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# India Ratings Revises Gujarat State Fertilisers & Chemicals' Outlook to Stable; Affirms 'IND AA+'

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India Ratings and Research (Ind-Ra) has revised the Outlook on Gujarat State Fertilisers & Chemicals Limited (GSFC) to Stable from Negative, 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 | - | - | - | INR3,000 (reduced from INR4,650) | IND AA+/Stable/IND A1+ | Affirmed; Outlook revised to Stable from Negative |
| Non-fund-based working capital limits | - | - | - | INR10,000 | IND AA+/Stable/IND A1+ | Affirmed; Outlook revised to Stable from Negative |
| Short-term debt programme | - | - | - | INR9,650 (increased from INR8,000) | IND A1+ | Affirmed |
| CP | - | - | 7-365 days | INR10,000 | IND A1+ | Affirmed |

**Analytical Approach:** To arrive at the ratings, Ind-Ra continues to take a consolidated view of GSFC and its subsidiaries - GSFC Agrotech Limited (100% stake),Gujarat Arogya Seva Pvt. Ltd.(50.94%), Gujarat Port and Logistics Company Limited (60%) and Vadodara Jal Sanchay Private Limited (60%) – and its associates - Vadodara Enviro Channel Limited, Gujarat Green Revolution Company Limited and Karnalyte Resources Inc - owing to the significant operational and financial linkages between the entities.

The Outlook revision reflects Ind-Ra's expectation of a recovery in the consolidated entity's operating performance in the near term. The same was evident during 1HFY21, by way of an increase in the volumes and gross margins in the fertiliser segment, and by way of continued soft raw material prices, the restart of the methanol plant, a visibility on improvement of the caprolactam-benzene spread (which drives the profitability of the industrial segment) and stabilisation of the new melamine capacity in the industrial segment. This, coupled with an improvement in working capital cycle resulted in an improvement in credit metrics during 1HFY21, which Ind-Ra expects to sustain in the near-to-medium term, given the aforementioned factors.

# Key Rating Drivers

**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 (45% market share). However, the industrial segment continues to be exposed to volatility in the benzene-caprolactam spreads. Furthermore, given its significant share in the industrial segment and the overall profitability, Ind-Ra has modified the negative trigger of the net adjusted leverage to 1.5x from 2.0x.

**Improvement in EBITDA:** GSFC's operating EBITDA improved to INR2.98 billion in 1HFY21 (1HFY20:INR2.13 billion; FY20: INR3.2 billion), primarily led by an increase in the volumes of the fertiliser segment, which cumulatively increased to 1.4 million metric tonne (MT) (1.2 million MT;2.5 million MT). The EBITDA margins improved to 8% in 1HFY21 (1HFY20: 5.2%; FY20: 4.1%), owing to a decline in raw material costs. In FY20, the performance had weakened due to a longer-than-expected shutdown in the ammonia plant, and a sharp fall in the caprolactam-benzene spread. GSFC's revenues moderated to INR37.5 billion in 1HFY21 (1HFY20:INR41.3 billion; FY20:INR77.98billion), led by the moderation in the key product realisations in both the fertiliser and industrial segments.

**Fertilizer Segment Recovers:** The fertiliser segment saw a healthy increase in EBIT to INR2.6 billion at 1HEFY21 (1HEFY20:INR1.4 billion; FY20:INR3.3billion), with the EBIT margin rising to 8.4% (4.1%, 5.21%), on the back of low input prices. The company would also increase the trading volumes of urea over the near-to-medium term, which would be done on the government's account. However, the EBITDA is likely to be partially offset in the near term by the loss incurred due to the tightening of the gas efficiency norms for production of urea.

The industrial segment's EBIT loss were contained to negative INR36 million in 1HFY21 (FY20: negative INR693 million), despite a reduction in the average caprolactam-benzene spread to USD650/tonne during 1HFYE21 (FY20: USD754/tonne) and a fall in realisations of other industrial products. The company saw a negative EBIT in 1QFY21, which turned positive in 2QFY21 owing to i) the stabilisation of the new melamine plant, which is now running at a full capacity of 40,000 metric tonnes Per Annum (MTPA), ii) the restart of the methanol plant in September 2020, running at a 90% capacity, which would contribute meaningfully to the EBITDA going forward, and iii) continued soft input prices. Considering these factors, Ind-Ra expects the overall EBITDA margins for FY21 to be 6%-8%.

At the standalone level, GSFC's net revenue was INR36.8 billion in 1HFY21 (1HFY20: INR40.5 billion; FY20: INR76.2 billion), while the EBITDA was INR2.97 billion (INR2.3 billion; INR3.02 billion), leading to the EBITDA margins improving to 8.1% (5.7%,4%).

**Liquidity Indicator - Adequate:** At end-1HFY21, GSFC had unencumbered cash and cash equivalents of INR0.6 billion (FY20: INR0.4 billion). Furthermore, it had access to fund-based and non-fund based working capital limits of INR19.2 billion and INR10 billion, respectively, within and outside the bank consortium; the average utilisation of the fund-based and non-fund limits (including commercial paper utilization) was 39% and 25%, respectively, for the 12 months ended November 2020. GSFC also had liquid investments of INR16.1 billion in other listed entities at FYE20 (FYE19: INR19.4 billion). In addition, the company has access to capital markets and has strong relationships with the banking system and benefits from low rates of interest for their borrowings, which reduced to average 5.6% in 1HFY21 (FY20: 8.7%).

The cash flow from operations improved to INR9.6 billion in 1HFY21(FY20: negative INR972 million; FY19:INR4.5 billion, FY18: INR3.4 billion), owing to an improvement in the EBITDA and lower working capital needs. The cash flow from operations was further aided by receipt of the pending ammonium sulphate subsidy of INR2.2 billion (FY20: 0.2 billion), which it has now fully recovered. Given that GSFC has term debt repayments of only INR0.5 billion due per year in FY21 and FY22, Ind-Ra expects the debt-service coverage ratio to remain comfortable over this period.

