

July 15, 2019

Zuari Agro Chemicals Limited: Rating assigned to long term debt program

Summary of Rated Instrument:

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term Loans	260.0	260.0	[ICRA]D; outstanding
Long Term Fund Based	1000.0	1000.0	[ICRA]D; outstanding
Long Term un-allocated limits	465.0	465.0	[ICRA]D; outstanding
Short Term non-fund-based limits	1980.0	1980.0	[ICRA]D; outstanding
Short Term un-allocated	510.0	510.0	[ICRA]D; outstanding
Compulsorily convertible Debentures (CCD)	-	500.0	[ICRA]D; assigned
Total	4215.0	4715.0	

*Instrument details are provided in Annexure-1

Rationale

The rating factors in the continuing delay in meeting the dues for the payment of letter of credits (LCs) by the company since April 22, 2019 and the delay in payment of a term loan instalment of Rs. 19 crore at the end of June 2019. The company is planning to raise Rs. 500 crore by issuing Compulsorily Convertible Debentures (CCDs) to its existing shareholders. The company plans to use the funds so raised to meet the current delays in the LC payments and improve the liquidity position of the company. ZACL's liquidity position deteriorated materially in FY2019 driven by significant cash losses posted during the year and the delay in subsidy receipts from the GoI during April-May 2019. The company posted a cash loss of ~Rs. 174.0 crore in FY2019 owing to the agri-stress prevalent in parts of the operating territories of ZACL i.e. Northern Karnataka and the Marathwada region resulting in inability of the company to pass on the increase in raw material price to farmers as well as a two-month long shutdown undertaken at the urea plant in Q3 FY2019. As a result, the company faced cash flow mismatches and was not able to meet the payment for the maturing Letters of Credit (LCs) and term loans. The rating also factors in the reduced financial flexibility of the company.

Key rating drivers

Credit strengths

Established track record of the company in fertiliser and other agri-businesses: ZACL has had an established track record in the fertiliser and other agri-business since 1967. ZACL through its subsidiaries and joint ventures is engaged in manufacturing of fertilisers, seeds, and other agri-inputs.

Diversified product portfolio including urea, DAP and NPK complexes as well as traded products: ZACL is engaged in manufacturing of urea as well as DAP/NPK fertilisers at its Goa manufacturing facility along with water soluble fertilisers (WSF) and Single Super Phosphate (SSP) manufactured at other plants of the company. It also undertakes trading of various fertilisers to provide wide range of agri products to the farmers. ZACL also benefits from access to the DAP/NPK fertilisers manufactured by its JV Paradeep Phosphate Limited (PPL).

Favourable long-term demand outlook for fertilisers in India due to scarcity of nutrients in the soil: Indian soil remains deficient in nutrient content which has resulted in lower agri-productivity. With increasing population, the demand for food will increase which will make productivity improvement imperative for the agri sector. Thus, the demand outlook for fertilisers remains positive in India.

High operating efficiency of the plants, although the company has faced certain operational issues in recent years: Though ZACL's plants had faced operational issues in the past, the operational efficiency has improved over the last few years. Urea as well as DAP/NPK plant has shown healthy capacity utilisation in last few years. Urea plant has witnessed improving capacity utilisation and energy efficient operations post implementation of gas pooling for the fertiliser sector resulting in lowering of gas costs for ZACL.

Strong marketing network and leading market position in Karnataka and Maharashtra: ZACL caters to the southern and western part of India and enjoys leading market position in Karnataka and Maharashtra. ZACL along with PPL enjoy a major part of the DAP/NPK market in south –western part of India and a strong marketing network.

Credit challenges

Vulnerability of profitability to agro-climatic conditions, regulatory risks and seasonality of the fertiliser business: Agriculture sector in India remains vulnerable to the vagaries of monsoon as the area under irrigation remains low which exposes fertiliser sector to volatility as well. The sector being highly regulated also remains vulnerable to changes in the regulations by Gol.

