Gujarat Alkalies and Chemicals Limited

June 27, 2022

Ratings

Facilities/Instruments	Amount (₹ crore)	Ratings[1]	Rating Action
Long-term bank facilities	723.98 (Reduced from 764.04)	**CARE AA+; Stable (Double A Plus; Outlook: Stable)**	Reaffirmed
Short-term bank facilities	45.00	**CARE A1+ (A One Plus)**	Reaffirmed
Total facilities	**768.98 (₹ Seven hundred sixty-eight crore and ninety-eight lakh only)**		
Commercial paper issue	100.00	**CARE A1+ (A One Plus)**	Reaffirmed
Total instruments	**100.00 (₹ One hundred crore only)**		

Details of facilities/instruments in Annexure-1.

Detailed rationale and key rating drivers

The ratings assigned to the bank facilities and instrument of Gujarat Alkalies and Chemicals Limited (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 draw comfort from the improvement in its profitability during FY22 (refers to the period from April 1 to March 31), after witnessing significant moderation during the preceding two years, the commencement of commercial operations of the project for manufacturing caustic soda in its joint venture (JV) with National Aluminium Company Limited (NALCO), viz, GACL-NALCO Alkalies & Chemicals Pvt Ltd (GNAL), and the execution of an off-take agreement with NALCO, a leading player in the domestic aluminium industry, for a large part of the envisaged production of caustic soda in the JV.

The long-term rating of GACL, however, continues to be constrained due to its presence in an inherently cyclical chlor-alkali industry, as evident from the volatile electrochemical unit (ECU)[2] realisations. Moreover, the ratings are constrained due to the competition from imports; the susceptibility of its profitability to adverse movement in the market prices of gas and power, which constitutes a significant part of its cost structure; and the risk related to adverse movement in foreign exchange rates. Furthermore, the long-term rating is also tempered by the implementation and post-implementation salability risks associated with its large-sized own ongoing projects as well as those under its JV.

Rating sensitivities

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

- Significant volume-driven growth in its scale of operations along with diversification of its operations to other chemical products, thereby insulating itself from the inherent cyclicality of the chlor-alkali industry, and thus, earning a healthy PBILDT margin on a sustained basis; along with maintaining a total debt/PBILDT below 0.25x on a sustained basis.
- Gaining a significant market leadership position in the caustic soda industry while securing a significant portion of its power requirement (its major cost component) through captive low-cost sources, along with a greater share of value-added products in its sales mix, to consistently earn a high PBILDT margin with greater resilience, despite the impact of the inherent cyclicality in the chlor-alkali industry and the competition from imports.
- Improvement in its return on capital employed (RoCE) to more than 25% on a sustained basis.

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

- Sustained pressure on its profitability, marked by the PBILDT margin remaining below 20% on a sustained basis, along with its adverse impact on its debt coverage indicators, leading to a deterioration in the total debt/PBILDT beyond 2.50x on a sustained basis.
- Heavy dumping of caustic soda products significantly impacting its ECU realisation.
- Significantly more-than-envisaged debt-funded capex/investments, leading to its overall gearing deteriorating to more than 0.50x on a sustained basis.
- Any tightening of the prevailing pollution control and environmental norms and/or regulatory ban on the production and sales of certain major products, thereby significantly impacting the company's business and profitability.

[1]Complete definition of the ratings assigned are available at www.careedge.in and other CARE Ratings Ltd.'s 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 the second-largest player in caustic soda in the country, with an installed capacity (for caustic soda lye and caustic soda flakes combined) of around 1,750 metric tonne per day (MTPD) as on March 31, 2022, at its plants in Vadodara and Dahej, in Gujarat. GACL has gradually built a strong position in the industry through the continuous expansion of production capacities to cater to the growing demand for its products over the past four decades. It has already commissioned its caustic soda project in the JV with NALCO for 800-MTPD and is also focusing on expanding its own caustic soda capacity by 425 MTPD, at Dahej, which is expected to further consolidate its position in the chlor-alkali industry in India.
Over the years, GACL has also introduced new chlorine derivatives (downstream products) for higher captive utilisation of chlorine, an essential by-product generated during the manufacturing of caustic soda. The company has more than 36 products in its basket, which has enabled it to leverage upon its large production capacity and protect its profitability from the effects of the volatility in chlorine prices, to some extent.

