Deepak Fertilizers and Petrochemicals Corporation Limited
January 04, 2019

Ratings

Facilities	Amount (Rs. crore)	Ratings[1]	Rating Action
Commercial Paper (CP) issue	600	**CARE A1+ (A One Plus)**	Reaffirmed
Total	**600 (Rupees Six Hundred crore only)**		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The rating reaffirmation to the Commercial Paper issue of Deepak Fertilisers and Petrochemicals Corporation Limited (consolidated, hereafter referred to as DFPCL/ The company) takes into account DFPCL's long track record of over 35 years of operations in the fertilizer and industrial chemical business, experienced promoters and management team, diverse product portfolio across the fertilizer and chemical verticals, diverse and well established distribution network and the company's leading market position in the industrial chemicals segment especially in Technical Ammonium Nitrate (TAN) and Iso-Propyl Alcohol (IPA).

The rating further take into account receipt of withheld subsidy of Rs.310.52 crore against a bank guarantee of equivalent amount and dismissal by Hon. Delhi High Court, of Gas Authority of India Limited's (GAIL's) claim of Rs.357 crore in respect of supply of domestic natural gas for the period July 2006 to May 2014, alleging usage for manufacture of products other than Urea.

The rating also take a note of deterioration in the consolidated profitability during H1FY19 (refers to period from July 2018 to September 2018), working capital intensive nature of operations and ongoing and planned debt funded capital expenditure (capex) and maintenance capex at various locations, leading to moderation in the capital structure and debt coverage indicators.

The rating strengths are moderated by volatility in prices and supply of key raw materials (natural gas, propylene, ammonia and phosphoric acid) and fluctuating sales realizations in the chemicals business, exposure to agro-climactic risks for the fertilizer business, risk related to the regulated nature of the fertilizer industry, foreign exchange fluctuations, import duty levels, cyclicality associated with other industrial products and continued under- performance of the company's realty business.

The rating further takes into account group's announcement of two sizable capex for Ammonia (raw material requirement) and IPA & TAN totaling to Rs.5300 crore which is to be funded in debt equity mix of 70:30. The said capex is subject to financials closure for debt tie up, equity infusion and regulatory approvals.

As indicated by the management in August 2018, the company has reduced its reliance on short term borrowing including commercial paper program and by moving to longer tenure borrowings.

Rationalization of debt levels through materialization of the above funding plans by inflow of debt and equity in a time bound manner, more contribution of manufacturing sales and consequent improvement of gearing levels & profit margins and any regulatory headwinds including potential liability arising from recovery of undue benefits further to the judgment of the Honorable High Court of Delhi remain the key rating sensitivities. Further, during November 2018 the Income Tax authorities conducted a search and seizure operation from November 16, 2018 to November 21, 2018. Any un-envisaged liability would be a rating monitorable.

Detailed description of the key rating drivers

Experienced promoters and management team

The promoters of the group (the Mehta family) have been involved in the fertilisers and chemicals business for more than 35 years through various entities. DFPCL is currently headed by the second generation entrepreneur, Mr. Shailesh Mehta (CMD). Mr. Shailesh Mehta is assisted by a team of professionals having experience within the fertiliser and chemicals business. The board of directors of DFPCL comprises eminent lawyers, bankers and other professionals who have experience within the fertiliser and petrochemical space.

Long track record of operations and established market presence

The group has been in the fertiliser and chemicals business since 1978 and over the years has established its position within the industry and has created a brand recall for its products especially within the fertiliser segment. Its brands including Mahadhan, Mahapower and Bhoodhan are well known in the fertiliser space.

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

DFPCL has demerged two of its core businesses viz. fertilizers and Technical Ammonium Nitrate (TAN) into STL, effective retrospectively from January 1, 2015.

Diversified product profile with dominant market position in various industrial chemicals

The group currently operates in three business segments – Industrial Chemicals, Fertilizers and Realty.

Within fertilizer and chemical segments group's product portfolio comprises of variety of products. Fertilizer segment comprises of different varieties of manufactured (Bulk fertilizer: nitro phosphate fertilizers and speciality fertilizer: Bentonite Sulphur) and traded (Di-ammonium Phosphate (DAP), Ammonium Sulfate, Single Super Phosphate (SSP)) products.

