Deep Industries Ltd.
(Formerly known as Deep CH4 Limited)
October 01, 2020

Ratings

Facilities	Amount (Rs. Crore)	Ratings[1]	Rating Action
Long term bank facilities	92.96	CARE A; Stable (Single A; Outlook: Stable)	**Assigned**
Short term bank facilities	9.17	CARE A1 (A One)	**Assigned**
Long term / Short term bank facilities	77.50	CARE A; Stable / CARE A1 (Single A; Outlook: Stable / A One)	**Assigned**
Total	**179.63 (Rupees One hundred seventy nine crore and sixty three lakhs only)**		

**Details in Annexure I*

Detailed Rationale & Key Rating Drivers

Upon approval of the scheme of demerger of Deep Energy Resources Ltd. (DERL; formerly known as Deep Industries Ltd.) through the National Company Law Tribunal (NCLT) approval route, its erstwhile Oil & Gas services business along-with largely its entire assets and liabilities have been hitherto transferred to Deep CH4 Ltd. (DCL) with an appointed date of April 01, 2017. The name of DCL has been subsequently changed to Deep Industries Ltd. (DIL) w. e .f. Sept. 25, 2020.

The ratings assigned to the bank facilities of DIL derive strength from its established position in the domestic gas & air compression services business along-with its increasing operations in the rigs and related services business with strong clientele, healthy profitability, comfortable leverage and debt coverage indicators and adequate liquidity on the back of realisation of its stuck receivables.

The ratings are, however, constrained on account of DIL's moderate scale of operations with intense competition in the rigs service business which is also susceptible to volatile day rates due to its linkages with crude oil prices, moderate order book, inherent risk associated with renewal of contracts arising from client concentration risk; albeit it has track record of renewal of various contracts and nascent stage of operations in its overseas subsidiary.

CARE also notes that DIL has availed moratorium as a Covid relief measure from its lenders on servicing of its term debt principal repayments for the period from March 2020 to August 2020.

Rating Sensitivities

Positive Factors

- ✓ Growth in scale of operations marked by Total Operating Income (TOI) of more than Rs.500 crore along with PBILDT margins of more than 50% on a sustained basis
- ✓ Faster realization of its debtors leading to operating cycle of less than 60 days
- ✓ Greater share of income from gas compression, air compression and gas dehydration works along with greater customer diversification

Negative Factors

- × Decline in its scale of operations marked by TOI of less than Rs.200 crore on a sustained basis
- × Reduction in its PBILDT margin to less than 40% on a sustained basis
- × Elongation in its operating cycle beyond 120 days affecting its liquidity
- × Any large size debt funded capex leading to moderation in its overall gearing beyond 0.50 times
- × Extension of any direct / indirect financial support for the exploration & production (E & P) activities in Deep Energy Resources Ltd. (DERL) or undertaking any such activity in the company itself

[1] *Complete definitions of the ratings assigned are available at www.careratings.com and in other CARE publications.*

Detailed description of the key rating drivers

Key Rating Strengths

Established position in gas & air compression services with increasing operations in rigs and related services business

DIL has been serving the oil and gas industry for the past two decades and has varied service offerings including gas compression, work-over rigs & drilling rigs and gas dehydration units in its portfolio. It has a leading position in providing third party gas compressing services with a dominant domestic market share, and is increasing its presence in the rigs and related service business. DIL has also ventured in to overseas market for providing oil & gas services through its subsidiary in the Middle-East. Successful overseas operations through establishment of a long track record while efficiently managing various geo-political risks associated with such geographies will be a key monitorable.

Diversified revenue stream coupled with strong clientele and healthy operating profitability

Till FY18, DIL earned majority of its income from Gas Dehydration Units (GDU) and gas compression business. However, upon cancellation of DIL's two high value GDU contracts, it diversified its operations with greater focus on rigs business leading to marginal decline in its TOI during FY19 & FY20. During FY20, gas compression, rigs, Integrated Project Management Services (IPMS) and GDU segments contributed ~38%, ~32%, ~27% and ~3% of the TOI reflecting its diversified revenue stream. Operating profitability, although moderated, remained healthy marked by PBILDT margin of 47.03% during FY20. Operating profitability had moderated during FY19 & FY20 from the level of FY18 majorly on account of increase in the revenue share of the lower margin service segment i.e. IPMS wherein DIL is outsourcing majority of the work. Its PAT margin stood low mainly due to amortization of Rs.641 crore of Goodwill (created upon demerger of its Services business from DERL) over a period of 10 years from FY18; however the same is a non-cash item and thereby not impacting its cash accruals.

