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India Ratings Revises Gujarat State Fertilizers & Chemicals’ Outlook to Negative; Affirms ‘IND AA+’

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India Ratings and Research (Ind-Ra) has revised Gujarat State Fertilizers & Chemicals Limited’s (GSFC) Outlook to Negative from Stable while affirming its Long-Term Issuer Rating at ‘IND AA+’. The instrument-wise rating actions are as follows:

Instrument Type	Date of Issuance	Coupon Rate	Maturity Date	Size of Issue (million)	Rating/Outlook	Rating Action
Fund-based working capital limits	-	-	-	INR4,630	IND AA+/Negative/IND A1+	Affirmed; Outlook revised to Negative from Stable
Non-fund-based working capital limits	-	-	-	INR9,972.8	IND AA+/Negative/IND A1+	Affirmed; Outlook revised to Negative from Stable
Fund-based working capital limits*	-	-	-	INR20	IND AA+/Negative/ IND A1+	Assigned
Non-fund-based working capital limits*	-	-	-	INR27.2	IND AA+/Negative/ IND A1+	Assigned
Short-term debt programme	-	-	-	INR8,000	IND A1+	Affirmed
CP	-	-	7-365 days	INR10,000	IND A1+	Affirmed

*The final ratings have been assigned following the receipt of executed financing documents by Ind-Ra.

Analytical Approach: To arrive at the ratings, Ind-Ra has taken a consolidated view of GSFC and its subsidiaries - GSFC Agrotech Limited and Gujarat Arogya Seva Pvt. Ltd. - and its associates - Vadodara Enviro Channel Limited, Gujarat Green Revolution Company Limited and Karnalyte Resources Inc - owing to significant operational and financial linkages between the entities.

The Outlook revision reflects Ind-Ra's view that the consolidated entity's operating performance will be weaker than expected in FY20, as the delayed monsoons and elongated rains, and a sharp decline in the caprolactam-benzene spreads (which drive the profitability of the industrial segment) during 1HFY20 would collectively result in lower-than-anticipated profitability. Given that the realisations have remained benign even post H1FY20, Ind-Ra expects the industrial segment's profitability to remain subdued during the year. Additionally, the prolonged monsoon season has resulted in slower-than-expected pick-up in fertiliser sales, leading to higher inventory in the fertiliser segment during 1HFY20. This is likely to lead to higher-than-expected leverage and lower-than-expected interest coverage for FY20.

Key Rating Drivers

Weaker-than-expected Operating Performance in 1HFY20: In FY19, GSFC's revenue increased to INR84.9 billion (FY18: INR62.7 billion) due to higher volumes and realisations. The company's EBITDA rose to INR7.5 billion (INR5.6 billion), primarily due to a rise in the capro-benzene spread to an average USD1,252/tonne in FY19 (FY18: USD1,050/tonne) and higher energy savings in the fertiliser segment.

However, during 1HFY20, GSFC's net revenue decreased 7.6% yoy to INR41.3 billion, led by a 26.9% yoy fall in revenue from the industrial segment to INR7.9 billion. During the same period, revenue from the fertiliser segment fell 1.5% yoy to INR33.4 billion.

The industrial segment's EBIT declined to INR0.2 billion in 1HFY20 from INR2.2 billion in 1HFY19, primarily owing to a sharp fall in the capro-benzene spread to USD888 /tonne from USD1,305/tonne and a fall in realisations of other industrial products. A decline in demand, resulting from the slowdown in the auto segment (the key end-user market) and the ongoing US-China trade war, which led to dumping of caprolactam in the Indian markets, resulted in the fall in the capro-benzene spread. In addition, production from the new melamine capacity (40,000mtpa) remained subdued during 1HFY20. Furthermore, the fertiliser segment's EBIT fell 20.1% yoy to INR1.4 billion during 1HFY20 owing to lower realisations of key products, resulting from the competition in the market and the large inventory with the fertiliser players. Thus, GSFC's EBITDA decreased 50.7% yoy to INR2.1 billion in 1HFY20. Ind-Ra expects the fall in realisations and low capro-benzene spread to impact the operating profitablity of GSFC during FY20.