Under the chemicals segment, the group is one of the leading producers of industrial chemicals like IPA, TAN, various grades of Nitric Acid, Methanol, Propane, Liquid Carbon Dioxide and Hydrogen in India.

Reputed client base coupled with robust sales and distribution network

The group has a customer base of more than 600 for its industrial chemical products, operating across industries such as mining and explosives, fertilizers and pesticides, pharmaceuticals, dyes, beverages and steel.

The sales of the group are diversified across India. For fertilizer segment, the group has a dealer network of more than 2,000 dealers in the states of Maharashtra, Gujarat, Andhra Pradesh, Karnataka, Madhya Pradesh, Punjab and Haryana and has a network of more than 50 channel partners across India for chemical segment.

Updates on release of subsidy amount by Government of India and procurement of natural gas

STL (100% subsidiary of DFPCL) has received the entire withheld amount of Rs.310.52 crore against a bank guarantee of equivalent amount. However, since the formula for the recovery amount has not been finalized, the quantum of potential liability is not clear and is a key rating monitorable.

Key Rating Weaknesses

Deterioration in profit margin, albeit improved Total operating income (TOI) during FY18, H1FY19 and Q2FY19

Consolidated TOI during FY18 (refers to the period April 01 to March 31) improved to Rs.6000.96 crore from Rs. 4393.98 crore during FY17. PBILDT margin declined from 11.57% in FY17 to 9.18% in FY18. Further the PAT margin declined from 4.18% in FY17 to 2.73% in FY18. The growth in TOI and decline in profit margin was on account of increase in proportion from trading activity to TOI (38% of TOI from trading activity in FY18).

Performance during Q2FY19 (Unaudited) and H1FY19 (Unaudited) (Consolidated):

The TOI of the company during Q2FY19 (Unaudited) grew by 44% from Rs.1233.93 crore in Q2FY18 to Rs.1782.44 crore in Q2FY19. TOI of the company during H2FY19 (unaudited) grew by almost 60% to Rs.4016.22 crore vis-à-vis H1FY18 (Rs.2517.73 crore). PBILDT margin stood at 7.22% in Q2FY19 (H1FY19:7.08%) as compared with 11.87% in Q2FY18 (H1FY18: 10.93%). The decline was on account of higher prices of key raw materials during the period.

Capital expenditure, debt rationalization and equity infusion plans

The group has recently announced two major capex for Ammonia under Performance Chemiserve Private limited (PCPL), 76% subsidiary of STL, amounting to Rs. 2950 crore and for IPA & TAN amounting to Rs. 2350 crore in the debt equity mix of 70:30. Investment in Ammonia is expected to bring much required backward linkages to the existing downstream with a capacity of 1500 TPD which will find 100% captive and cost-effective consumption. Further with capex in IPA & TAN the company is expected to tap the opportunities arising out of demand supply gap and improve market share.

The company plans to infuse fresh equity amounting to Rs. 800 crore by way of preferential allotment of warrants and QIP or right issue for capex and general corporate purpose by end of Q3FY19.

The company also articulated a plan to reduce the reliance on short term debt/instrument and proposes to have the proportion of long term debt/instrument of 20% to total debt from current 46.72% as on September 30, 2018. Further, as indicated by the management, the proportion of trading revenue is expected to come down to 35 to 40% in FY19 from ~42% in H1FY19 (on a consolidated level), thus improving margin.

Lower proportion of Short Term debt backed by reducing contribution of trading revenue which generally requires higher working capital borrowings, and with the infusion of fresh equity capital, overall gearing level is expected to improve and remain in the range of ~1.15x as on March 31, 2019 from 1.63x as on September 30, 2018. Any significant deviation from the current envisaged plan affecting the gearing levels and debt coverage indicators would be key rating sensitivity.

Further, timely completion of capex without any cost overrun and realisation of envisaged benefits out of completed and ongoing debt-funded capex in terms of profit margin expansion along with necessary funding tie-up and required regulatory approvals in a timely manner as envisaged is critical from the credit perspective.

Working capital intensive nature of operations

The group operates in working capital intensive industry, characterized by funds getting blocked in the form of subsidies receivable from the government. The working capital requirements are managed with cash credit facilities and commercial paper. Average utilization of cash credit facilities remains low throughout the year. Operating cycle of the company was at 94 days in FY18 as compared with 135 days during FY17. The average collection period reduced to 97 days in FY18 from 121 days.

