Mangalore Chemicals and Fertilizers Limited

March 25, 2021

Ratings

Facilities/Instruments	Amount (Rs. crore)	Ratings	Rating Action
Long Term Bank Facilities	535.50	CARE BBB+; Stable (Triple B Plus; Outlook: Stable)	Revised from CARE BBB; Stable (Triple B; Outlook: Stable)
Long Term / Short Term Bank Facilities	1,899.50	CARE BBB+; Stable / CARE A3+ (Triple B Plus; Outlook: Stable/ A Three Plus)	Revised from CARE BBB; Stable / CARE A3 (Triple B; Outlook: Stable / A Three)
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 revision in the ratings assigned to the bank facilities of Mangalore Chemicals & Fertilizers Ltd (MCFL) takes into account the likely improvement in the financial and operational performance of the company on account of receipt of the gas supply post the successful completion of laying of gas pipeline from Kochi to Mangalore by GAIL and the subsequent conversion of the urea manufacturing process by the company from naptha based feedstock to natural gas. The envisaged improvement in the financial profile of the company shall happen with the revision in the allowable consumption norms for the company and increased efficiency of operations. The revision in the ratings also factor in the recent release of subsidy by the government leading to significant reduction in the outstanding subsidy receivables of the company and thereby reducing its reliance on the working capital borrowings, which shall further lead to lower interest outgo and improvement in the interest coverage indicators going ahead. 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. The ratings are also constrained by the stressed liquidity and financial risk profile of the promoters of the company, Zuari Agro Chemicals Limited (ZACL).

MCFL has not sought any moratorium on payments from its lenders as part of the COVID-19 - Regulatory Package announced by the RBI on March 27, 2020 and May 22, 2020.

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 65% of the company's products are sold in the state of Karnataka, which meets about 13% 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.

Envisaged higher operational efficiency post receipt of gas supply

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 and gas transmission agreement with GAIL (India) Limited in February 2020. 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 of Rs. 150 per MT and also makes the company eligible to produce urea beyond Reassessed Capacity (RAC).

Improvement in the financial risk profile

During FY20 (refers to period from April 01 to March 31), the total operating income of the company declined by 11.37% y-o-y and has largely remained volatile over the past few years. The decline in income in FY20 is majorly on account of suppressed realizations in line with decline in raw material prices although the quantity of the fertilizers sold increased during the year. Higher Production (by 30,000 MTs) and sales of manufactured Urea by 23598 MTs during FY20 against FY19, lower commodity prices and comparatively favorable season in the marketing areas of Karnataka, Tamil Nadu, Andhra Pradesh and Telangana coupled with higher increase in saving in energy consumption led to improved PBILDT margins in FY20 at 8.75% as compared to 6.56% during FY19. The improvement in the PBILDT margins coupled with the stagnant interest cost with lower working capital borrowings outstanding resulted in increase in PAT to Rs. 65.75 cr during FY20 as against Rs. 32.88 cr during FY19.

During 9MFY21 (refers to period from April 01 to Dec 31), the company reported income from operations at Rs. 1567.99 cr as compared to Rs. 2166.24 cr during 9MFY20 on account of the production loss and plant shutdown in Q3FY21 with the process of feedstock change being undertaken from naptha to natural gas. However, the PBILDT margin of the company improved to 11.57% during 9MFY21 as against 8.90% during 9MFY20 on account of subdued prices of naptha, furnance oil and phosphoric acid during H1FY21. The PAT margin also stood at 3.34% during 9MFY21 as compared to 1.88% during 9MFY20.

Part of diversified group albeit 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% 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, as on December 31, 2020, ZACL has pledged 99.09% of its holding in MCFL of 6,34,46,382 shares, which is equivalent to 54.03% of total shareholding of MCFL.

Adequate liquidity position
The liquidity profile of MCFL is adequate with current ratio of 1.02x (PY: 1.05x) and unencumbered cash and bank balances of Rs. 212.99 cr as on March 31, 2020 (PY: Rs. 41.65 cr) on account of the funds received from short term loan under Special Banking Arrangement (SBA) during March 2020. The company has cash and bank balances (including fixed deposits) of Rs. 443 cr as on February 28, 2021 (which also includes subsidy received from the government). Further, MCFL has not availed of the moratorium for the servicing of its bank facilities, 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 (163 days for FY19) on account of subsidy receivables outstanding from GoI, which stood at Rs. 1107.42 cr as on March 31, 2020 (40.50% of total operating income) as against Rs. 1115.43 cr of subsidy as on March 31, 2019 (36.16% of total operating income of the company). However, the subsidy receivables of the company have substantially declined to Rs. 416.37 cr as on February 28, 2021 on account of the release of the subsidy by the government under Atmanirbhar 3.0 stimulus. This is expected to significantly improve the collection period of the company, while reducing its reliance on the working capital borrowings. MCFL has the sanctioned working capital limits (including CC limits and non-fund based limits) for an amount of Rs. 1380 cr for the business operations with average utilization of 87.66% during last 12 months ended December 2020.

