

Gujarat Alkalies and Chemicals Limited

October 5, 2017

Ratings

Facilities	Amount (Rs. crore)	Rating ¹	Rating Action
Long-term Bank Facilities	349.57 (reduced from 425.94)	CARE AA+; Stable (Double A Plus; Outlook: Stable)	Reaffirmed
Short-term Bank Facilities	45.00	CARE A1+ (A One Plus)	Reaffirmed
Total Facilities	394.57 (Rupees Three Hundred Ninety Four Crore and Fifty Seven Lakh Only)		
Commercial Paper Issue	100.00 (Rupees One Hundred Crore Only)	CARE A1+ (A One Plus)	Reaffirmed

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The ratings for various bank facilities and instruments of Gujarat Alkalies and Chemicals Ltd (GACL) continue to draw strength from its strong parentage, well-established position as the market leader in domestic chlor-alkali industry along with its integrated operations and wide product portfolio which finds application across diversified end-use industries.

The ratings are also underpinned by its state-of-the-art technology, captive power generation to meet part of its energy requirements along with its comfortable leverage and strong debt coverage indicators. The ratings also factor improvement in its profitability during FY17 (refers to period from April 1 to March 31) due to lower power cost on the back of reduction in gas prices driven by global market forces.

The ratings take cognizance of the fact that GACL has investment requirements for its joint venture (JV) with National Aluminum Company Ltd (NALCO) for manufacturing caustic soda. Apart from project implementation risk, GACL would also have to manage the salability risk associated with the new capacity including the disposal of chlorine after factoring the off-take arrangement with NALCO.

The long term rating, however, continues to be constrained by susceptibility of its profitability to adverse movement in market price of gas and power cost which constitute a significant part of its cost structure, risk related to adverse movement in foreign exchange rates, large-sized capex/investment plans and its presence in a cyclical industry which also faces competition from imports; albeit the same is currently being mitigated due to presence of anti-dumping duty.

GACL's ability to increase its scale of operations and maintain stability of its high profitability by securing significant portion of its power requirement through captive low cost sources (e.g. renewable energy) so as to shield against market-driven fluctuations of gas/energy prices and through greater share of value-added products in its sales-mix so as to improve captive consumption of chlorine; thereby resulting in greater resilience of its profitability even in the scenario of any future withdrawal of anti-dumping duty by Government of India on import of caustic soda would be the key rating sensitivities. Further, significant adverse impact of more than envisaged large-size debt funded capex/investments on its capital structure would also be a key rating monitorable.

Detailed description of the key rating drivers

Key Rating Strengths

Market leader in domestic caustic soda industry: GACL is the largest independent producer of caustic soda in the country with an installed capacity of 412,500 metric tonne per annum (MTPA) as on March 31, 2017 at its plants in Vadodara and Dahej in Gujarat. GACL has gradually built its leadership position through continuous expansion of production capacities to cater to the growing demand for its products over the last three decades.

Over the years it has also introduced new chlorine derivatives (downstream products) for captive utilization of chlorine, an essential by-product generated during manufacturing of caustic soda. This has equipped the company to leverage upon its large production capacity and protect its profitability from the effects of volatility in chlorine prices to some extent.

¹Complete definition of the ratings assigned are available at www.careratings.com and other CARE publications

Integrated operations and diversified customer base: The operations of GACL are well-integrated with by-product of one process being used as raw material for another process, enabling the company to optimally utilize its large production capacity. It also protects GACL's profitability to an extent from the effects of inherent cyclicity in the demand for its major products, as adverse demand scenario for one set of products is countered by favorable movement in other products. GACL's products find application across diverse range 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 on account of its membrane cell technology used for production of caustic soda, captive power plant for meeting some of its energy requirements and investment in wind-mills to offset higher cost of power purchased from the market. The membrane cell technology used for electrolysis of salt consumes one-third less power compared to the traditional mercury cell technology and is also less polluting.

Healthy financial risk profile: GACL's financial risk profile continued to remain healthy. Its PBILDT margin improved y-o-y by 555 bps to 24.29% during FY17 primarily on account of reduction in power cost driven by lower market price of natural gas. Further, it had a comfortable overall gearing of 0.13 times and Total Debt/GCA of 0.76 times as on March 31, 2017.

Stable outlook for caustic soda industry: The outlook for the domestic chlor-alkali industry is likely to remain stable in the near-term, mainly on account of expectation of steady demand from its key end-use industries like textile, pulp and paper, aluminum, pharmaceuticals and agrochemicals. As per Centre for Monitoring Indian Economy (CMIE), the demand for caustic soda is expected to increase by around 3% in FY18 driven by likely increase in output of aluminum and paper industry. Profitability in the industry has improved in 5MFY18 and is expected to remain stable in with better sales realization on the back of healthy demand from the consuming industries.

