

Discussion on

Nagarjuna Fertilizers and Chemicals Limited

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What did we do?

Any comment on a company has to be made after taking into account two issues: (a) the emerging industrial environment for that sector; and (b) after looking at the comparative numbers generated by its peers. Hence, we got hold of last four annual reports of Nagarjuna Fertilizers and Chemicals Limited (NFCL) and Chambal Fertilisers and Chemicals Limited (CFCL).

We completed an analysis of their “Statement of Cash Flow”. We also did the financial statement analysis of both the players. We enclose the same at the end of the following discussion.

We provide our observations as bullet points in the next few pages.

Acknowledgements: While we would like to thank NFCL for their initiative and also for providing their annual reports. We take the responsibility of all errors that may have crept in this report.

A Note of Caution: The discussion points below are to be taken as observations of outsider(s) (whose perceptions about the industry need not be fully correct).

A Request: The author welcomes feedback on the enclosed discussion and analysis points.

Our Observations:

Comments on the Industry

- ❖ In the last five years, the industry players have been deliberating de-leveraging themselves by reducing their long-term liabilities and avoiding any expansion plans. This could be due to policies adopted by the government.
- ❖ In a regulated industry ... the industry players possibly become risk averse.
- ❖ In a regulated industry ... the industry players largely work for the bankers

Observations on CFCL (vis-à-vis NFCL)

- ❖ In the last six years, CFCL has consciously diversified into non-regulated industries creating a small unrelated portfolio which includes such as (a) cotton spinning; (b) software; and (c) housing finance. The company has also stepped into non-regulated areas within the agriculture related sectors such as (a) seeds; (b) processed foods; and (c) purchasing mines (as future raw material) outside India. Most of these initiatives were taken using the subsidiary route (reducing the company's potential bankruptcy costs and risks).
- ❖ CFCL also faces a major risk due to a potential hike in the gas prices from 2009 onwards. Whereas, NFCL has the possible opportunity to get cheap and stable priced raw material & gas supplies due to gas find in the East coast.
- ❖ CFCL pays a high proportion of corporate tax (compared to international environment).

- ❖ CFCL follows a constant dividend payout ratio of 30–35%.
- ❖ CFCL’s new business has also resulted in higher level of inventory. CFCL products possibly need a lot of product market push and hence result in high WCM requirement.
- ❖ CFCL has been following an aggressive WCM policy (for example, its low cash cover for daily expenses). The company also stretches its supplier’s payments (i.e., accounts payables).

Qualitative Comments on NFCL:

- ❖ NFCL has poor profitability ratios (compared to CFCL) largely due to revaluation of its fixed assets in 2004–05. The worst hit numbers have been the ratios relating to “efficiency of use of assets”. High operating costs and high interest costs have also worked towards the lower profitability of NFCL.
- ❖ In the last few years, NFCL has seen a fast rise in its “Cost of Goods Sold” resulting in pressure on its gross profit margins. Going further, this also could be a cause of concern. NFCL also has a higher level of operating/other expenses. The numbers indicate that the company has some more carry forward of losses.
- ❖ NFCL has better WCM skills and also good market demand for its urea (compared to CFCL). The company’s low inventory levels suggest a good inventory management policy (it could also be an indication of high product demand). NFCL also has been stretching its supplier’s payments (i.e., account payables). In FY2006, the company had a sudden jump in its cash balance (is it to repay a loan/debenture!!).
- ❖ What is the longevity of the existing two plants? Can the recent gas finds by Reliance and others be considered as possibly cheap raw material alternatives for NFCL?

Suggestions to NFCL and Future Possibilities for NFCL:

- ❖ **Cost of Debt:** The Company needs to seriously consider ways and means of cutting its cost of debt. A fresh debt restructuring could be one option. Another option could be talking to some foreign lenders. Other options largely depend on the existing debt covenants of NFCL.
- ❖ **Fertilizer Regulatory Issues:** The company needs to work with multiple ministries, related departments, and other government owned institutional intermediaries for a new pricing policy especially without any capacity constraints (for new urea plants)
- ❖ **Rewarding Shareholders:** The Company could avoid paying cash dividends to its shareholders. The company should ideally opt for buyback of shares as a policy to reward its shareholders. Buyback gives NFCL the opportunity to cut its huge equity base, provides timing option to its shareholders, is a good signaling mechanism, and also possibly provides tax advantage (due to zero long-term capital gains tax).
- ❖ **Future Scenarios:** If the fertilizer policy becomes amicable then one can see a possible doubling of urea capacity. A very small chance also exists of a possible M&A by a very large Indian business group.
- ❖ **Networking:** A favorable policy environment (say, fertilizer pricing policy) requires creation and aggressive participation in networks. (the interaction among members should determine the rules of the system).
- ❖ Going forward, NFCL should also keep itself aware of any emerging disruptive technologies in the fertilizer sector. History shows that disruptive technologies are usually created by small, unknown start-ups operating in other industry. The company needs to identify those technologies which create customers “lock-in”.

