

CREDIT RATING REPORT

Gujarat Fluorochemicals Limited

March 2010



| INSTRUMENTS RATED | | | | | RATINGS |
|---|-----------|---------------|------------|----------------------|---|
| Rs.1461.92 Million Proposed Long-Term Bank Loan Facility | | | | | AA-/Stable |
| Rs.3833.33 Million Rupee Term Loans | | | | | AA-/Stable |
| Rs.697.50 Million Cash Credit | | | | | AA-/Stable |
| Rs.2284.65 Million Foreign Currency Term Loan | | | | | AA-/Stable |
| Rs.5.60 Million Packing Credit | | | | | P1+ |
| Rs.1717.00 Million Letter of Credit and Bank Guarantee | | | | | P1+ |
| Rs.560 Million Commercial Paper Programme | | | | | P1+ |
| <i>Note – Please refer Annexure for details of bank-loan facilities</i> | | | | | Analytical Contacts at CRISIL: |
| RATING HISTORY | | | | | |
| Date | Long-Term | Fixed Deposit | Short-Term | Rating Watch/Outlook | |
| April 07, 2008 | AA- | - | P1+ | Stable | Pawan Agrawal Tel: +91-22-6691 3301 Email: pagrawal@crisil.com |
| August 22, 2006 | AA- | - | - | Positive | |
| October 11, 2005 | AA-* | - | - | Stable | Akash Deep Jyoti Tel: +91-22-6691 3234 Email: ajyoti@crisil.com |
| <i>*Initial rating assigned</i> | | | | | CRISIL Rating Desk: Tel: +91-22-3342 3047/3342 3064 Email: CRISILratingdesk@crisil.com |
| Analytical Approach For arriving at its ratings, CRISIL has combined the financials of Gujarat Fluorochemicals Ltd (GFL) and GFL's subsidiaries Inox Leisure Ltd (Inox, 65 per cent stake), Inox Infrastructure Pvt Ltd (Inox Infra, wholly owned), and Inox Motion Pictures Ltd (Inox Motion, wholly owned). | | | | | <i>Disclaimer:</i> CRISIL has taken due care and caution in compilation of data for this rating rationale, based upon the information provided by the issuer and also upon information obtained from sources it considers reliable. However, CRISIL does not guarantee the accuracy, adequacy or completeness of any information. CRISIL especially states that it has no financial liability whatsoever to the subscribers / users / transmitters / distributors of the rating or the rationale. No part of this rationale may be published / reproduced in any form without CRISIL's prior written approval. A CRISIL rating reflects CRISIL's current opinion on the likelihood of timely payment of the obligations under the rated instrument and does not constitute an audit of the rated entity by CRISIL. A CRISIL rating is not a recommendation to buy, sell or hold the rated instrument; it does not comment on the market price or suitability for a particular investor. All CRISIL ratings are under surveillance. Ratings are revised as and when circumstances so warrant. CRISIL Ratings' rating criteria are generally available without charge to the public on the CRISIL public web site, www.crisil.com. For the latest rating information on any instrument of any company rated by CRISIL, please contact CRISIL RATING DESK at CRISILratingdesk@crisil.com, or at (+91 22) 3342 3000 - 09. |

Rating Drivers

Strengths

- Strong cash accruals from carbon credit business and robust liquidity position
- Comfortable financial risk profile
- Integrated operations in chemicals segment leading to high operational efficiency

Weaknesses

- Large, debt-funded expansion plans in wind power business
- High implementation and counterparty risks associated with windmill project

CRISIL Complexity Levels are assigned to various types of financial instruments. The CRISIL Complexity Levels are available on www.crisil.com/complexity-levels. Investors are advised to refer to the CRISIL Complexity Levels for instruments that they propose to invest in. Investors can also call the CRISIL Helpline at +91 22 3342 3047 / + 91 22 3342 3064 with queries on specific instruments.

Rating sensitivity factors

- Pricing and continuation of certified emission reduction (CER, or carbon credit) awards under Kyoto Protocol and successive protocols
- Extent of debt-funded investment, and phasing thereof, in unrelated businesses
- Significant increase in gearing beyond 1 time

Outlook: Stable

CRISIL expects GFL to maintain its moderately-conservative capital structure on the back of its strong cash accruals from the carbon credit business over the medium term. Furthermore, GFL's windmill power project is likely to be implemented in phases, which will restrict deterioration in the company's capital structure. A significant improvement in GFL's business risk profile could result in a 'Positive' outlook. Conversely, the outlook may be revised to 'Negative' if GFL's gearing increases to more than 1 time or if there is any deterioration in the carbon-credit business.