Liquidity

The average cash credit utilization of the 12 months ending November 30, 2018 was low at ~42.50%. The cash and cash equivalent for the quarter ended September 30, 2018 stood at Rs.119.45 crore. The current ratio of the company stood at 0.97x as on September 30, 2018.

Risk associated volatility in raw material prices and its supply and foreign exchange rates

The group's margins continue to remain susceptible to volatility in prices of key raw materials such as natural gas, ammonia, propylene and phosphoric acid. The company procures Re-gasified Liquefied Natural Gas (RLNG) at spot prices, as supply of gas at pooled prices has not resumed. The profitability is susceptible to fluctuations in prices of key raw materials. Furthermore, dependence on imports exposes the company's profitability to fluctuations in foreign exchange rates to some extent.

During Q2FY19, fertilizer sales volumes subdued due to Phosphorous Acid availability issue. Further, IPA Revenue was down due to raw water availability issues at Taloja location. Thus uninterrupted flow of raw materials going forward is also a key rating sensitivity.

Exposure to agro-climatic risks for the fertiliser business

The fertiliser business is heavily dependent on the agro-climatic risks such as vagaries of the monsoon which has a direct bearing on the sowing undertaken by farmers. In addition the off take of a particular type of fertiliser is a direct relation to the crop patterns in a particular area, besides the expected precipitation and other weather conditions.

Highly cyclical nature of Industrial Chemical business

The industrial chemicals are highly commoditized and cyclical in nature; the prices remain volatile on back of global demand and supply, cheaper imports from other countries, prices of its substitutes and key raw material prices. As a result, the operating profit margin for the segment is susceptible to volatility associated with the products.

Claim by GAIL

GAIL had claimed a sum of Rs.357 crore in respect of supply of domestic natural gas for the period July 2006 to May 2014, alleging usage for manufacture of products other than Urea. However, the claim has been rejected by the arbitration on want of merit and being time barred. However, as per the intimation provided by the company on stock exchange dated December 27, 2018, the Hon'ble Delhi High Court vide a common judgement dated December 20, 2018 did not find any merits in GAIL's objection as well as the appeal and dismissed the same on merits and thereby upholding the well-reasoned arbitration award and order in the company's favor.

Regulatory risk related to fertilizer segment

The allocated fertilizer subsidy budget of Rs.70,000 crore for FY17 was grossly inadequate with back-log of unpaid subsidy of Rs.35,000 crore for FY16. As a result, the allocated subsidy budget of FY17 for urea and P&K fertilizers was exhausted in early H2FY17. The subsidies for fertilizers were reduced during FY17 due to lower raw material costs resulting in lower subsidy outlay for FY17. Despite lower subsidy requirement for FY18, GoI continued the fertilizer subsidy budget at Rs.70,000 crore for FY18 (unchanged from FY17 level) which is likely to reduce the unpaid subsidy backlog of around Rs.32,000 crore from FY17. With the reduction in subsidies and stable subsidy budget, the receivables and thus interest cost of short term borrowing is expected to reduce, thus positively impacting the profitability of the companies. Overall with normal monsoon and softening of raw material prices, fertilizer off-take for FY18 and profitability is likely to be stable.

Analytical approach: Consolidated

CARE has considered consolidated financials of the DFPCL Group consisting of DFPCL, its 9 subsidiaries (including STL) and four associate companies. CARE has analysed DFPCL's credit profile by considering the consolidated financial statements owing to financial and operational linkages between the parent and subsidiaries. As per the scheme of arrangement, DFPCL has demerged two of its core businesses viz. fertilizers and Technical Ammonium Nitrate (TAN) into a wholly owned subsidiary company, STL. The demerger will be effective retrospectively from January 1, 2015.