Appendix:

Financial Analysis of NFCL and CFCL

Table: Statement of Cash Flow Analysis of Nagarjuna Fertilizers and Chemicals Limited (FY2002-06)

	FY 2006 (12m)	FY 2005 (12m)	FY 2004 (12m)	FY 2003 (12m)
Major Sources	Operations (28)	Operations (43) Increase in Share Capital (5)	Operations (5) Sale of Investments (3)	Operations (10) Decrease in Cash Balance (4)
Major Uses	Borrowings (11) Capex (2) Increase in Cash Balance (4)	Borrowings (20) Capex (17)	Borrowings (6) Capex (3)	Borrowings (9) Capex (5)
CFO compared to Net Income	CFO > 0; CFO > Net Income CFO up due to - Depreciation (12) - A/R Down (11) - Trade Payables Up (10) But - Inventories Up (1.8)	CFO > 0; CFO > Net Income CFO up due to - Depreciation (12) - Trade Payables Up (2.7) - Inventories Down (1.4) But - A/R Up (9.8)	CFO > 0; CFO > Net Income CFO up due to - Depreciation (12) But - Inventories Up (12) - Trade Payables Down (11)	CFO > 0; CFO > Net Income CFO up due to - Depreciation (12) But - A/R Up (17) - A/P Down (3)
CFO > Capex? Capex > Depreciatn?	Yes Capex (2) < Depreciation (13)	Yes Capex (17) < Depreciation (13)	Yes Capex (3) < Depreciation (12)	Yes Capex (5) < Depreciation (12)
CFO > Capex + Dividend	Yes, No Dividends	Yes, No Dividends	Yes, No Dividend	Yes, No Dividend
Excess Cash Invested	Repay Borrowings	Repay Borrowings	Repay Borrowings	Repay Borrowings
Sources of Cash for Dividends + Capex	Operations	Operations	Operations	Operations
Other Major Items Affecting Cash Flows	Sale of Fixed Assets (1) Sales Tax Deferral (1)	Sale of Fixed Assets (2) Sales Tax Deferral (1) Increase in Cash Balance		Sale of Fixed Assets (1)
Trends Income CFO Capex Dividends Net Borrowing Working Capital	No Change (5) Down (28) Down (2) None Net Repayer (11) A/R & A/P Source, Inventory Use	Positive (6) Up (43) Up (17) None Net Repayer (20) Inventories & A/P Source (minor), A/R Use, Other WC Items (minor)	Up (-2) Down (5) Down (3) None Net Repayer (6) Inventories, A/R & A/P Use	Negative (-17) Positive (10) 5 None Net Repayer (9) A/R & A/P Use
Overall Assessment	An established company coming out of some tough times and going through a phase of debt repayment. This has also resulted in the company becoming cautious in decision making. Recently WCM has improved. One needs to keep a watch on its capex plans in the near future. Otherwise, one can say that ... is this company working for its bankers. It also needs to improve on the capex front.			

Table: Statement of Cash Flow Analysis of Chambal Fertilisers & Chemicals Limited (FY2002-06)