Liquidity

GFL has strong liquidity backed by cash inflows from carbon credits (dated up to December 2012), and a large portfolio of marketable securities – Rs.3.50 billion as on March 31, 2009.

Rationale

GFL is India's largest manufacturer of hydrochlorofluorocarbon (HCFC), which is used in refrigeration, air conditioning, and as feedstock for polytetrafluoroethylene (PTFE) production. GFL's manufacturing plant, located in Ranjitnagar, near Vadodara (Gujarat), is the first Indian refrigerant gas plant to have obtained ISO 9002 accreditation. The company has an installed capacity of 25,000 tonnes per annum (tpa) for manufacture of HCFC and chlorofluorocarbon (CFC). The company has also been successful in implementing a clean-development-mechanism (CDM) project, which helps reduce emission of greenhouse gases (GHG) by thermal oxidation of hydrofluorocarbon-23 (HFC-23, a by-product of HCFC) and earns carbon credits. GFL also has exposure to the film exhibition business through its subsidiary Inox, which has presence in 20 cities and 102 screens. Inox's multiplexes have state-of-the-art facilities, with modern equipment and infrastructure.

In 2007-08 (refers to financial year, April 1 to March 31), GFL commissioned a 52,500-tpa caustic soda/chlorine plant, a 30-megawatt (MW) captive power plant, a 41,500-tpa chloromethane plant, and a 5500-tpa PTFE plant. Furthermore, GFL has established a 33 per cent joint venture with a Chinese company for production and sourcing of hydrofluoric (HF) acid, a critical raw material in the production of HCFC. Hence, GFL has transformed itself into an integrated PTFE manufacturer from a plain refrigerant company.

In November 2009, GFL announced a large-scale expansion plan to increase the production capacity of its caustic soda plant to 170,000 tpa, chloromethane capacity to 120,000 tpa, and PTFE capacity to 12,500 tpa, for an estimated investment of Rs.5.0 billion, spread over the next two years.

GFL has also entered the wind-energy space, with a significant capital expenditure (capex) for setting up substantial capacity over the next few years. Hence, over the long term, GFL will have a prominent presence in the wind-energy space. In November 2009, the company indicated that it is setting up wind-turbine manufacturing facility in Una, Himachal Pradesh, in a new subsidiary Inox Wind Ltd for a total investment of Rs.1.5 billion, and that it expects to produce around 300 turbines per annum. The manufacturing facility is expected to be ready by February 2010, and the first set of turbines will be rolled out by March 2010.

The rating reflects GFL’s following strengths:

Strong cash accruals from carbon credit business and robust liquidity position

GFL’s strong cash accruals are marked by the high certainty of revenues from carbon credits. The company has entered into forward contracts for a significant portion of its CER generation up to 2012 (refers to calendar year, January 1 to December 31). As a strategy, the forward contracts are entered into with entities having investment-grade rating, thereby minimising counterparty risks. This will provide a stable and assured revenue stream. GFL has a minimum technology failure risk, as it has employed thermal oxidation of HFC-23 at its CDM project for generation of CERs. This technology, which has been in use at its technical partner’s facilities in the UK for several years, is well established globally, and accounts for 53 per cent of the CERs generated from CDM till date.

GFL has strong liquidity backed by revenues from carbon credits. The company generated revenues of Rs.6.3 billion in 2008-09 and Rs.4.5 billion in 2007-08 from the sale of CERs. CRISIL expects GFL to report revenues of about Rs.5.0 billion from the sale of CERs in 2009-10.