Smartchem Technologies Limited (Subsidiary)
Platinum Blasting Services Pty. Limited (Subsidiary)
Australian Mining Explosives Pty. Limited (Subsidiary)
Performance Chemiserve Private Limited (Subsidiary)

SCM Fertichem Limited (Subsidiary)
Deepak Mining Services Private Limited (Subsidiary)
Deepak Nitrochem Pty Limited (Subsidiary)
Runge Pincock Minarco India Private Limited (Subsidiary)
Yerrowda Investment Limited (Subsidiary)
Ishanya Brand Services Limited (Associate)
Ishanya Realty Corporation Limited (Associate)
Mumbai Modern Terminal Market Complex Private Limited (Associate)
Desai Fruits and Vegetables Pvt. Ltd. (Joint Venture)

Applicable Criteria
Criteria for Short Term Instruments
CARE's Policy on Default Recognition
CARE's methodology for manufacturing companies
Rating Methodology - Wholesale Trading
CARE's methodology for fertilizer companies
Financial ratios – Non-Financial Sector
Rating Methodology: Factoring Linkages in Ratings

About the Company
DFPCL was incorporated in May 1979 and is one of the leading manufacturers of industrials chemicals and fertilisers in India. DFPCL is the flagship company of Deepak Group of companies which has presence in fertilisers and chemicals. DFPCL was established by the Mr. Chimanlal Mehta and is currently promoted by his son Mr. Shailesh Mehta who is the Chairman and Managing Director (CMD).The company is one of the world's largest producers of Technical Ammonium Nitrate (TAN) with a capacity of 469,000 MTPA and various grades of Nitric Acid (8,41,500). It also manufactures bulk fertilisers like Nitro-Phosphate (NP) (229,500 MTPA, to be increased to 11,00,000 MTPA in a phased manner) and specialty fertilisers like Bentonite Sulphur (Bensulf) (25,000 MTPA). Besides manufacturing, the company also trades in bulk fertilizers such as Diammonium Phosphate (DAP), Ammonium Sulfate, and Single Super Phosphate (SSP) etc. The company has 9 subsidiaries (including 2 overseas subsidiaries) and four associate companies as on March 31, 2018.

Brief Financials ((Consolidated) Rs. crore)	FY17 (A)	FY18 (A)	H1FY18(UA)	H1FY19(UA)
Total operating income	4393.98	6000.96	2517.73	4016.22
PBILDT	489.25	550.60	275.15	284.45
PAT	154.62	164.10	76.21	84.13
Overall gearing (times)	1.04	1.73	1.51	1.63
Interest coverage (times)	7.64	3.18	3.43	2.48

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

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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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
Commercial Paper	-	-	7 to 364 days	150.00	CARE A1+
Commercial Paper	-	-	-	50.00	CARE A1+
Commercial Paper-Commercial Paper (Standalone)	-	-	-	400.00	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 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017	Date(s) & Rating(s) assigned in 2015-2016
1.	Debentures-Non Convertible Debentures	LT	-	-	-	1)Withdrawn (21-Mar-18) 2)CARE AA-; Stable (05-Jan-18) 3)CARE AA-; Stable (19-Sep-17)	1)CARE AA- (Under Credit Watch) (16-Nov-16)	1)CARE AA- (Under Credit Watch) (20-Oct-15)
2.	Debentures-Non Convertible Debentures	LT	-	-	-	-	1)Withdrawn (14-Nov-16)	1)CARE AA- (Under Credit Watch) (20-Oct-15)
3.	Commercial Paper	ST	150.00	CARE A1+	1)CARE A1+ (21-Aug-18)	1)CARE A1+ (05-Jan-18)	1)CARE A1+ (16-Nov-16)	1)CARE A1+ (20-Oct-15)
4.	Debentures-Non Convertible Debentures	LT	-	-	-	1)Withdrawn (21-Mar-18) 2)CARE AA-; Stable (05-Jan-18) 3)CARE AA-;	1)CARE AA- (Under Credit Watch) (16-Nov-16)	1)CARE AA- (Under Credit Watch) (20-Oct-15)

						Stable (19-Sep-17)		
5.	Debentures-Non Convertible Debentures	LT	-	-	-	-	1)Withdrawn (14-Nov-16)	1)CARE AA- (Under Credit Watch) (20-Oct-15)
6.	Commercial Paper	ST	50.00	CARE A1+	1)CARE A1+ (22-Nov-18) 2)CARE A1+ (21-Aug-18)	1)CARE A1+ (05-Jan-18)	1)CARE A1+ (16-Nov-16)	1)CARE A1+ (20-Oct-15)
7.	Commercial Paper-Commercial Paper (Standalone)	ST	400.00	CARE A1+	1)CARE A1+ (22-Nov-18) 2)CARE A1+ (21-Aug-18)	1)CARE A1+ (05-Jan-18)	1)CARE A1+ (16-Nov-16)	1)CARE A1+ (20-Oct-15)

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