	FY 2006 (12m)	FY 2005 (12m)	FY 2004 (12m)	FY 2003 (12m)
Major Sources	Operations (51) Sale of Investments (4)	Operations (32) Sale of Investments (14)	Operations (36) Decrease in Cash Balance (4)	Operations (30) Short-term Borrowings (7)
Major Uses	Capex (18) Borrowings (19) Dividends (9) Increase in Cash Balance (4)	Borrowings (21) Capex (9) Dividends (7)	Borrowings (18) Dividends (7) Capex (3) Purchase of Investments (2)	Purchase of Investments (9) Dividends (6) Increase in Cash Balance (5) Capex (4)
CFO compared to Net Income	CFO > 0; CFO > Net Income CFO up due to - A/R Down (19) - Depreciation (17) - Inventory Down (5) - Advances Down (3) But - Trade Payables (8)	CFO > 0; CFO > Net Income CFO up due to - Depreciation (15) - Trade Payables Up (11) - Advances Down (4.3) But - A/R Up (8.8) - Inventories Up (7.7)	CFO > 0; CFO > Net Income CFO up due to - Depreciation (14) - Interest (10) - A/P (3) But - A/R (3.5) - Inventories Up (1.3)	CFO > 0; CFO > Net Income CFO up due to - Depreciation (14) - Interest (14) - Trade Payables (5.8) - Advances (4) But - A/R Up (9) - Inventories Up (3.7)
CFO > Capex? Capex > Depreciatn?	Yes Capex (18) > Depreciation (17)	Yes Capex (9) < Depreciation (15)	Yes Capex (3) < Depreciation (14)	Yes Capex (4) < Depreciation (14)
CFO > Capex + Dividend	Yes	Yes	Yes	Yes
Excess Cash Invested	Repay Borrowings	Repay Borrowings	NA	NA
Sources of Cash for Dividends + Capex	Operations	Operations	Operations	Operations
Other Major Items Affecting Cash Flows	Interest Paid (5.7) Increase in Cash Balance (4)	Investment (+8.7) Interest (7.8)	Investment (-2.6) Decrease in Cash Balance (4.3),	Borrowings (7.5)
Trends Income CFO Capex Dividends Net Borrowing Working Capital	No Change (28) Up (51) Double (18) Up (8.5) Net Borrower A/R, Advances & Inventory Source, A/P Use	Up (28) Down (32) Up (9.4) Up (7.3) Net Repayer Advances & A/P Source A/R & Inventories Use,	Up (18) Up (35.5) Down (2.8) No Change (6) Net Repayer A/P Source Inventories & A/R Use	Positive (11) Positive (30) 4.4 5.8 Net Borrower A/P & Advances Source, Inventories & A/R Use,
Overall Assessment	Performing Good. In 2006 the company has doubled its CAPEX and also gone for some borrowings. All components of working capital being source except accounts payable. Needs to check the forthcoming results. Rating 3			

Table: Financial Statement Analysis of Nagarjuna Fertilizers & Chemicals Limited (FY2002-06)

Nagarjuna Fertilizers and Chemicals Ltd. ~ Common Size Numbers				
BALANCE SHEET				
Assets Side	FY2006 (12m)	FY2005 (12m)	FY2004 (12m)	FY2003 (12m)
Cash & Bank Balances	1.6	0.5	0.5	0.6
Accounts Receivable	8.3	5.9	12.1	11.6
Loans and Advances	6.5	4.8	15.3	14.0
Inventories	1.5	2.0	2.1	5.8
Current Assets	18.0	13.2	29.9	32.0
Fixed Assets	63.9	69.2	44.0	44.2
Other Assets (includes investments)	18.1	17.6	26.1	23.9
Total Assets	100.0	100.0	100.0	100.0
Liabilities Side	FY2006 (12m)	FY2005 (12m)	FY2004 (12m)	FY2003 (12m)
Accounts Payable	3.4	1.9	1.7	1.9
Other Current Liabilities	1.9	0.8	1.0	2.1
Long-term Liabilities	46.5	48.8	68.1	69.5
Net Worth	48.2	48.5	29.3	26.5
Total Liabilities	100.0	100.0	100.0	100.0
No of Equity Shares	1.1	1.1	1.4	1.3
INCOME STATEMENT				
Total Sales	100.0	100.0	100.0	100.0
Other Income	1.4	2.5	4.4	1.8
Cost of Goods Sold (RM + Other Direct Expenses)	61.6	59.1	47.0	41.5
Gross Profit	39.8	43.4	57.4	60.3
Operating/Other Expenses	18.6	18.5	19.8	37.3
PBDIT	21.1	24.9	37.6	23.0
Interest	9.1	11.1	26.8	28.5
Depreciation	8.4	9.4	12.7	12.7
Tax	-0.9	2.0	-3.7	-4.6
Profit After Tax	4.6	2.3	1.8	-13.6
Dividend to Shareholders	0.0	0.0	0.0	0.0

