September 21, 2020

Dhanuka Agritech Limited: Ratings reaffirmed; removed from watch with negative implications and Positive outlook assigned

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund based - Working Capital Facilities	30.0	30.0	[ICRA]AA- (Positive); reaffirmed and removed from watch with negative implications; Positive outlook assigned
Non-fund based – LC/BG	33.35	33.35	[ICRA]A1+; reaffirmed and removed from watch with negative implications
Total	**63.35**	**63.35**	

**Instrument details are provided in Annexure-1*

Rationale

The Positive outlook factors in ICRA's expectation of Dhanuka Agritech Limited's (DAL) strong financial performance, reflected in strong revenue growth, healthy profitability, robust debt protection metrics and sound liquidity profile in FY2021. The company reported steady performance in FY2020 as well as Q1 FY2021 as marked by revenue growth and sustenance of profit margins, supported by its position as one of the leading players in the agrochemical industry.

The ratings were earlier placed under watch with negative implications as DAL's promoters were pledging part of their shareholding in DAL, to raise debt for part funding of an acquisition (of Orchid Pharma Limited; OPL) by DAL's related company—Dhanuka Laboratories Limited[1] (DLL). However, there was a change in the funding mix of the acquisition and accordingly most of the shares pledged have been released. There has not been any adverse impact on DAL's credit profile or financial flexibility in the interim. Additionally, no funding support is expected to be extended by DAL to OPL.

Additionally, the ratings factor in DAL's established market position supported by its diverse product portfolio (across all agrochemical categories), strong brand presence, wide distribution network and geographical presence in the domestic market. Its long-standing relations with reputed international technicals manufacturers, which enable it to regularly introduce speciality formulations, also support the ratings. DAL's liquidity position remains comfortable on the back of healthy internal accrual generation, free cash balances/liquid investments, undrawn bank lines and no debt repayment liability. Additionally, limited capex requirements have continued to translate into negligible reliance on external debt to meet the funding requirements, resulting in a comfortable capital structure and robust debt protection metrics.

However, the ratings are constrained by high working capital intensity of the business and intense competition in the industry that limits the pricing flexibility of industry participants, including DAL. and susceptibility of operations to any adverse regulatory development related to manufacturing/sales of agrochemicals or any discontinuation of tie-ups with international technical manufacturers. Moreover, DAL's revenues and profitability remain vulnerable to agroclimatic conditions, volatility in raw material prices and foreign exchange rates, given that part of the raw material requirement is met through imports. ICRA notes that the management had in the past demonstrated support towards the inorganic growth plans of DLL and continues to extend a Rs. 50-crore credit line. Any increase in support to the Group's ventures would remain a key monitorable.

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1 Rated [ICRA]BBB-@/[ICRA]A3@

Key rating drivers and their description

Credit strengths

Position among leading agrochemical players in India; strong brand presence – DAL has an established operational track record and its promoters have extensive experience of around three decades in the agrochemical industry. Over the years, DAL has set up a well-entrenched distribution network across the country and a wide product portfolio (speciality and generic formulations), which cushions the company from the slowdown in offtake for any crop or region to a large extent. These factors have enabled the company to develop strong brand presence and emerge as one of the leading players in the industry.

Long relation with reputed international technical manufacturers – DAL has associations with reputed international technicals manufacturers (such as Nissan Chemicals, FMC Corporation, and Hokko Chemicals), which provide access to speciality molecules. Almost 50–60% of the company's revenues are driven by the sales of speciality formulations, which also support profit margins. Going forward too, increased revenue contribution from speciality formulations is expected to aid the company's profit margins.

Comfortable financial profile – The company's financial strength is characterised by steady revenue growth, stable profitability, healthy internal accrual generation, low reliance on debt (only working capital) and robust debt protection metrics. DAL's operating income grew by 11% to Rs. 1,120.1 crore in FY2020 from Rs. 1,005.8 crore in the previous fiscal. Maintaining the momentum, the company has reported strong YoY revenue growth in Q1 FY2021 and expansion in margins on the back of healthy demand for agrochemicals, which is expected to largely sustain for the entire fiscal. Moreover, DAL's liquidity position remains comfortable, supported by sizeable free cash/liquid investments, undrawn working capital limits and no debt repayment liability.

Credit challenges

Intensely competitive industry – The intensely competitive and fragmented nature of the agro-chemical industry exerts pricing pressure and necessitates constant marketing and branding expenditure. Nevertheless, DAL benefits to an extent because of its strong brand presence.