Moderation in Credit Metrics: GSFC's net financial leverage (adjusted debt net of free cash and subsidy receivables/operating EBITDAR) continued to be negative in FY19 and 1HFY20, as the subsidy adjusted net debt remained negative. At end-1HFY20, GSFC's gross debt increased to INR15.6 billion (FY19: INR10.7 billion, FY18: INR10.9 billion), with a total term loan of INR1.7 billion (INR 2.0 billion; INR2.51 billion) taken for the melamine project, while its working capital loan increased to INR13.9 billion (INR8.7 billion; INR8.4 billion). The increase in working capital debt was driven by a decline in trade payables to INR8.7 billion in 1HFY20 (FY19: INR10.4 billion; FY18: INR8.3 billion), an increase in total receivables (including subsidy) to INR27.5 billion (INR24.7 billion, INR26.5 billion), and slower-than-expected liquidation of inventory, which declined to INR15.7 billion (INR16.6 billion, INR8.7 billion).

Despite a reduction in the company's subsidy receivables to INR15.0 billion at 1HFYE20 (FYE19: INR16.6 billion; FYE18: INR17.2 billion), the total receivables increased because of a sharp rise in the debtors in the industrial segment, as company had to give a significantly higher credit period to customers in a weak demand environment. Although the management expects to liquidate a significant portion of the inventory by 3QFY20, the subsidy receivables are likely to see increase as the subsidy budget is likely to have been exhausted by November 2019. Hence, the overall working capital requirements could continue to be high at FYE20.

Moreover, the increase in working capital borrowings pushed up the interest expenses during 1HFY20. This coupled with the decline in EBITDA caused GSFC's gross interest coverage (operating EBITDAR/gross interest expense) to decline to 3.4x in 1HFY20 (FY19: 12.3x; FY18 11.0x). Ind-Ra expects GSFC's interest coverage to remain above 3x in the short term.

Liquidity Indicator: Adequate: At end-1HFY20, GSFC had cash and cash equivalents of INR1.4 billion (FY19: INR0.6 billion). Furthermore, it has access to fund-based working capital limits of INR19.2 billion within and outside the bank consortium; the average utilisation of the same was 44% for the 12 months ended October 2019. GSFC also has INR19.4billion of investments in other listed entities as of FYE19 (FYE18: INR23billion), which could provide an additional liquidity cushion if required. In addition, the company has access to capital markets and has strong relationships with the banking system.

The cash flow from operations (CFO) had increased to INR4.5 billion in FY19 (FY18: INR3.4 billion), owing to an improvement in the EBITDA. However, the CFO deteriorated sharply to a negative INR3.5 billion in 1HFY20 owing to the weak operating performance and high working capital needs. Given that GSFC has term debt repayments of only INR0.5 billion due per year in FY20 and FY21, Ind-Ra expects the DSCR to remain comfortable over this period. Furthermore, any favourable dispensation of the pending INR2.6 billion (as of March 2019) of ammonium sulphate subsidy would aid the overall liquidity of the company.

Established Business Profile: GSFC's ratings continue to benefit from its established position in the domestic fertiliser and chemical segments. It has high operational and business synergies on account of its integrated manufacturing operations, diversified product offerings and market leadership position in the space for industrial chemical products, especially caprolactam (72% market share) and melamine (33% market share). However, the Industrial segment continues to be exposed to volatility in the prices of caprolactam, the largest contributor to the industrial segment's profitability

Capex Plans Could Lead to Additional Long-Term Borrowings: GSFC manufactures DAP at its Sikka facility and is also planning to manufacture phosphoric acid. The company might undertake capex to set up a 1,000 metric tonnes per day (mtpd) phosphoric acid facility and 3000mtpd sulphuric acid plant. In addition, GSFC is also evaluating the expansion of the Sikka Jetty capacity, which would enable it to handle more imports of rock phosphate for the phosphoric acid plant and also enable it to increase the direct imports of fertilisers. In addition, GSFC might undertake additional capex for setting up a methyl methacrylate capacity of 64,800mtpa and an additional caprolactum capacity of 50,000mtpa at Vadodara. GSFC incurred capex of INR2billion in 1HFY20 (FY19: INR3 billion, FY18: INR5 billion). Given the plans, Ind-Ra expects the capex to increase in the short-to-medium term, which could have an adverse impact on the credit metrics.