Comfortable financial risk profile

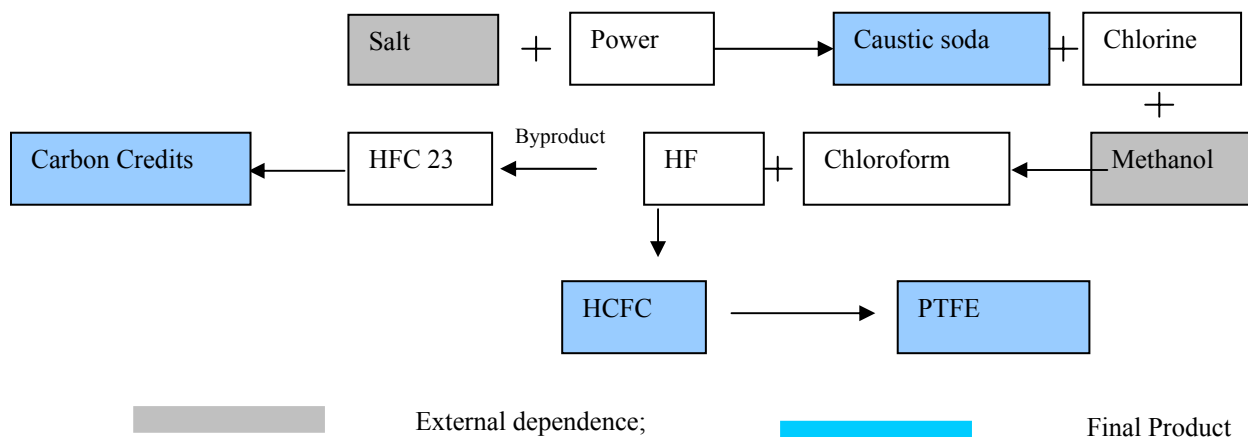
GFL has large net worth, moderate gearing, healthy debt protection measures, and strong liquidity.

GFL had a net worth of Rs.14.6 billion, and a gearing of 0.5 times, as on March 31, 2009. The company also has healthy debt protection measures, with net cash accruals to total debt (NCATD) ratio of 0.5 times, and interest coverage ratio of 10.5 times, for the year ended March 31, 2009. Although GFL has a large, debt-funded capex programme (wind farms and other expansions), in CRISIL’s opinion, GFL has the flexibility of implementing the windmill project in phases. In view of the above, CRISIL expects GFL to maintain a gearing of about 1 time in the medium term.

Integrated operations in chemicals segment leading to high operational efficiency

GFL is the largest manufacturer of refrigerant gas (HCFC) in India using chloroform and HF acid. The company’s integrated operations are marked by forward integration into PTFE and backward integration into the manufacture of chloroform. This not only reduces its dependence on external sources for supply of raw materials (see Figure 1) but also helps in improving margins and capacity utilisation of the HCFC plant.

Figure 1: Integrated manufacturing operations



The company has a 33 per cent joint venture with a Chinese company for the manufacture of HF acid; GFL is able to procure the required quantity of HF acid at a preferential rate. Furthermore, the integration has added new products, such as caustic soda, apart from PTFE to GFL's portfolio. PTFE is a high-margin product which finds application in the construction, automobile, petrochemical, aviation, food, and insulation industries. CRISIL expects the operating performance of GFL's chemicals division to continue to benefit on account of synergies arising out of integration.

The above-mentioned rating strengths are partially offset by GFL's following weaknesses:

Large, debt-funded expansion plans in wind power business

GFL's aggressive growth strategy is reflected in its large, debt-funded capex for the installation of wind-power capacity of 400 MW by 2012-13. The capex is structured such that the depreciation benefit from the investment will minimise the tax incidence and the effective tax saving will be leveraged in the ratio of 1:4 to fund the project – that is, 80 per cent of the capex will be funded through debt. In CRISIL's opinion, although GFL may control the absolute capex through phased implementation of the windmill project, the aggressive funding mix will result in a moderately high gearing of about 1 time over the medium term. CRISIL will monitor GFL's gearing closely. Any significant increase in the gearing over 1 time may have an adverse impact on the rating.

High implementation and counterparty risk associated with windmill project

GFL faces risks on account of lack of experience in in-house commissioning of windmills and counterparty risks related to the project.

Lack of experience in setting up windmills - GFL is a relatively new player in the wind-energy space, with an installed capacity of about 65 MW, which is about 16 per cent of the 400-MW capacity it plans to add by 2012-13. Furthermore, GFL will implement the projects in-house (*no outsourcing to Suzlon Energy Ltd, Enercon India Ltd*). GFL also faces challenges in acquiring land in Gujarat, Rajasthan, and Karnataka; GFL has so far acquired land in Gujarat to accommodate wind farm capacity of about 250 MW. Also, GFL is exposed to the risk of the relatively new technology, which may not have been tested for Indian conditions. GFL's ability to manage financial costs associated with such time overruns will determine its impact on the company's financial risk profile.