Integrated operations and diversified customer base: The operations of GACL are well-integrated, with the byproduct of one process used as a raw material for another, thus enabling the company to optimally utilise its large production capacity. It also protects GACL's profitability, to an extent, from the effects of the inherent cyclicality in the demand for its major products, as the adverse demand scenario for one set of products is countered by the favourable movement in other products. GACL's products find application in various processes across a diverse range of industries, including textile, pulp and paper, alumina, soaps and detergents, rayon, fertilisers, petroleum, fertilisers, pharmaceuticals, agrochemicals, water treatment, ink, paint, etc. This allows the company to cater to a diversified customer base, and thus, helps it counter the slowdown in any 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 because of its membrane cell technology used for the electrolysis of salt, which consumes one-third less power as compared to the traditional mercury cell technology, and is also less polluting. The captive power plant for meeting part of its energy requirements and the investment in windmills and solar power plants to offset the higher cost of power purchased from the market, aids its cost structure. The total installed capacity of the solar power plant stood at 35 MW at the Charanka Solar Park – Patan, 640 kW floating solar power plant on the reservoir of the captive power plant, and 220 kW solar rooftop installations at its Dahej complex, apart from a wind power 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 Limited (GIPCL; rated CARE AA-; Stable/CARE A1+). The average cost of power consumed by GACL stood at ₹7.12 per unit in FY22.

Improvement in profitability during FY22 after moderation in the past two years: owing to cyclical nature of business: GACL's total operating income (TOI), after witnessing a moderation of around 14% in FY20 and around 12% in FY21 on a y-o-y basis, improved by 56% on a y-o-y basis in FY22, mainly because of the improved realisation of caustic soda products due to the inherent cyclical nature of the industry. In line with this, the PBILDT and profit-after-tax (PAT) margin also improved by 1,246 bps and 820 bps, respectively, on a y-o-y basis and stood at 26.38% and 14.91%, respectively, during FY22. Its profit margins, despite the significant improvement, did not reach the FY19 levels, owing to the elevated prices of salt, potassium chloride, rock phosphate, and aluminium chloride (which comprise a large part of the total cost of materials consumed).

Comfortable capital structure and strong debt coverage indicators: GACL's capital structure remained comfortable, with an overall gearing of 0.10x as on March 31, 2022. Also, its debt coverage indicators stood strong, marked by interest coverage of more than 150x while its total debt/PBILDT stood at 0.60x during FY22, as against 1.49x during FY21, despite the availment of debt for its ongoing capex owing to the improved profitability during FY22. Its debt coverage indicators are expected to moderate over the medium term because of the expected availment of term debt to complete its ongoing capex and the consolidation of the JV, ie, GNAL, which has recently commenced operations of its pre-dominantly debt-funded project. However, the debt coverage indicators are expected to be supported by improved profitability on the back of improved demand prospects from end-user industries.

Key rating weaknesses

Presence in an inherently cyclical caustic soda industry: The caustic soda industry is inherently cyclical. The industry witnessed a cyclical downturn after H1FY20, which was further exacerbated during FY21 owing to the COVID-19 pandemic-related contraction in demand from major end-use industries. ECU realisations dropped to a decadal low level of around ₹23,000 per metric tonne (MT) in FY21. However, from March 2021 onwards, the sector has seen revival with an improvement in demand from end-user industries and better availability of raw materials, leading to a rebound in the ECU realisations to around ₹55,000 per MT currently, which augurs well for GACL.