With the outbreak of COVID-19 pandemic which was followed by nationwide lockdown, there was moderation in its revenue with TOI of ~Rs.40 crore during Q1FY21. DIL reported moderation in the revenue from rigs segment during April and May 2020; however, majority of the Gas compression and Gas dehydration contracts were operational even during the lockdown as well. Further, as stated by the management, in June 2020, company started operating at ~80% of its pre-Covid level which further increased to ~90% during the month of July 2020 and since August 2020, DIL is operating at pre-COVID level.

ONGC (rated, CARE AAA; Stable / CARE A1+) has remained one of the key client for DIL over the years and DIL has been regularly receiving various orders across its business segments (including both new and renewal of orders) which has gradually mitigated the earlier uncertainty pertaining to receipt of future orders from ONGC post the event of cancellation of its two GDU contracts. Income from ONGC & ONGC led consortium constitutes ~60% of DIL's TOI in FY20.

Comfortable capital structure and debt coverage indicators

The overall gearing of the company has improved from 0.60x as on March 31, 2019 to a comfortable level of 0.17x as on March 31, 2020. Improvement in the capital structure was on account of prepayment of significant amount of its debt pertaining to its terminated GDU contracts during FY19 by utilizing its available liquidity as well as on account of healthy accretion of profits. On the back of low debt levels, its debt coverage indicators also stood comfortable marked by PBILDT interest coverage of 11.22 times & Total debt / GCA of 0.84 years on March 31, 2020.

Revised hydrocarbon licensing and exploration policy to expedite E&P activities which entail good business prospects for oil & gas service providers

Government of India aims at reducing the country's dependence on oil imports from around 84% at present to 50% by 2030. Thus, to increase the pace of activities in the E&P segment, it formulated revised licensing policy, viz. 'Hydrocarbon Exploration and Licensing Policy (HELP)' to replace New Exploration and Licensing Policy (NELP). HELP is focused on uniform licensing for all hydrocarbons, bidding on revenue sharing basis rather than profit sharing basis which hitherto was requiring estimation of costs, Open Acreage Licensing Policy' wherein a bidder may apply to the government seeking exploration of any block and pricing freedom for gas produced in high risk / high pressure areas and reduced royalty rates to address issues such as licensing requirements, cost finalization and gas pricing which presently beleaguer the E&P industry. Furthermore, the government in 2016 also launched the 'Discovered Small Field' policy (DSF policy) to auction idle fields of ONGC and Oil India Ltd in order to expedite production from these small fields and recently launched its second round of bidding. These are likely to increase the pace of E&P activities which may also augur well for oil and gas field service providers like DIL through additional business opportunities.

Liquidity: Adequate
Adequate liquidity of DIL is characterized by sufficient cushion in cash accruals vis-à-vis debt repayment obligations and available free liquidity (in the form of cash & bank balance and liquid mutual funds) of Rs.53.25 crore on August 31, 2020 on the back of realisation of its hitherto stuck receivables related to terminated GDU contracts during 5MFY21. Its capex requirements are expected to be modular and it has sufficient gearing headroom marked by its overall gearing of 0.17 times as on March 31, 2020. Average utilisation of its fund based working capital limits stood at ~27% for the last 12 months ended August 2020, supported by its current ratio of 2.97 times as on March 31, 2020. Utilization of its non-fund based working capital limits also stood moderate at ~69% during the last 12 months ended August 2020.
On the back of lack of clarity about the probable scenario due to outbreak of the corona virus pandemic, in order to conserve its liquidity, DIL availed moratorium from its lenders on servicing of its term debt principal repayments for the period from March 2020 to May 2020 for two of its term loans and for the period from March 2020 to August 2020 for the balance two term loans.

Key Rating Weaknesses

Moderate scale of operations with high competition in rigs business segment which is also susceptible to volatile day rates
TOI of DIL declined from ~Rs.305 crore during FY18 to ~Rs.261 crore during FY19 & Rs.254 crore during FY20 primarily due to decline in its revenue on account of termination of its 2 large GDU segment contracts by ONGC. Also, DIL's orders are availed through tendering; hence it remains exposed to competition in the industry, particularly in the niche segment of rigs and its related business. The company also remains exposed to the risk of non-renewal of contracts on their expiry which is, however, inherent in the oil and gas industry as it is linked to the capex and growth plans of the major oil & gas E&P companies. Furthermore, the company also remains exposed to risks associated with volatility in day rates of rigs, which largely move in tandem with crude oil prices and hence are volatile in nature.

