Mangalore Chemicals and Fertilizers Limited

October 08, 2020

Ratings

Facilities	**Amount (Rs. crore)**	**Rating[1]**	**Rating Action**
Long term Bank Facilities	535.50 (enhanced from 267.08)	**CARE BBB; Stable (Triple B; Outlook: Stable)**	**Reaffirmed**
Long term/ Short term Bank Facilities	1899.50 (reduced from 2167.92)	**CARE BBB; Stable/CARE A3 (Triple B; Outlook: Stable/A Three)**	**Reaffirmed**
Total	**2435.00 (Rupees Two Thousand Four Hundred Thirty Five crore only)**		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The reaffirmation of the ratings assigned to the bank facilities of Mangalore Chemicals & Fertilizers Ltd (MCFL) continue to derive strength from its 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 rating also factors in the improvement in the profitability of the company in FY20 (refers to period from April 01 to March 31), Q1FY21 (refers to period from April 01 to June 30) on account of high yielding product mix and lower commodity & raw material prices. 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).

Key Rating Sensitivities

Positive Factors

- Ability of the company to increase its scale of operations by 20% annually on a sustained basis going forward amidst a regulated industry.
- Ability of the company to timely receive the gas supply from GAIL and successfully execute the energy improvement project leading to envisaged energy saving and improvement in its profitability margins.
- Ability of the company to manage its working capital requirements while timely realizing the subsidy from government.

Negative Factors

- Decline in PBILDT margin of more than 3% from the current envisaged levels on a sustained basis going forward.
- 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 3x.

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 60% of the company's products are sold in the state of Karnataka, which meets about 20% 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

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

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.

Part of diversified group; however 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 June 30, 2020, the entire holding of ZACL in MCFL of 6,40,28,362 shares are pledged by ZACL, which is equivalent to 54.03% of total shareholding of MCFL.

Conversion to Gas Based Plant

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 with GAIL (India) Limited in February 2020 and a Gas Transmission Agreement with GAIL (India) Limited in February 2011. Though Petronet LNG terminal of Kochi has been commissioned in September 2013, unsatisfactory progress in laying of gas pipeline from Kochi to Mangalore has deprived MCFL and other 2 Naptha-based units in south India from receiving gas for urea production. In February 2017, GAIL has awarded two contracts for building Kochi-Koottanad-Mangalore pipeline and the gas is expected to reach the plant by December 2020.

However, till the commissioning of pipeline for supply of gas, company would continue to receive subsidy based on the criteria for naphtha based units i.e. at current Govt. notified consumption norms of 6.902GCal/ 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 Gas supply). The energy norm will be revised at 6.50 Gcal/MT after a period of five years after receipt of natural gas.

Moderate financial risk profile

During FY20, 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.

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. 250 cr as on September 29, 2020 (which also includes subsidy received from the government). MCFL has scheduled repayments of Rs. 70 cr vis-à-vis projected GCA of Rs. 100 cr during FY21. 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). MCFL has the sanctioned working capital limits (including CC limits and non-fund based limits) for an amount of Rs. 1440 cr for the business operations with average utilization of 90.50% during last 12 months ended August 2020.

Key Rating Weaknesses

Leveraged capital structure

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. The total debt of the company stood at Rs. 1224.49 cr as on June 30, 2020.
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.

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 and furnace oil 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.

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 Q2FY22, after receipt of gas to their plant which is expected in December 2020. EIP will 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 norms 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]. Since investment for natural gas project was completed in June 2014 the preset energy norm of 7.356 Gcal/ MT will be made available to MCFL when it starts operating on natural gas. Also, according to the management not only the energy consumption will be lowered but also the normal maintenance expense will be reduced by operating the plant on natural gas. 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. 21 cr being incurred in FY20 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.

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 fertilizer production had increased by 0.3% and 2.7% during FY19 and FY20. The overall fertilizer production is to grow by 4-6% by the end of FY21. Currently the liquidity situation of manufacturers seems to have improved. Fall in input

costs has abetted the working capital situation of manufactures. Overall fertilizers production has increased by 3.8% during FY21 (April-July) after registering a negative growth of 0.4% in the corresponding period in the previous financial year. The country witnessed an on-time arrival of Southwest monsoon, followed by a quick spread across the regions which have resulted in higher sowing thus augmenting the increase in production. Increase in production can also be ascribed to restocking activities undertaken by the manufactures in order to keep up with the sharp increase in fertilizer sales witnessed during the year. Imports (Q1-FY21) have increased by 1% supported by the sharp increase in urea imports.

Production of urea increased by 8.6% during FY21 (April-July). Production increased as manufacturers were quick enough to resume operations once the government announced relaxations came into effect April 15, 2020 onwards. Imports too have risen sharply by 31.3% to supplicate the increase in demand.

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]
[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 June 30, 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)
Total operating income	3084.82	2733.85
PBILDT	202.34	239.30
PAT	32.88	65.75
Overall gearing (times)	3.47	2.77
Interest coverage (times)	1.82	2.15

A: Audited

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 (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 (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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