Financial Guarantee for TIFERT Loans: GSFC and other sponsors of the JV, Tunisian Indian Fertilisers S.A. (TIFERT) had provided a sponsor guarantee proportionate to their shareholding. Although the guarantee expired in March 2018, it is under discussion with TIFERT lenders and is likely to be renewed for the residual tenor of the loan. GSFC's liability for the balance loan amount is likely to be restricted in proportion to its shareholding (15%). Accordingly, Ind-Ra has included GSFC's obligation towards this loan on pro-rata basis in its total adjusted debt calculations. The total amount of loans availed by TIFERT was USD316 million, which reduced to USD131 million as on 30 September 2019.

Fertiliser Policy and Industry Cyclicality: GSFC remains exposed to changes in the fertiliser policy, as it depends on the government for subsidies. Any change in the subsidy payout mechanism or timing is, thus, critical to GSFC's credit profile. The company has received high subsidy payouts in the last few years; however, delays were observed in FY19. The industrial segment also remains exposed to international competition and cyclicality. The segment contributed 28.0% and 38.0% to GSFC's revenue and EBIT, respectively, in FY18 (FY17: 33.0% and 34.0%).

Rating Sensitivities

Outlook Revision to Stable: An improvement in profitability in both the segments, coupled with reduction in borrowings, favourable structural changes in the urea subsidy policy, leading to the timely receipt of subsidy receivables, resulting in an improvement in net adjusted leverage and interest coverage could result in the Outlook being revised back to Stable.

Negative: Continued muted operating performance and/or significant delays in subsidy reimbursements will be negative for the ratings. Any debt-led capex plans or an increase in the adjusted debt for providing financial support to associate companies, leading to the net financial leverage exceeding 2.0x and/or gross interest coverage reducing below 3.0x, on a sustained basis, will be negative for the ratings.

Company Profile

Incorporated in 1962, GSFC is a government of Gujarat public sector undertaking, operating in the fertilisers and industrial segments. Gujarat State Investments Limited and institutional investors (domestic and foreign) hold about 38% and 35% in GSFC, respectively, followed by non-institutional investors (about 27%). GSFC has four manufacturing facilities across Gujarat.

FINANCIAL SUMMARY

Particulars	**1HFY20**	**1HFY19**	**FY19**	**FY18**
Revenue (INR billion)	41.3	44.7	84.9	62.7
EBITDA (INR billion)	2.1	4.3	7.5	5.6
EBITDA margin (%)	5.2	9.7	8.8	9.0
Gross interest expense (INR billion)	0.6	0.4	0.6	0.5
Profit before tax (INR billion)	1.3	4.1	6.7	4.9
Net income (INR billion)	1.0	3.0	4.9	4.7
Source: GSFC				

Solicitation Disclosures

Additional information is available at www.indiaratings.co.in. The ratings above were solicited by, or on behalf of, the issuer, and therefore, India Ratings has been compensated for the provision of the ratings.

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Rating History

Instrument Type	**Current Rating/Outlook**			**Historical Rating/Outlook**		
	Rating Type	**Rated Limits (million)**	**Rating**	**13 November 2018**	**5 October 2017**	**29 June 2016**
Issuer rating	Long-term	-	IND AA+/Negative	IND AA+/Stable	IND AA+/Stable	IND AA+/Stable

Fund-based working capital limits	Long-/short-term	INR4,650	IND AA+/ Negative/IND A1+	IND AA+/Stable/IND A1+	IND AA+/Stable/IND A1+	IND AA+/Stable/IND A1+
Non-fund-based working capital limits	Long-/short-term	INR10,000	IND AA+/ Negative/IND A1+	IND AA+/Stable/IND A1+	IND AA+/Stable/IND A1+	IND AA+/Stable/IND A1+
Short-term debt programme	Short-term	INR8,000	IND A1+	IND A1+	IND A1+	IND A1+
CP programme	Short-term	INR10,000	IND A1+	IND A1+	IND A1+	IND A1+

Complexity Level of Instruments

For details on the complexity levels of the instruments, please visit https://www.indiaratings.co.in/complexity-indicators.

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APPLICABLE CRITERIA

Corporate Rating Methodology

Short-Term Ratings Criteria for Non-Financial Corporates

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