Susceptibility of its profitability to adverse movement in the prices of gas and power and the threat of cheaper imports: GACL's profitability is susceptible to adverse movements in the market prices of gas and power since electrolysis is an energy-intensive process and power cost constitutes a significant part of its cost structure. Power cost constituted around 29% of GACL's TOI in FY22 (32% in FY21). Besides, the Indian chlor-alkali industry faces competition from cheap imports from lower power-cost countries. Of India's total imports, more than 90% are contributed by Japan, China, Korea, Qatar, and Iran, with over 50% imports from Japan alone, mainly due to the tax treaty and lower logistics cost to cater to the requirement of aluminium manufacturers on the Eastern coast of India. Domestic manufacturers have sought a level-playing field from the government by way of an increase in customs duty on caustic soda imports, a GST structure for electricity taxes, and the imposition of export duty on salt, to effectively compete against imports. Furthermore, there was an anti-dumping duty on caustic soda imports from China, ranging up to US$ 48.39 per MT until November 2020, which helped limit the imports, thereby benefitting domestic players. At the request of domestic chlor-alkali manufacturers, the Ministry of Commerce, in December 2020, initiated an anti-dumping investigation on the imports of caustic soda from Japan, Iran, Qatar, and Oman.

Risk of adverse movement in foreign exchange rates: GACL is exposed to the risk of adverse movement in foreign exchange rates because of its long-term borrowings denominated in US Dollar, raised for part-funding of its capex plans. Furthermore, as a matter of policy, GACL does not hedge its foreign currency exposure. During FY22, GACL imported raw materials worth ₹222.21 crore and had term debt repayment liabilities of ₹63.42 crore, against which it made exports of around ₹500 crore, thus providing a natural hedge to its foreign currency exposure to a large extent. To mitigate its forex risk, the company has opened an Exchange Earners' Foreign Currency Account (EEFC) US Dollar account, as per the Reserve Bank of India (RBI) guidelines, to deposit the export earnings in the said account and to utilise the same for making US Dollar repayments towards servicing its foreign currency debt and import pay-outs, which mitigates the exchange rate risk to a large extent.

Large-sized ongoing capex plans along with associated salability risk: GACL has a capex plan of around ₹1,160 crore over the next three-year period ending March 31, 2025, which is expected to be funded by a debt of ₹400.00 crore (already tied-up) and the balance through internal accruals and available liquidity. The progress of the projects was impacted due to the COVID-19 pandemic because of which the projects are expected to be completed with delay from their previously envisaged completion timelines. Nevertheless, most of the company's projects are at an advanced stage and are likely to be completed in the current fiscal, i.e., FY23. Hence, no major hindrance is expected to the funding and implementation of the said capex. Post FY23, the company has no major capex plans, except for the setting up of a chloro-toluene plant.
Furthermore, GACL's project under the 60:40 JV with NALCO, viz, GNAL, for setting up a manufacturing unit for producing an 800-MTPD of caustic soda plant along with a 130-MW captive power plant at Dahej, in the vicinity of GACL's existing plant, has commissioned operations on March 30, 2022. From the caustic soda produced from the plant, at least 450 MTPD is agreed to be sold to NALCO (Odisha plant) at market rates, as against the earlier envisaged 300 MTPD, and the remaining will be sold in the open market; the marketing rights of which will vest with GACL. The unit will also contain manufacturing facilities for other downstream products and for the utilisation of chlorine, an essential byproduct generated for manufacturing caustic soda. The balance quantities of all the products manufactured by the JV will be sold by GACL as the sole commission selling agent of the JV. Thus, GACL will be exposed to marketing risks as well as the risk of chlorine disposal for GNAL. However, GACL's significant experience and presence in the industry, along with the 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 with the commissioning of these projects.

Liquidity: Strong

The liquidity of GACL is marked by strong accruals and the presence of liquid investments to the tune of ₹348 crore as on March 31, 2022. With an overall gearing of 0.10x as of March 31, 2022, it has sufficient gearing headroom to avail additional debt for its capex; although over the past few years, the company has largely funded its capex through its healthy internal cash accruals. Nonetheless, the debt required for its ongoing capex has already been tied-up by the company. The company's entirely unutilised bank lines are more than adequate to meet its incremental working capital needs over the next one year. The operating cycle also improved and remained comfortable, at 27 days during FY22, and the current ratio remained healthy, at 1.48x as on March 31, 2022. Also, its cash flow from operations remained healthy, at ₹793 crore during FY22.