Key Rating Weaknesses
Leveraged capital structure albeit reduction in working capital borrowings in 9MFY21
The overall gearing of the company improved, however, continued to remain high at 2.77x as on March 31, 2020 as against 3.47x as on March 31, 2019. The total debt of the company decreased to Rs. 1506.22 cr as on March 31, 2020 from Rs. 1713.02 cr as on March 31, 2019 owing to lower working capital requirements of the company due to release of subsidy and also on account of the lower commodity prices during the year. The total debt includes the loan received by the company under SBA which is bridge funding for the delay in receipt of subsidy. The repayment of such loan shall be made directly by the government to the lenders and the amount so paid by the government shall be adjusted from the subsidy receivable (due from government). The balance outstanding as on March 31, 2020 is Rs. 232.73 cr (Rs. 175.41 cr as on March 31, 2019, Rs.96.88 cr as on March 31, 2018). The loan carries an interest rate of 6.15% p.a., which is fully borne and paid directly by GoI to the bank. However, the loan was subsequently cleared off in May 2020.
The total debt outstanding of the company, however, stood lower at Rs. 1305.57 cr comprising of Rs. 221.20 cr as term loans and Rs. 1084.37 cr as the working capital borrowings as on December 31, 2020. Further, on account of the release of subsidy by the government, the subsidy receivables of the company have significantly declined to Rs. 416.37 cr as on February 28, 2021 as compared to Rs. 1107.42 cr as on March 31, 2020, reducing its reliance on working capital borrowings. The company also plans to undertake capital expenditure for energy savings projects in the next couple of years in order to comply with energy efficiency norms which will be applicable to the company going ahead.

Project Risk associated with Energy Improvement Project
The company is planning to undertake an Energy Improvement Project (EIP) to further reduce the energy consumption for the manufacturing of Urea. The project is expected to be commissioned in Q4FY22. EIP is expected to 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 (actual consumption of 6.263 Gcal/MT during FY20 and 6.289 Gcal/MT during FY19) on naphtha to 5.50 Gcal/MT when it operates on natural gas [NG]. 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 has been incurring small amount of capex towards the project with ~Rs. 105 cr being incurred till December 2020 entirely financed by the internal accruals. 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.

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 naphtha, furnace oil and Regasified Liquified 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.

Industry Outlook
The underlying macros for the Indian fertilizer industry look promising despite the coronavirus pandemic and macroeconomic uncertainty. With surplus reservoirs levels, record high kharif crop sowing and plentiful rainfall during the monsoon season, demand for the procurement of fertilizers has been promising till date. Sales have increased sharply by 25.1% during FY21 (April-August) and going forward with the increase in liquidity of farmers, good prospect for the rabi season coupled with the revival of the rural economy, demand for fertilizers for the rest of FY21 seems sanguine for the industry.
Overall fertilizers production has increased by 3% during 10MFY21 after registering a growth of 4.2% during 10MFY20. The country witnessed an on-time arrival of Southwest monsoon, followed by a quick spread across the region which has resulted in higher sowing thus augmenting the sales of fertilizers which has led to an increase in production. Increase in production can also be ascribed to restocking activities undertaken by the manufacturers in order to keep up with the sharp increase in fertilizer sales witnessed during the year. On a monthly basis, production increased by 2.7% during January 2021 due to build-up of stocks by companies and increase in production of Complex fertilizers and DAP. The demand for these fertilizers is usually high during the rabi season. Imports have increased sharply by 12.6% due to the sharp increase in urea and MOP imports. Import dependence (imports as a proportion of production plus imports) has increased from 36% during 10M-FY20 to 38% during 10MFY21.
Production of urea increased by 2.3% during 10M-FY21 due to favorable weather and market conditions. Urea is largely sourced domestically; however, high demand necessitates imports which have risen sharply by 16.6% to supplement the increase in demand. Import dependence of urea (imports as a proportion of production plus imports) has increased to 32% during 10MFY21 compared with 29% during 10MFY20.

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 60% of the company’s products are sold in the state of Karnataka, which meets about 20% 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 December 31, 2020) (earlier stake (53.03%) held by Zuari Fertilizers & Chemicals Limited which was, merged with ZACL w.e.f. November 13, 2017). It was earlier a United Breweries (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

Brief Financials (Rs. crore)	FY19 (A)	FY20 (A)	9MFY21 (UA)
Total operating income	3084.82	2733.85	1567.99
PBILDT	202.34	239.30	181.48
PAT	32.88	65.75	52.37
Overall gearing (times)	3.47	2.77	2.19
Interest coverage (times)	1.82	2.15	2.76

A: Audited, UA: Unaudited

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 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	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	535.50	CARE BBB+; Stable
Fund-based/Non-fund-based-LT/ST	-	-	-	1899.50	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 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018
1.	Fund-based - LT-Term Loan	LT	535.50	CARE BBB+; Stable	1)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)	1)CARE BBB; Stable (18-May-17)
2.	Fund-based/Non-fund-based-LT/ST	LT/ST	1899.50	CARE BBB+; Stable / CARE A3+	1)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)	1)CARE BBB; Stable / CARE A3 (18-May-17)

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

Name of the Instrument	Detailed explanation
A. Financial covenants	
Term Loan	The Indian currency term loan is secured by first pari-passu charge on all movable and immovable fixed assets (along with working capital lenders) other than fixed assets exclusively charged to other lenders.
B. Non-financial covenants	
1. Non-fund based limits	The non-fund based limits include buyer's/suppliers' credit, cash credit and letter of credit/bank guarantee.

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

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