Client concentration risk
Majority of DIL's present orders (including the integrated project management order for rigs and related oil & gas services business) are awarded by ONGC or ONGC-led consortium. Over the period of last 3 years, share of top 5 customers in the TOI has increased from ~85% in FY18 to ~94% in FY20 which exposes the company to risks associated with customer concentration.

Moderate order book position
Over the past 3 years, order book of DIL has remained moderate. As on June 30, 2020, DIL had an order book of Rs.377 crore compared with Rs.532 crore as on June 30, 2019. Decline in order book during the last one year is mainly due to lower bidding activity from Feb 2020 due to outbreak of Covid-19. Lower order book provides lower revenue visibility.

Nascent stage of operations in its overseas subsidiary
In order to diversify its operations, DIL has started operations in Middle-East countries through its wholly owned subsidiary viz. Deep International DMCC which has currently nascent stage of operations marked by TOI of ~Rs.13 crore in FY20. Operations in the subsidiary carry various geo-political risk factors as it being a new geography of operations for DIL. However, DIL has decided to go slow w.r.to operations in its overseas subsidiary considering these risk factors only.

Analytical approach: Standalone along-with factoring the operations of its subsidiaries

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-Manufacturing Companies
Financial ratios – Non-Financial Sector

About the Company
Promoted by Mr Paras Savla and Mr Rupesh Savla in 1991, Ahmedabad based DERL (formerly known as DIL) was engaged in providing services such as gas compression, air compression, rigs (both work-over and drilling) and gas dehydration in the oil and gas industry (Oil and Gas services business). Subsequently, DERL had also ventured in to exploration and

production (E&P) business of oil, gas, coal bed methane (CBM) and marginal oil fields. In May 2018, DERL's board of directors approved a scheme of demerger to segregate Oil and Gas services business into a separate company i.e. Deep CH4 Limited (DCL).

Now, post receipt of NCLT order which has approved the scheme of demerger with an appointed date of April 01, 2017, company has prepared separate financials of DCL for FY18, FY19 & FY20 to give effect to the approved scheme of demerger. As per the scheme, entire assets & liabilities related to Oil & Gas services business of erstwhile DERL have been transferred to DCL. Subsequently, name of DCL has been changed to DIL on Sept. 25, 2020.

Brief Financials - DIL (Rs. Crore)	FY19 (A)	FY20 (A)
Total operating income (TOI)	260.53	254.04
PBILDT	136.55	119.48
Reported PAT	(3.60)	17.37
Adjusted PAT *	60.55	81.52
Overall Gearing (times)*	0.23	0.17
Interest coverage (times)	11.73	11.22

A: Audited

* Adjusted PAT is after addition of goodwill amortization and for calculation of overall gearing, goodwill created by DIL upon scheme of demerger is reduced from its tangible net-worth.

As per published results for Q1FY21, DIL has reported TOI of Rs.40.84 crore with net losses of Rs.7.73 crore.

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

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

Annexure-1: Details of 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	-	-	Jan 2023	62.96	CARE A; Stable
Fund-based - LT-Cash Credit	-	-	-	30.00	CARE A; Stable
Non-fund-based - LT/ ST-Bank Guarantees	-	-	-	77.50	CARE A; Stable / CARE A1
Non-fund-based - ST-Credit Exposure Limit	-	-	-	2.17	CARE A1
Fund-based - ST-Term loan	-	-	July 2021	7.00	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 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	62.96	CARE A; Stable	-	-	-	-
2.	Fund-based - LT-Cash Credit	LT	30.00	CARE A; Stable	-	-	-	-
3.	Non-fund-based - LT/ ST-Bank Guarantees	LT/ST	77.50	CARE A; Stable / CARE A1	-	-	-	-
4.	Non-fund-based - ST-Credit Exposure Limit	ST	2.17	CARE A1	-	-	-	-
5.	Fund-based - ST-Term loan	ST	7.00	CARE A1	-	-	-	-

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.	Fund-based - LT-Term Loan	Simple
3.	Fund-based - ST-Term loan	Simple
4.	Non-fund-based - LT/ ST-Bank Guarantees	Simple
5.	Non-fund-based - ST-Credit Exposure Limit	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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