Performance of non-urea fertilisers is relatively more vulnerable to regulatory and economic variables: Non-urea fertiliser demand is relatively more volatile as the preference for urea is driven by the price differential. In case of weak monsoon, the non-urea fertilisers have seen more impact on demand relative to that on urea. The domestic manufacturers are also affected by movement in international prices of end products as well as raw material which impact the profitability. Post implementation of Nutrient Based Subsidy (NBS) for P&K fertilisers, the price differential between urea and P&K fertilisers has widened which has adversely impacted demand for P&K fertilisers. The profitability of the companies depends on the movement of international prices of raw material as majority of these are imported. The ability of the company to pass on any increase in raw material prices to end-consumer through revision of retail price also plays a crucial role in protecting profitability which may be constrained by high level of stocks or poor monsoon etc.

Imports expose ZACL to forex risk; partly mitigated by the hedging policy of the company: ZACL imports its entire requirement of phosphoric acid, ammonia and MOP for production of DAP/NPK fertiliser which exposes it to foreign exchange risks. The risk is however partly mitigated as the company leaves very small amount of its foreign exchange exposure as unhedged.

Debt funded capex to meet energy norms under NUP-2015: ZACL will be undertaking significant debt funded capex to meet energy consumption norms applicable under NUP-2015 from FY2021 onwards. The capex for the project is around Rs. 380 crore and is to be funded in a debt-equity ratio of 70:30. The capex is expected to keep the credit metrics subdued in the near term.

Subdued capital structure characterised by low capitalisation, high debt and low core profitability: Capital structure of the company has weakened since demerger from Zuari Industries Limited. Low capitalisation, high debt due to subsidy receivable driven working capital borrowings along with weak core profitability over the past few years has resulted in weak capital structure. Going forward the debt funded capex will keep the capital structure subdued unless equity infusion is completed in a timely manner by the company.

High working capital intensity due to subsidy delays and high trade receivables resulting in high borrowings: As the subsidy receivables from GoI continue to remain outstanding for as long as 4-5 months working capital borrowings to fund the receivables keep the borrowing levels elevated. The high receivable days also lead to high working capital intensity for the business and high interest costs for the company impacting profitability.

MCF acquisition leading to cash outflow: ZACL had acquired 53.03% ownership in MCFL through its subsidiary Zuari Fertilisers & Chemicals Limited (ZFCL, now merge with ZACL) with a total cash outflow of Rs. 510 crore. The acquisition was majorly debt funded and ZACL continues to service the debt leading to cash outflows in the form of interest and debt repayments.

Liquidity Position:

Liquidity position of the company has weakened materially owing to large loss posted by the company in FY2019 coupled with continued delay in the subsidy receivables from the GoI which has led to elongation of the working capital cycle. Owing to stretched liquidity position and weakening credit profile of the company, the financial flexibility of the company has weakened. While company is in the midst of fund-raising timely completion of the same will be a key monitorable for improvement in the liquidity position of the company.

Analytical approach:

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for entities in the fertiliser industry
Parent	NA
Consolidation / Standalone	The ratings are based on standalone financials of the company

About the company:

Zuari Agro Chemicals Limited (erstwhile Zuari Holdings Limited) constitutes the fertiliser operations of the Adventz Group following the demerger of Zuari Industries Limited (ZIL). It is also the holding company for the other agri-business operations of the Adventz Group. The group has interests in agri-inputs, engineering, infrastructure, real estate, consumer durables and services sectors. It was a part of the erstwhile K.K. Birla Group. In April 2011, the Bombay High Court (Goa bench) approved the demerger of ZIL's fertiliser business into Zuari Holdings Limited (later renamed as ZACL), while the residual entity ZIL (later renamed as Zuari Global Limited) retained the non-fertiliser business operations and investments. The demerger scheme was applicable w.e.f July 1, 2012.

The erstwhile ZIL was promoted in 1967 in financial and technical collaboration between the K.K. Birla Group and the U.S. Steel Corporation to manufacture urea, compound nitrogenous fertilisers and phosphates in Goa. In 1985, ZIL promoted Chambal Fertilisers & Chemicals Limited (CFCL, rated [ICRA]A1+) to produce urea using natural gas at Gadepan, Rajasthan. In 2002, ZIL acquired Paradeep Phosphates Ltd (PPL - rated [ICRA]A(Stable)/[ICRA]A1) through a JV company, as part of the disinvestment process of GoI. PPL manufactures DAP and NPK fertilisers, with its plant located at Paradeep, Orissa. While the equity shareholding of ZIL in PPL is now held by ZACL (40.225% of entire shareholding of PPL through the JV company), the 13.3% shareholding of ZIL in CFCL continues to be held by ZGL.