**Moderation in Credit Metrics in FY20, to Improve in FY21:** During 1HFY21, GSFC's gross interest coverage (operating EBITDAR/gross interest expense) improved to 9.7x (FY20:2.8x, FY19: 12.3x) and the net financial leverage (adjusted debt net of free cash and subsidy receivables/operating EBITDAR) continued to be negative. The metrics improved due a significant decline in GSFC's gross debt to INR6.3 billion in 1HFY21(FY20:INR15.6 billion, FY19: INR10.7 billion), with the term debt declining to INR1.2 billion (INR 1.7 billion; INR2.0 billion) and the working capital debt falling to INR5.1 billion (INR13.9billion, INR8.7 billion). Furthermore, GSFC and other sponsors of the joint venture, Tunisian Indian Fertilisers S.A. (TIFERT), had provided a sponsor guarantee proportionate to their shareholding for latter's bank loan, which expired in FY18, and was not renewed. TIFERT has been making its debt repayments in a timely manner, and as per GSFC's management, it is unlikely the sponsors would have to make any payments under said guarantee. Accordingly, Ind-Ra has excluded GSFC's obligation towards this loan in its total adjusted debt calculations.

The decrease in working capital debt was driven by a decrease in the overall working capital requirement, which reduced to INR26.1 billion in 1HFY21 (FY20:INR35.8 billion, FY19:INR30.9 billion). This reduction was led by the recovery in trade payables to INR9.6 billion in 1HFY21 (FY20:INR4.4billion, FY19: INR10.4 billion), which had earlier declined in FY20 because of the decline in the trading activities owing to the COVID-19-led lockdown. There was also a moderation in total receivables to INR24.8 billion in 1HFY21 (FY20: INR26.4billion; FY19: INR24.7 billion; which includes subsidy receivables of INR18.2 billion (INR17.9 billion, INR16.6 billion)) and inventory levels to INR10.9billion (INR13.7 billion; INR16.6 billion). The resultant reduction in the working capital interest costs coupled with the improvement in EBITDA and moderate debt led capex plans are likely to result in an improvement in the credit metrics during FY21.

On a standalone basis the interest coverage was 9.7x in 1HFY21 (FY20: 3.7x, FY19: 2.6x) and the net financial leverage continued to be negative.

**Moderate Capex Plans:** GSFC incurred capex of INR0.6 billion in 1HFY21 (FY20: INR3 billion, FY19: INR3 billion). The company plans to incur a moderate capex of INR3 billion for the revamp of the urea facility at the Baroda plant by FY23, to be funded by a debt: equity ratio of 70:30, with the equity part being funded by internal accruals. Furthermore, the company is also incurring a capex of INR0.3 billion on a nylon compounding line of which INR0.2 billion, which has been funded through internal accruals. Given the market conditions, the company has postponed other major planned capital expenditures.

**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 pay-out mechanism or timing is, thus, critical to GSFC's credit profile. The company has received high subsidy pay-outs in the last few years; however, higher-than-usual delays were observed in FY20. The industrial segment also remains exposed to international competition and cyclicality. Noticeably, in November 2020, the finance ministry, as part of the stimulus package, announced an extra budget of INR650 billion for disbursement towards outstanding subsidies of the fertiliser industry, which is yet to be approved in the parliament. Post this approval, Ind-Ra expects a disbursement of INR250 billion in the near term, which would result in a meaningful reduction in the debt levels of sector entities by way of lower working capital borrowings, thereby improving their credit metrics.

## Rating Sensitivities

**Positive:** A sustained 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 the net adjusted leverage and the interest coverage, could result in a positive rating action.

**Negative:** A sustained decline in operating performance and/or significant delays in subsidy reimbursements will be negative for the ratings. Any significant debt-led capex or an increase in the adjusted debt for providing financial support to associate companies, leading to the net financial leverage exceeding 1.5x and/or the 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 joint sector company promoted by government of Gujarat, with a presence in the space for fertilisers and industrial products. 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 two operational manufacturing facilities across Gujarat.

**FINANCIAL SUMMARY**

| Particulars | 1HFY21 | FY20 | FY19 |
|---|---|---|---|
| Revenue (INR billion) | 37.5 | 77.98 | 84.9 |
| EBITDA (INR billion) | 2.98 | 3.17 | 7.5 |
| EBITDA margin (%) | 8 | 4.1 | 8.8 |
| Gross interest expense (INR billion) | 0.31 | 1.15 | 0.6 |
| Net income (INR billion) | 1.7 | 1.1 | 4.9 |
| Source: GSFC, Ind-Ra | | | |

## 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 | 26 December 2019 | 13 November 2018 | 5 October 2017 |
| Issuer rating | Long-term | - | IND AA+/Stable | IND AA+/Negative | IND AA+/Stable | IND AA+/Stable |
| Fund-based working capital limits | Long-/short-term | INR3,000 | IND AA+/ Stable/IND A1+ | IND AA+/ Negative/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+/ Stable/IND A1+ | IND AA+/ Negative/IND A1+ | IND AA+/Stable/IND A1+ | IND AA+/Stable/IND A1+ |
| Short-term debt programme | Short-term | INR9,650 | IND A1+ | IND A1+ | IND A1+ | IND A1+ |

| | | | | | | |
|---|---|---|---|---|---|---|
| CP programme | Short-term | INR10,000 | IND A1+ | IND A1+ | IND A1+ | IND A1+ |

## Bank wise Facilities Details

Click here to see the details

## 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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