Financial Ratios	Nagarjuna Fertilizers and Chemicals Ltd.			
	FY2006 (12m)	FY2005 (12m)	FY2004 (12m)	FY2003 (12m)
Solvency				
Short Term Solvency				
Net Working Capital (Rs in Millions)	4736.0	3980.0	8004.0	8895.0
Current Ratio	3.4	5.0	11.3	8.0
Quick Ratio	3.1	4.2	10.5	6.6
Average Daily Expenses (Rs in Millions)	28.1	24.7	13.2	15.8
Cash Cover for Daily Expenses (days)	21.6	7.8	11.1	12.2
Quick Assets Cover for Daily Expenses (days)	219.3	170.9	619.8	528.1
Current Assets Cover for Daily Expenses (days)	239.8	201.7	666.5	644.4
Current Liabilities Cover for Daily Expenses (days)	71.6	40.7	59.0	80.3
Accounts Receivable Turnover	5.4	4.5	2.6	2.5
Average Collection Period (days)	67.2	81.7	138.2	144.0
Inventory Turnover	13.3	11.0	3.7	2.1
Inventory Conversion Period (days)	27.4	33.1	99.6	172.3
Average Payables Period (days)	41.0	28.8	43.9	55.7
Long Term Solvency				
Total Debt to Total Capital	1.1	1.1	2.4	2.8
Long-term Debt to Total Capital	1.0	1.0	2.3	2.6
Long-term Debt to Fixed Assets	0.7	0.7	1.5	1.6
Interest Cover	1.4	1.4	0.9	0.4
Times Fixed Charges Covered	0.6	0.6	0.5	0.2
Net Gain from Borrowed Funds (Rs Millions)	628.9	753.6	1179.3	-473.1
Equity Multiplier	2.1	2.1	3.4	3.8
	FY2006 (12m)	FY2005 (12m)	FY2004 (12m)	FY2003 (12m)
Profitability				
Margin on Sales				
Gross Profit Margin (%)	38.4	40.9	53.0	58.5
Operating Profit Margin (%)	11.3	12.9	20.4	8.5
Net Profit Margin (%)	4.6	2.3	1.8	-13.6
Return on Investment				
Operating Profit to Operating Assets (%)	4.4	4.9	6.4	2.5
Net Income to Total Assets (%)	1.8	0.9	0.6	-4.0
Return on Equity (%)	3.7	2.2	2.0	-15.2
Efficiency of Use of Assets				
Total Asset Turnover	0.4	0.4	0.3	0.3
Operating Asset Turnover	0.5	0.5	0.4	0.4
Working Capital Turnover	3.3	2.1	1.1	1.1
Shareholder Equity Turnover	0.8	1.0	1.1	1.1
Return per Share of Equity				
Earnings per Share	1.6	0.7	0.4	-3.1

Dividends per Share (including Dividend Tax)	0.0	0.0	0.0	0.0
Other Ratios				
Book Value per Share	42.2	43.9	20.6	20.2
Dividend Payout Ratio (%)	0.0	0.0	0.0	0.0
Price-to-Book Value	0.3	0.3	0.4	0.4
Price-to-Earnings	9.0	17.0	19.2	-2.6
Dividend Yield	0.0%	0.0%	0.0%	0.0%
Gearing (%)	3.2	3.9	5.7	-2.0

Table: Financial Statement Analysis of Chambal Fertilisers & Chemicals Limited (FY2002-06)

Chambal Fertilisers and Chemicals Limited ~ Common Sized Numbers				
BALANCE SHEET				
Assets Side	FY2006 (12m)	FY2005 (12m)	FY2004 (12m)	FY2003 (12m)
Cash & Bank Balances	0.4	1.2	0.6	2.1
Accounts Receivable	11.7	17.5	14.5	12.9
Loans and Advances	3.7	3.2	4.5	4.0
Inventories	9.2	10.5	7.9	7.1
Current Assets	25.0	32.5	27.6	26.1
Fixed Assets	62.6	59.2	61.3	63.9
Other Assets (includes investments)	12.4	8.3	11.0	10.0
Total Assets	100.0	100.0	100.0	100.0
Liabilities Side	FY2006 (12m)	FY2005 (12m)	FY2004 (12m)	FY2003 (12m)
Accounts Payable	7.2	9.8	6.1	4.2
Other Current Liabilities	8.7	6.0	4.6	5.3
Long-term Liabilities	48.8	54.6	62.6	66.4
Net Worth	35.3	29.5	26.8	24.2
Total Liabilities	100.0	100.0	100.0	100.0
No of Equity Shares	1.5	1.4	1.5	1.4
INCOME STATEMENT				
	FY2006 (12m)	FY2005 (12m)	FY2004 (12m)	FY2003 (12m)
Total Sales	100.0	100.0	100.0	100.0
Other Income	0.7	1.2	1.3	1.2
Cost of Goods Sold (RM + Other Direct Expenses)	67.5	70.2	67.2	62.6
Gross Profit	33.1	31.0	34.1	38.5
Operating/Other Expenses	14.1	11.7	13.9	17.9
PBDIT	19.0	19.3	20.3	20.6
Interest	2.8	3.5	5.6	7.7
Depreciation	5.9	5.5	6.5	7.1
Tax	2.9	2.2	2.5	1.3
Profit After Tax	7.5	8.0	5.7	4.5
Dividend to Shareholders	2.8	2.7	2.9	3.1