Counterparty risk - GFL will be exposed to counterparty risk associated with financially weak state electricity boards (SEBs), power utilities, and private entities to the extent of their credit worthiness. The performance of SEBs has been weak due to factors like low plant-load factors (PLF) and high auxiliary consumption of generating plants, high transmission and distribution (T&D) losses, poor metering, low billing and collection efficiencies, and high manpower levels. This reflects in the overall high adjusted book loss (ABL) position across all SEBs in India. Furthermore, 21 of India's 29 state utilities have defaulted on loans from state governments, banks, or financial institutions; most SEBs have poor financial positions. GFL plans to set up windmills in Gujarat, Maharashtra, Tamil Nadu, and Rajasthan. Exposure to SEBs with a poor operational and financial performance is a factor that will have a strong bearing on GFL's credit profile.

Business Profile

Chemicals business

Caustic soda and chlorine - GFL's entry into the caustic soda and chlorine segments is primarily a backward integration initiative to secure its requirement of chlorine for the manufacture of HCFC. GFL will also sell the caustic soda in the domestic markets.

HCFC - GFL is India's largest manufacturer of refrigerant gas HCFC. Stringent environmental regulations and high technology intensity act as entry barriers. Production bases are increasingly shifting from developed countries to developing ones due to environmental cost considerations and less stringent environmental norms. Consequent to the implementation of the Montreal Protocol, GFL has moved from the manufacture of CFCs to HCFCs. GFL exports about 90 per cent of its HCFC production. Capacity utilisation of HCFC is likely to increase due to in-house demand for the manufacture of PTFE.

PTFE - GFL has integrated its operations forward to manufacture high value-added PTFE, which will consume about 44 per cent of its HCFC production. The resultant change in product mix is expected to result in improvement in the operating margin of the chemical division. Demand for PTFE is expected to be driven by diverse end uses in the petrochemical, food, construction, semiconductor, and electrical appliance sectors, as it offers exceptional resistance to chemical reaction, high temperatures, corrosion, and stress-cracking. GFL has a buy-back arrangement with a European company for the purchase of 2650 tpa of PTFE. Domestic demand is estimated at 2000 tpa, a majority of which is being met by imports.

Carbon emission credit business

GFL commissioned its CDM project in February 2006 and has started generating carbon credits under the Kyoto Protocol. The Kyoto Protocol, an international treaty on global warming that came into force on February 16, 2005, provides mechanisms for developed countries to achieve their emission reduction targets by purchasing CERs generated from CDM projects. The traded carbon credit market grew to 2.4 billion tonnes in 2007 from 799 million tonnes in 2005. By far, the European Union (EU) remains the major consumer of carbon credits. Australia, a major GHG producer, has become an active member of the Kyoto Protocol since March 2008. The protocol imposes a penalty of EUR100 per CER for not complying with emission reduction norms.

Continuation of award of carbon credits under Kyoto Protocol remains a key sensitivity factor - GFL's capital structure will be largely driven by cash accruals from its business of carbon credits generated under the Kyoto Protocol. The protocol's first commitment period is up to December 2012; there is high uncertainty over CER trading after December 2012.

Wind-energy business

Sustained rise in the cost of energy from thermal power and growing environmental concerns are resulting in an increasing shift to non-conventional sources of energy, like wind power. India has a gross wind-energy potential of 45,195 MW, of which 13,390 MW could be developed with present grid conditions as against the current level of 7845 MW. Zero input cost and favourable incentives - 80 per cent depreciation in the first year, tax holidays for newer power projects for 10 years, excise duty exemption and zero import duty on certain parts, and preferential treatment by SEBs (up to 5 per cent of their total demand) - offered by the government are major investment drivers. Various state governments have provided wind-power generators with preferential tariff and wheeling facilities. A wind-energy project also qualifies as a CDM project and has the potential to generate CERs. However, wind energy suffers from low PLFs of 20 to 25 per cent, which is a major barrier for a large-scale substitution of fossil fuel-generated power with wind power.

Film exhibition business

GFL has exposure to the film exhibition business through its subsidiary, Inox, which has presence in 20 cities. Inox's multiplexes, with their state-of-the-art facilities, are positioned at the premium end of the market. The company has 102 screens across 28 multiplexes. CRISIL believes that the potential for the entertainment business in India is high, with the country's ratio of screens per million viewers being one of the lowest in the world (13 screens per million people as against 117 screens in the US).