ZACL's plant is located in Goa and comprises of a urea plant of 0.4 MMTPA capacity, complex (NPK) plant of 0.36 MMTPA capacity and DAP-cum-Complex plant of 0.36 MMTPA capacity, which is capable of manufacturing a range of complexes. ZACL completed its feedstock conversion project and is now using gas as a feedstock for manufacturing urea (it was earlier using naphtha). For complexes and DAP, it uses imported ammonia and phosphoric acid. As of March 2019, 65.04% of the shareholding of ZACL was held by the promoter group, while the rest is held by domestic and foreign institutional investors and public.

Key financial indicators (audited)

	FY2018	FY2019
Operating Income (Rs. crore)	4647.6	5126.6
PAT (Rs. crore)	30.3	-211.2
OPBDIT/OI (%)	7.3%	2.4%
RoCE (%)	9.8%	-4.1%
Total Debt/TNW (times)	4.7	5.9
Total Debt/OPBDIT (times)	9.2	16.8
Interest coverage (times)	1.1	0.6

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

Current Rating (FY2020)							Chronology of Rating History for the Past 3 Years					
Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	July 2019	May 2019	May 2019	Date & Rating in FY2019		Date & Rating in FY2018		Date & Rating in FY2017	
							February 2019	Aug 2018	September 2017	August 2017	December 2016	October 2016
1 Fund Based	Long Term	1000.0	-	[ICRA]D	[ICRA]D	[ICRA]BB (Negative)	[ICRA]BBB+ (Negative)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Negative)	[ICRA]BBB+ (Stable)
2 Term Loan	Long Term	260.0	260.0	[ICRA]D	[ICRA]D	[ICRA]BB (Negative)	[ICRA]BBB+ (Negative)	-	-	-	-	-
3 Un-allocated	Long term	465.0	-	[ICRA]D	[ICRA]D	[ICRA]BB (Negative)	[ICRA]BBB+ (Negative)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Negative)	[ICRA]BBB+ (Stable)
4 Non-fund-based limits	Short Term	1980.0	-	[ICRA]D	[ICRA]D	[ICRA]A4	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+
5 Un-allocated	Short term	510.0	-	[ICRA]D	[ICRA]D	[ICRA]A4	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+
6 Compulsorily convertible Debentures	Long term	500.0	-	[ICRA]D	-	-	-	-	-	-	-	-

Complexity level of the rated instrument:

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument Details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
-	Term Loan	December 2014	9.6%-11.4%	March 2022	260.0	[ICRA]D
-	Fund Based long term	-	-	-	1000.0	[ICRA]D
-	Long term Un-allocated limits	-	-	-	465.0	[ICRA]D
-	Non-fund-based limits	-	-	-	1980.0	[ICRA]D
-	Short term unallocated	-	-	-	510.0	[ICRA]D
-	Compulsorily convertible debentures	-	-	-	500.0	[ICRA]D

ANALYST CONTACTS

K Ravichandran

+91 44 4596 4301

ravichandran@icraindia.com

Prashant Vasisht

+91 124 4545 322

prashant.vasisht@icraindia.com

Varun Gogia

+91 124 4545 373

varun.gogia@icraindia.com

RELATIONSHIP CONTACT

L Shivakumar

+91 22 6114 3406

shivakumar@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani

Tel: +91 124 4545 860

communications@icraindia.com

Helpline for business queries:

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

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For more information, visit www.icra.in

ICRA Limited

Corporate Office

Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002

Tel: +91 124 4545300

Email: info@icraindia.com

Website: www.icra.in

Registered Office

1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001

Tel: +91 11 23357940-50

Branches

Mumbai + (91 22) 24331046/53/62/74/86/87
Chennai + (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,
Kolkata + (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008,
Bangalore + (91 80) 2559 7401/4049
Ahmedabad+ (91 79) 2658 4924/5049/2008
Hyderabad + (91 40) 2373 5061/7251
Pune + (91 20) 2556 0194/ 6606 9999

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