Analytical approach: Consolidated

CARE Ratings Limited (CARE Ratings) has considered the 'Consolidated' analytical approach for the ratings of GACL because of the strong operational and financial linkages of GACL with its JV company, i.e., GACL-NALCO Alkalies and Chemicals Limited (GNAL), which has set 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 Ratings' policy on Default Recognition
Criteria for short-term instruments
Liquidity analysis of non-financial sector entities
Rating methodology – Consolidation
Rating methodology – Manufacturing companies
Financial ratios – Non-financial sector

About the company

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, 2022, GoG as the promoter, through its various undertakings, held a 46.28% equity in the company, the largest being through Gujarat State Investments Ltd (GSIL) with 20.87% holding. GACL is

the second-largest player 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, pharmaceuticals, water treatment, and agricultural chemicals. GACL's manufacturing facilities have a combined installed capacity to produce around 1,750 MTPD of caustic soda (caustic soda lye and caustic soda flakes) as on March 31, 2022, along with large capacities for downstream products. GACL also has an ongoing project for expansion of its caustic soda capacity by 425 MTPD, at Dahej.
Moreover, in December 2015, GACL entered a 60:40 JV with NALCO; GNAL (rated CARE A; Stable/CARE A1) to set up a 800-MTPD caustic soda plant along with a 130-MW coal-based captive power plant, at Dahej, in the vicinity of GACL's existing plant. The said project under the JV has commenced operations on March 30, 2022.

Brief Financials of GACL – Consolidated (₹ crore)	FY21 (A)	# FY22 (A)
TOI	2,405	3,755
PBILDT	335	990
PAT	166	560
Overall gearing (times)	0.09	0.10
Interest coverage (times)	21.66	161.15

A: Audited; # Abridged audited results published on stock exchange.

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 the rated instruments/facilities: Not applicable

Complexity level of various instruments rated for this company: Annexure-3

Annexure-1: Details of instruments/facilities

Name of the Instrument/Bank Facilities	ISIN	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (₹ crore)	Rating Assigned along with Rating Outlook
Term Loan-Long term		-	-	March 2028	593.98	CARE AA+; Stable
Fund-based - LT-Cash credit		-	-	-	130.00	CARE AA+; Stable
Non-fund-based - ST-BG/LC		-	-	-	45.00	CARE A1+
Commercial Paper-CP/STD		-	-	7-364 days	100.00	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 (₹ 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	Term Loan-Long Term	LT	593.98	CARE AA+; Stable	-	1)CARE AA+; Stable (July 06, 2021) 2)CARE AA+; Stable (May 07, 2021)	1)CARE AA+; Stable (October 06, 2020)	1)CARE AA+; Stable (October 03, 2019)
2	Commercial Paper-CP/STD	ST	100.00	CARE A1+	-	1)CARE A1+ (July 06, 2021)	1)CARE A1+ (October 06, 2020)	1)CARE A1+ (October 03, 2019)
3	Fund-based - LT-Cash Credit	LT	130.00	CARE AA+; Stable	-	1)CARE AA+; Stable (July 06, 2021) 2)CARE AA+; Stable (May 07, 2021)	1)CARE AA+; Stable (October 06, 2020)	1)CARE AA+; Stable (October 03, 2019)
4	Non-fund-based - ST-BG/LC	ST	45.00	CARE A1+	-	1)CARE A1+ (July 06, 2021) 2)CARE A1+ (May 07, 2021)	1)CARE A1+ (October 06, 2020)	1)CARE A1+ (October 03, 2019)

Annexure 3: Complexity level of various instruments rated for this company

Sr. No.	Name of Instrument	Complexity Level
1.	Commercial paper-CP/STD	Simple
2.	Fund-based - LT-Cash credit	Simple
3.	Non-fund-based - ST-BG/LC	Simple
4.	Term loan-Long term	Simple

Annexure-4: Bank lender details for this company

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

Note on 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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