Financial Profile

Financial policy

GFL has a moderately conservative financial policy, with gearing expected at about 1 time over the medium term. The company's dividend payout track record has also been conservative in relation to the profits generated (averaging 13 per cent of profits after tax [PAT] over the past three years). The company invests in equity markets (either through equity mutual funds or direct equity investment), debt mutual funds, bonds, and principal-protected structured products.

GFL has derivative exposure by way of hedging of its foreign currency loan and euro receivables from carbon credits. However, the management has indicated that the derivative exposure is backed by actual trade exposures, and is not speculative.

Profitability and cash-flow protection

GFL has healthy profitability, driven by revenues from CER; the company generated revenues of Rs.6.3 billion in 2008-09, up from Rs.4.5 billion in 2007-08. The profitability was high, at 29.0 per cent, in 2008-09; however, it was much higher at 38.5 per cent in the previous year, and the deterioration in 2008-09 was mainly because of foreign exchange loss of Rs.0.7 billion during the year. The profitability of GFL's HCFC business was under pressure in 2006-07 and 2007-08 owing to a steep rise in raw material prices of fluorspar and chloroform, a change in the product mix, high fuel costs due to an off-take agreement for supply of natural gas involving a take-or-pay liability, and strong competition from Chinese players.

However, GFL's operating margin is expected to remain high due to integrated operations; GFL's profitability will be driven by its CDM business over the medium term.

Capital structure and financial flexibility

GFL had a consolidated gearing of 0.5 times as on March 31, 2009, down from 0.6 times as on March 31, 2008. As the company has planned to fund its wind energy projects with 80 per cent debt, its capital structure is expected to deteriorate, with the gearing expected at about 1 time over the medium term. Furthermore, GFL has good financial flexibility with high net worth and strong cash flows from carbon credits.

Liability management

GFL is expected to fund its large capex in windmills through long-term debt with average maturity in excess of 10 years. The proportion of short-term debt in the overall debt profile is very low, and is likely to remain so in the medium term.

Consolidated financial performance of GFL

| Particulars | Units | 31-Mar-09 | 31-Mar-08 | 31-Mar-07 | 31-Mar-06 |
|---------------------------------|-------------|-----------|-----------|-----------|-----------|
| | | 12 months | 12 months | 12 months | 12 months |
| Net Sales | Rs. Billion | 12.40 | 9.05 | 7.14 | 2.83 |
| Operating Income | Rs. Billion | 12.46 | 9.07 | 7.17 | 2.85 |
| OPBDIT | Rs. Billion | 6.68 | 4.25 | 3.77 | 0.83 |
| PAT | Rs. Billion | 3.61 | 3.49 | 2.70 | 1.15 |
| Net Cash Accruals | Rs. Billion | 3.80 | 3.27 | 2.73 | 1.21 |
| Cash Flow from Operations | Rs. Billion | 2.73 | 0.97 | 3.61 | 0.93 |
| Equity Share Capital | Rs. Billion | 0.11 | 0.12 | 0.12 | 0.12 |
| Tangible Net Worth | Rs. Billion | 14.64 | 12.02 | 9.01 | 6.51 |
| Total Debt | Rs. Billion | 7.23 | 5.23 | 4.89 | 2.12 |
| | | | | | |
| OPBDIT Margins | % | 53.6 | 46.9 | 52.5 | 29.3 |
| Net Profit Margins | % | 29.0 | 38.5 | 37.7 | 40.5 |
| RoCE | % | 27.3 | 31.7 | 34.2 | 21.4 |
| | | | | | |
| PBDIT / Int. & Finance Charges | Times | 10.48 | 14.92 | 36.39 | 16.18 |
| Net Cash Accruals / Total Debt | Times | 0.53 | 0.63 | 0.56 | 0.57 |
| Total Debt / Tangible Net Worth | Times | 0.49 | 0.44 | 0.54 | 0.33 |
| Total Debt / PBDIT | Times | 1.16 | 0.96 | 1.12 | 1.29 |
| Current Ratio | Times | 1.75 | 1.13 | 1.94 | 2.45 |