Chambal Fertilisers and Chemicals Limited ~ Index Based Numbers				
	FY2006	FY2005	FY2004	FY2003
	(12m)	(12m)	(12m)	(12m)
Assets Side				
Cash & Bank Balances	17	56	29	100
Accounts Receivable	87	136	109	100
Loans and Advances	88	80	109	100
Inventories	122	148	108	100
Current Assets	91	124	103	100
Fixed Assets	93	92	93	100
Other Assets (includes investments)	117	83	107	100
Total Assets	95	100	97	100
	FY2006	FY2005	FY2004	FY2003
	(12m)	(12m)	(12m)	(12m)
Liabilities Side				
Accounts Payable	162	232	139	100
Other Current Liabilities	157	115	85	100
Long-term Liabilities	70	82	91	100
Net Worth	139	122	107	100
Total Liabilities	95	100	97	100
No of Equity Shares	103	100	100	100
	FY2006	FY2005	FY2004	FY2003
	(12m)	(12m)	(12m)	(12m)
Total Sales	137	139	112	100
Other Income	77	142	128	100
Cost of Goods Sold (RM + Other Direct Expenses)	148	155	120	100
Gross Profit	118	111	99	100
Operating/Other Expenses	108	91	86	100
PBDIT	126	129	110	100
Interest	50	63	81	100
Depreciation	112	107	102	100
Tax	310	239	219	100
Profit After Tax	227	247	140	100
Dividend to Shareholders	123	123	107	100

Financial Ratios	Chambal Fertilisers and Chemicals Limited			
	FY2006 (12m)	FY2005 (12m)	FY2004 (12m)	FY2003 (12m)
Solvency				
Short Term Solvency				
Net Working Capital (Rs in Millions)	2486.0	4753.0	4712.0	4766.0
Current Ratio	1.6	2.1	2.6	2.8
Quick Ratio	1.0	1.4	1.8	2.0
Average Daily Expenses (Rs in Millions)	58.5	59.2	46.7	40.6
Cash Cover for Daily Expenses (days)	1.8	5.7	3.7	14.8
Quick Assets Cover for Daily Expenses (days)	73.7	105.9	116.9	134.1
Current Assets Cover for Daily Expenses (days)	116.3	156.7	164.2	184.3
Current Liabilities Cover for Daily Expenses (days)	73.8	76.4	63.3	66.8
Accounts Receivable Turnover	6.6	6.1	5.7	5.4
Average Collection Period (days)	55.1	60.1	63.7	67.8
Inventory Turnover	6.7	7.4	7.0	6.1
Inventory Conversion Period (days)	54.8	49.3	52.1	59.9
Average Payables Period (days)	47.3	42.4	35.5	35.5
Long Term Solvency				
Total Debt to Total Capital	1.8	2.4	2.7	3.1
Long-term Debt to Total Capital	1.4	1.8	2.3	2.7
Long-term Debt to Fixed Assets	0.8	0.9	1.0	1.0
Interest Cover	4.7	3.9	2.5	1.8
Times Fixed Charges Covered	1.4	1.3	0.9	0.7
Net Gain from Borrowed Funds (Rs Millions)	1008.8	1090.3	901.0	803.1
Equity Multiplier	2.8	3.4	3.7	4.1
Profitability				
Margin on Sales				
Gross Profit Margin (%)	32.5	29.8	32.8	37.4
Operating Profit Margin (%)	12.5	12.6	12.4	12.3
Net Profit Margin (%)	7.5	8.0	5.7	4.5
Return on Investment				
Operating Profit to Operating Assets (%)	12.2	12.2	9.7	8.5
Net Income to Total Assets (%)	7.3	7.8	4.4	3.1
Return on Equity (%)	22.5	27.8	17.4	12.9
Efficiency of Use of Assets				
Total Asset Turnover	1.0	1.0	0.8	0.7
Operating Asset Turnover	1.1	1.1	0.9	0.8
Working Capital Turnover	7.5	5.8	4.7	4.2
Shareholder Equity Turnover	3.0	3.5	3.1	2.9
Return per Share of Equity				
Earnings per Share	4.9	5.4	3.1	2.2
Dividends per Share (including Dividend Tax)	1.8	1.8	1.6	1.5

Other Ratios

Book Value per Share	23.1	20.8	18.3	17.0
Dividend Payout Ratio (%)	36.9	34.0	51.9	68.1
Price-to-Book Value	1.6	1.3	1.1	0.7
Price-to-Earnings	7.6	4.9	6.5	5.7
Dividend Yield	4.9%	6.9%	8.0%	12.0%
Gearing (%)	5.7	5.4	4.4	3.7