High working capital intensity – Given the seasonality inherent in demand, diverse product portfolio, dependence on imports for raw materials and wide distribution network across the country, the company needs to maintain high raw material and finished goods inventory. This has continued to result in high working capital intensity for it.

Exposure to agro-climatic conditions and regulatory risks – The company's sales and profitability remain susceptible to agro-climatic conditions, development of pest-resistant genetically modified (GM) seeds and regulatory risks inherent in the business. This is also demonstrated by revenue growth moderation and contraction in margins in the past years due to sub-par monsoon seasons. The Government of India (GoI) had recently issued a draft order for banning the use of 27 pesticides after consultation with the Central Insecticides Board and Registration Committee (CIBRC/Registration Committee). While the same is being reassessed basis representations made by the industry participants, imposition of the same ban can adversely impact industry participants, including DAL.

Exposure to raw material price and foreign exchange volatility – Lack of backward integration into technical manufacturing and dependence on imports for around 20–30% of its raw material requirement exposes DAL's profit margins to volatility in raw material prices as well as foreign exchange rates. Moreover, given that tie-ups for technicals is critical for DAL's business position, it remains exposed to the risk of discontinuation of such tie-ups or increase in competition from other formulators, or the primary supplier developing its own formulation.

Liquidity position: Strong

The company's liquidity position is **strong** on the back of healthy internal accrual generation, sizeable free cash balances/liquid investments (~Rs. 125 crore as of August 2020), undrawn bank lines (~Rs. 30 crore) and no debt repayment liability. This has also further continued to result in minimal reliance on external debt. Cash flow from operations were positive in FY2020 and are expected to remain positive over the medium term, driven by steady financial performance.

Rating sensitivities

Positive triggers – The ratings could be upgraded if DAL demonstrates healthy growth in revenues and improvement in profit margins, resulting in continued negligible reliance on debt and healthy debt protection metrics.

Negative triggers – The outlook could be revised to Stable if there is considerable decline in revenues and pressure on profit margins due to lower offtake, or any adverse regulatory development. Moreover, any moderation in the company's credit profile or liquidity position due to elongation in the working capital cycle, sizeable debt-funded capex or significant funding support extended to related companies, could lead to a revision in the outlook.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Methodology for Agrochemical Industry
Parent/Group Support	Not applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of DAL; as on March 31, 2020, the company had one subsidiary (enlisted in Annexure-2).

About the company

DAL is part of the Delhi-based Dhanuka Group. It is involved in the formulation and marketing of agro-chemicals like insecticides, pesticides, herbicides, etc. The company's manufacturing facilities are in Sanand (Gujarat), Udhampur (Jammu and Kashmir) and Keshwana (Rajasthan).

In FY2020, the company reported a net profit of Rs. 141.4 crore on an operating income (OI) of Rs. 1120.1 crore compared with a net profit of Rs. 112.6 crore on an OI of Rs. 1005.8 crore in the previous year.

Key financial indicators (Audited) - Consolidated

	FY2019	FY2020
Operating Income (Rs. crore)	1,005.8	1,120.1
PAT (Rs. crore)	112.6	141.4
OPBDIT/OI (%)	14.5%	15.5%
PAT/OI (%)	11.2%	12.6%
Total Outside Liabilities/Tangible Net Worth (times)	0.3	0.3
Total Debt/OPBDIT (times)	0.2	0.0
Interest Coverage (times)	163.5	111.3

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2021)				Rating History for the past 3 years				
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	21-Sep-2020	FY2020		FY2019	FY2018	FY2017
						11-July-2019	6-May-2019	-	12-March-2018	20-February-2017
1	Fund based-Working Capital Facilities	Long Term	30.0	-	[ICRA]AA-(Positive)	[ICRA]AA-@	[ICRA]AA-(Stable)	-	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)
2	Non-fund based – LC/BG	Short Term	33.35	-	[ICRA]A1+	[ICRA]A1+@	[ICRA]A1+	-	[ICRA]A1+	[ICRA]A1+

@ - under watch with negative implications

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
NA	Fund based- Working Capital Facilities	-	-	-	30.0	[ICRA]AA- (Positive)
NA	Non-fund based – LC/BG	-	-	-	33.35	[ICRA]A1+

Source: Dhanuka Agritech Limited

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Dhanuka Agri-Solutions Private Limited	100%	Full Consolidation

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