Quarterly Performance

Rs. billion

| For the quarter ended | Dec 09 | % | Sep 09 | % | Jun 09 | % | Dec 08 | % |
|-------------------------------------|--------|-------|--------|------|--------|------|--------|------|
| Net sales | 2.50 | 100.0 | 2.14 | 100 | 2.21 | 100 | 2.51 | 100 |
| Cost of Goods Sold | 1.54 | 61.8 | 1.36 | 63.7 | 1.25 | 56.8 | 1.23 | 49 |
| OPBDIT | 0.95 | 38.2 | 0.78 | 36.3 | 0.95 | 43.2 | 1.28 | 51 |
| Interest | 0.12 | 5.0 | 0.13 | 6.1 | 0.12 | 5.4 | 0.18 | 7.1 |
| OPBDT | 0.83 | 33.2 | 0.65 | 30.3 | 0.84 | 37.9 | 1.1 | 43.9 |
| Depreciation | 0.16 | 6.3 | 0.13 | 6.2 | 0.12 | 5.4 | 0.12 | 4.8 |
| OPBT | 0.67 | 26.9 | 0.51 | 24 | 0.72 | 32.4 | 0.98 | 39.1 |
| Exceptional Exp. | 0.0 | 0.0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other Income (incl. Non-Op. Income) | 0.12 | 4.8 | 0.14 | 6.6 | 0.17 | 7.6 | 0.07 | 2.6 |
| PBT | 0.79 | 31.7 | 0.66 | 30.7 | 0.88 | 40 | 1.05 | 41.7 |
| Tax | 0.34 | 13.5 | 0.14 | 6.6 | 0.24 | 11.1 | 0.33 | 13.3 |
| PAT | 0.45 | 18.2 | 0.52 | 24.1 | 0.64 | 28.9 | 0.71 | 28.4 |

Half Yearly Performance

Rs. billion

| For the half year ended | Sep 09 | % | Sep 08 | % |
|-------------------------------------|--------|-----|--------|-----|
| Net sales | 4.35 | 100 | 5.12 | 100 |
| Cost of Goods Sold | 2.61 | 60 | 2.36 | 46 |
| OPBDIT | 1.73 | 40 | 2.94 | 57 |
| Interest | 0.25 | 6 | 0.22 | 4 |
| OPBDT | 1.49 | 34 | 2.71 | 53 |
| Depreciation | 0.25 | 6 | 0.25 | 5 |
| OPBT | 1.23 | 28 | 2.47 | 48 |
| Exceptional Exp. | - | - | - | - |
| Other Income (incl. Non-Op. Income) | 0.31 | 7 | - | - |
| PBT | 1.54 | 35 | 2.47 | 48 |
| Tax | 0.38 | 9 | 0.71 | 14 |
| PAT | 1.16 | 27 | 1.76 | 34 |

Annexure - Details of Bank-Loan Facilities

1. Cash Credit facilities

| | | Amount (in Million) |
|-------|-------------------------------|---------------------|
| S.No. | Bank | Existing |
| 1 | Canara Bank | 82.50 |
| 2 | Bank of Maharashtra | 15.00 |
| 3 | HDFC Bank Ltd./ ABN Amro Bank | 600.00 |
| | Total | 697.50 |

2. Rupee Term Loan

| | | Amount (in Million) |
|-------|---------------------------|---------------------|
| S.No. | Bank | Existing |
| 1 | United Bank of India | 1,131.67 |
| 2 | Oriental Bank of Commerce | 777.78 |
| 3 | UCO Bank | 423.89 |
| 4 | Indian Overseas Bank | 1,500.00 |
| 5 | Proposed | 1,461.92 |
| | Total | 5295.25 |

3. Foreign Currency Term Loan

| | | Amount (in Million) |
|-------|--------------------|---------------------|
| S.No. | Bank | Existing |
| 1 | ABN Amro Bank N.V. | 137.82 |
| 2 | ICICI Bank | 1,096.77 |
| 3 | Citibank FCNRB | 490.06 |
| 4 | BNP Paribas | 560.00 |
| | Total | 2,284.65 |

4. Packing Credit

| | | Amount (in Million) |
|-------|---------------------|---------------------|
| S.No. | Bank | Existing |
| 1 | Canara Bank | 5.50 |
| 2 | Bank of Maharashtra | 0.10 |
| | Total | 5.60 |

5. Letter of Credit & Bank Guarantee

| S.No. | Bank | Amount (in Million) |
|-------|------------------------------|---------------------|
| | | Existing |
| 1 | Canara Bank | 99.00 |
| 2 | Bank of Maharashtra | 18.00 |
| 3 | ICICI Bank Ltd. | 750.00 |
| 4 | HDFC Bank Ltd./ABN Amro Bank | 450.00 |
| 5 | Yes Bank | 400.00 |
| | Total | 1,717.00 |

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CRISIL rating actions are updated online on www.crisil.com