in H1FY22 as against Rs. 1234 crore in H1FY21 registering a growth of 16% y-o-y driven by higher production & sale of urea and complex fertilizers. However, the PBILDT margin of the company stood at 9.25% in H1FY22 as against 12.25% in H1FY21 primarily on account of higher raw material prices.

Adequate liquidity position
The liquidity profile of MCFL is adequate with current ratio of 1.01x (PY: 1.02x). Free cash as on March 2021 is Rs. 336 Crore & as on Sep 30, 2021 is Rs. 228 Crores. MCFL has scheduled repayments of Rs. 78.71 cr vis-à-vis projected GCA of Rs. 124 cr during FY22 and Rs 39.42 crore has been repaid so far till Sep 2021. MCFL repaid Rs. 53.07 Crore term loan up to Nov 21 out of Rs. 78.72 crore due for FY22.
Further, MCFL has not availed of the moratorium for the servicing of its bank facilities last year, however, has planned capex in the coming years to be financed from the external borrowings and internal accruals of the company. The operations of the company are working capital intensive majorly owing to the high collection days with average receivables days of the company at 200 days for FY20 which reduced substantially to 164 days by the end of March 2021 on account of release of subsidy as discussed above. Normally, suppliers are extending 30 days to 60 days credit against LCs. After that, LCs are paid by converting into Buyers Credit/Suppliers credit/ LC Bill Discounting and this will be repaid within 120 days to 180 days. MCFL has the sanctioned working capital limits (including CC limits and non-fund-based limits) for an amount of Rs. 1700 cr for the business operations with average utilization of ~80% during last 12 months ended Oct 2021.

Key Rating Weaknesses

Leveraged capital structure albeit improvement in FY21

The overall gearing of the company improved however, continued to remain high at 1.85x as on Mar 31, 2021 (PY: 2.77x as on March 31, 2020). The total debt of the company decreased from Rs. 1506 cr as on March 31, 2020 to Rs. 884 crore as on March 31, 2021 owing to lower working capital requirements of the company due to clearance of the subsidy backlog from the government.

The company also plans to undertake capital expenditure for energy savings projects for which debt will be drawn in FY22 in order to comply with energy efficiency norms which will be applicable to the company going ahead.

Highly regulated fertilizer industry

GoI subsidizes the sale of fertilizers and exercises control over distribution to a large extent. While, the complex fertilizers have been decontrolled with prices being governed by the market dynamics, urea has been kept out of the Nutrient Based Subsidy (NBS) scheme with its Maximum Retail Price (MRP) being decided by the government. This makes the fertilizer companies and their profitability vulnerable to timely receipt of subsidy from GoI.

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.

Project Risk associated with Energy Improvement Project

The company has undertaken an Energy Improvement Project (EIP) to further reduce the energy consumption for the manufacturing of Urea. The project is expected to be commissioned in Q1FY23. EIP will further reduce the consumption of feedstock in the production of ammonia by adopting new technology which requires replacement/addition of some of the equipment in ammonia plant. The EIP is expected to reduce the energy consumption from the current level of actual consumption. Since investment for natural gas project was completed in June 2014 the preset energy norm of 7.356 Gcal/ MT will be made available to MCFL when it has started operating on natural gas. Also, according to the management not only the energy consumption will be lowered but also the normal maintenance expense will be reduced by operating the plant on natural gas. The company is expected to incur capex of around Rs. 395 cr towards EIP with an estimated debt funding of Rs.280 cr and the remaining from the internal cash generations. The company incurred around Rs. 30 cr towards EIP implementation during FY20 financed by the internal accruals of the company and has incurred around Rs. 141 cr up to March 31, 2021 and Rs. 221 cr in expected to be incurred in FY22. Debt is completely tied up for the project. The ability of the company to successfully execute the energy saving project within the envisaged cost and time without adversely impacting its capital structure will continue to be a key rating sensitivity.

Analytical Approach: Standalone

Applicable criteria

[Criteria on assigning 'outlook' and 'credit watch' to Credit Ratings]

[CARE's Policy on Default Recognition]

[Financial Ratios - Non-Financial Sector]

[Liquidity Analysis of Non-Financial Sector Analysis]

[Criteria for Short-term Instruments]

[Rating Methodology - Manufacturing Companies]

[Rating Methodology: Consolidation and Factoring Linkages in Ratings]

[Rating Methodology - Fertilizer Companies]

About the Company

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, 60.21% holding as on Sep 30, 2021).

Brief Financials (Rs. crore)	FY20 (A)	FY21 (A)	H1FY22 (UA)
Total operating income	2,734	2,170	1,427
PBILDT	230	234	132
PAT	65	67	53
Overall gearing (times)	3.61	1.85	1.84
Interest coverage (times)	2.07	3.07	5.65

A: Audited, UA: Un-Audited

Status of non-cooperation with previous CRA: NA

Any other information: Not Applicable.

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

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

Complexity level of various instruments rated for this company: Annexure 4

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	-	-	-	March 2024	483.50	CARE BBB+; Stable
Fund-based/Non-fund-based-LT/ST	-	-	-	-	1951.50	CARE BBB+; Stable / CARE A3+

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	483.50	CARE BBB+; Stable	-	1)CARE BBB+; Stable (25-Mar-21) 2)CARE BBB; Stable (08-Oct-20)	1)CARE BBB; Stable (09-Oct-19)	1)CARE BBB+; Stable (22-Mar-19) 2)CARE BBB+; Stable (03-Oct-18) 3)CARE BBB; Stable (06-Apr-18)
2	Fund-based/Non-fund-based-LT/ST	LT/ST*	1951.50	CARE BBB+; Stable / CARE A3+	-	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)	1)CARE BBB+; Stable / CARE A3+ (22-Mar-19) 2)CARE BBB+; Stable / CARE A3+ (03-Oct-18) 3)CARE BBB; Stable / CARE A3 (06-Apr-18)

* Long Term / Short Term

Annexure-3: Detailed explanation of covenants of the rated instrument / facilities: NA

Annexure 4: Complexity level of various instruments rated for this company

Sr. No	Name of instrument	Complexity level
1	Fund-based - LT-Term Loan	Simple
2	Fund-based/Non-fund-based-LT/ST	Simple

Annexure 5: Bank Lender Details for this Company: NA

Note on complexity levels of the rated instrument: CARE Ratings Ltd. 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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