Key Rating Weaknesses

Susceptibility of its profitability to adverse movement in market price of gas and power cost along with competition from imports: GACL's profitability is susceptible to adverse movement in market price of gas and power cost since electrolysis is an energy intensive process and power cost constitutes a significant part of its cost structure. The power cost comprised around 32% of GACL's total operating income in FY17 (37% in FY16). The Indian chlor-alkali industry faces competition from cheap imports of lower power cost countries; however, the same is being mitigated by presence of anti-dumping duty on imports of caustic soda.

Risk of adverse movement in foreign exchange rates on un-hedged long-term borrowings; however, export volumes provide natural hedge to a certain extent: GACL is exposed to risk of adverse movement in foreign exchange rates on account of its long-term borrowings denominated in USD, raised for part-funding of its capex plans. Further, as a matter of policy, GACL does not hedge its foreign currency exposure. During FY17, GACL imported raw materials and capital goods worth Rs.305.55 crore and had repayment liabilities of Rs.89 crore against which it made exports of Rs.241.39 crore, thus partially hedging its foreign currency exposure naturally to some extent. Also, the interest cost on the forex borrowings is lower than that on comparable domestic rupee loans.

Large-size own capex plan and investment requirements in its JV along with associated salability risk: GACL has planned own capex of around 1,721 crore over the four year period ending FY21 which is expected to be funded by debt of Rs.828 crore and the balance through internal accruals. Further, in June 2015, GACL had announced its plan to enter into 60:40 joint venture with NALCO; GACL-NALCO Alkalies & Chemicals Pvt Ltd (GNAL) for setting up a chlor-alkali plant for producing 292,000 MTPA of caustic soda at Dahej, in the vicinity of GACL's existing plant. The joint venture would also establish a coal-based power plant (130 MW) to meet the power requirements on a captive basis. The cost of the JV project is expected to be around Rs.2,000 crore, to be funded through debt and equity in the ratio of 2.33:1, translating into an exposure of Rs.360 crore of equity investment by GACL spread over the next two years. However, with strong cash accruals and low debt repayment liabilities, GACL is expected to fund the same with reasonable comfort. Out of the total caustic soda to be produced from the JV plant, 54,750 MTPA would be provided to NALCO's alumina refinery and the remaining would be sold in the open market; the marketing rights of which would vest with GACL. The unit would also contain manufacturing facilities for other downstream products, for utilization of chlorine, an essential by-product generated for manufacturing of caustic soda. Thus, GACL will be exposed to marketing risk as well as risk of chlorine disposal for GNAL.

Analytical approach: Standalone

Applicable Criteria

[Criteria on assigning Outlook to Credit Ratings](#)

[CARE's Policy on Default Recognition](#)

[Criteria for Short Term Instruments](#)
[Rating Methodology-Manufacturing Companies](#)
[Financial ratios – Non-Financial Sector](#)

About the Company

GACL; CIN: L24110GJ1973PLC002247 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, 2017, GoG as the promoter, through its various undertakings, held 46.28% equity in the company, the largest being through Gujarat State Investments Ltd (GSIL) with 20.87% holding. GACL is the 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, pharmaceutical and agricultural chemicals. GACL's manufacturing facilities had a combined installed capacity for production of 412,500 Metric Tonne (MT) of caustic soda per annum.

Brief Financials (Rs. crore)	FY16 (A)	FY17 (A)
Total operating income	2,042	2,123
PBILDT	383	515
PAT	220	308
Overall gearing (times)	0.13	0.13
Interest coverage (times)	38.54	40.17

A: Audited

GACL reported total operating income of Rs.612 crore with PAT of Rs.95 crore during Q1FY18 as against total operating income of Rs.591 crore with PAT of Rs.86 crore during Q1FY17.

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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In case of partnership/proprietary concerns, the rating /outlook assigned by CARE is based on the capital deployed by the partners/proprietor and the financial strength of the firm at present. The rating/outlook may undergo change in case of withdrawal of

capital or the unsecured loans brought in by the partners/proprietor in addition to the financial performance and other relevant factors.

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
Term Loan-Long Term	-	-	July 2022	219.57	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 (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017	Date(s) & Rating(s) assigned in 2015-2016	Date(s) & Rating(s) assigned in 2014-2015
1.	Term Loan-Long Term	LT	219.57	CARE AA+; Stable	-	1)CARE AA+ (20-Oct-16)	1)CARE AA+ (14-Oct-15)	1)CARE AA+ (05-Sep-14)
2.	Commercial Paper-CP/STD	ST	100.00	CARE A1+	-	1)CARE A1+ (20-Oct-16)	1)CARE A1+ (14-Oct-15)	1)CARE A1+ (05-Sep-14)
3.	Fund-based - LT-Cash Credit	LT	130.00	CARE AA+; Stable	-	1)CARE AA+ (20-Oct-16)	1)CARE AA+ (14-Oct-15)	1)CARE AA+ (05-Sep-14)
4.	Non-fund-based - ST-BG/LC	ST	45.00	CARE A1+	-	1)CARE A1+ (20-Oct-16)	1)CARE A1+ (14-Oct-15)	1)CARE A1+ (05-Sep-14)

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