ICRA

Indian Chemicals Sector: Basic Chemicals

Impacted chemicals manufacturers back to over 85-90% of pre-covid monthly production levels

Trends & Outlook

December 2020

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CREDIT OUTLOOK: STABLE

Impacted chemicals manufacturers back to over 85-90% of pre-covid levels

Credit profiles of most players to be supported by diversification, manageable leveraging

- The global chemicals industry is continuing its recovery after having been dealt a series of blows from closures related to Covid-19, demand destruction and logistical challenges. Those impacted heavily chemicals are now back to over 85-90% of pre-covid levels of monthly production on yoy basis.
- ICRA continues to maintain that overall volumes are likely to be impacted by 300-500 bps following the weak demand scenario for some basic chemicals like caustic soda, soda ash, PAN, MAN, methanol, etc. Margins will be impacted by a decline in capacity utilization levels resulting in lower absorption of fixed costs and an increase in overheads such as freight costs this fiscal, while depreciation of the rupee, softer crude price environment and various cost rationalization exercises carried out by all companies should provide some offset. This analysis is based on the 12 ICRA rated basic chemical producers and other large listed peers.
- However, credit profiles of most ICRA rated basic chemical players are expected to remain resilient in 2021, supported by the diversification of products in their portfolio, wide applications of these chemicals and manageable leveraging levels. Additionally, in the long term, the demand supply balance of the industry is expected to remain healthy given the well-spaced out capacity additions which are expected to be absorbed driven by demand growth. While the industry may face near term headwinds, the medium to long term credit outlook remains stable for the industry.
- The pandemic has impacted the basic chemical demand though the severity varies across the industry. Food packaging, pharma, sanitary and medical applications, are witnessing a surge, primarily due to stockpiling, an increase in delivery services, and the high healthcare-focused activities. Other major consuming sectors, such as automotive and construction, have been severely impacted. Most basic chemicals have a diverse range of end-user industries thereby softening the impact of severe slowdown in any one industry on consumption.

Exhibit 1: Basic chemicals sub segment outlook

Chemical	Key end user segments	Near Term Financial Performance Outlook	Credit Outlook
Caustic Soda	Paper, alumina, soaps, detergents, chemicals, water treatment, mining, glass	Negative	Stable
Soda Ash	Construction, Automobile, FMCG	Stable	Stable
Carbon black	Tires, plastics, rubber goods, inks and toners	Negative	Stable
Methanol	Chemicals, Construction	Negative	Stable
Acetic Acid	Textiles, Paints, Adhesives, Pharma, Agrochemicals	Stable	Stable
Phenol	Electronics, Automobiles, Construction, Agrochemicals, Pharma	Stable	Stable
Acetone	Cosmetics, Paints, Construction, Automobiles, Pharma	Stable	Stable
Phthalic Anhydride and Maleic Anhydride	Construction, Automobile	Negative	Stable

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- The outlook for different sub segments covered by ICRA under the head “Basic Chemicals” is given below:
- **Caustic Soda** - The near-term outlook remains negative given the steep decline in caustic soda prices. The operating rate for the industry is expected to witness a sharp decline in FY2022 mainly due to the expected commissioning of the capacity of Gujarat Alkali & Chemicals Limited (GACL) while the demand is expected to witness subdued growth. The international prices are expected to remain subdued although the current prices are expected to act as a floor for the price. The operating margins of players with large scale of operations are expected to remain healthy although moderation from the elevated levels witnessed in the past is certain.
- **Soda Ash** - The outlook for the soda ash players remains stable on account of expected recovery in demand growth from the automotive and the real estate sector in the medium term although the near term demand may face headwinds due to the macroeconomic slowdown driven by the Covid-19 pandemic. The demand from the detergent segment is expected to remain stable given the expectation of a revival in rural consumption driven by healthy farm incomes. Currently the auto and the real estate sectors are facing slowdowns resulting in weaker demand from the glass sector while demand from the FMCG sector remains stable. Additionally, the demand supply balance of the industry is expected to remain healthy given the well-spaced out capacity additions which are expected to be absorbed driven by the demand growth. While the industry may face near-term headwinds, the medium to long term outlook remains stable for the industry.
- **Carbon Black** - H2FY21 is seeing a strong recovery supported by the tyre industry. FY2021 would remain negative due to the expected adverse impact on tyre demand following the pandemic. Demand outlook is favorable for next two years driven by the expected recovery in the tyre segment.
- **Methanol -** The global methanol market will remain weak in the H2FY2021 given the expectation that oversupply and high inventories will weigh on the key China market. ICRA expects global methanol demand to be down by 5-10% year on year in CY2020 with end-use consumption only expected to fully recover in the next 1-2 years. Demand from methanol’s energy related applications, which has 40% market share globally, is expected to be hit the most, with fuel blending, MTBE, biodiesel demand forecast to decline 10-20% year on year, as countries remain in lockdown and because of unattractive margins following the fall in the price of crude oil. Other traditional demand outlets for methanol, such as formaldehyde, acetic acid, ethylene and propylene are also expected to remain weak, pressured by weakened decoration segment and clothing market.
- **Acetic Acid -** The outlook for acetic acid demand is anticipated to remain firm over the near term and continue to improve as economic recovery continues. This is due to the increasing use of acetic acid derivatives in a variety of applications like packaging, pharmaceuticals, and textiles. The technology for manufacturing acetic acid is also concentrated with limited players and should ensure a good price environment for players having access to competitive manufacturing processes.

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- **Phenol -** The outlook for phenol demand is expected to remain muted in FY2021. Demand for phenol has been rising globally due to the growth of its end-user industries, owing to the increasing urbanisation, changing lifestyles and the rise in disposable incomes. Phenol finds wide applications in construction and automobile industries. Domestic phenol players to benefit from the imposition of ADD in December 2020.

- **Acetone** - The long term outlook for acetone is driven by the growing demand for it as a solvent and its downstream products in various end-user industries such as cosmetics and personal care, electronics, construction, automotive, pharmaceutical, paints and coatings, etc. Even during the Covid-19 pandemic, acetone demand was up due to its application in making of IPA/sanitizer. Pricing would be supported by the lower supply due to the weaker demand for its co-product - Phenol. Going forward, once IPA demand wanes off and economic activity picks up, demand should remain firm.

- **Phthalic Anhydride and Maleic Anhydride** - The outlook for phthalic anhydride and maleic anhydride is expected to be adversely impacted in FY2021 due to the impact of Covid-19 on construction and the auto sector, although the impact may be partly mitigated by the recent imposition of safeguard duty on imports. The medium to long term growth prospects however remain favourable given the recovery in Chinese demand and the expected recovery in the domestic end-user industries.

Exhibit 2: Key rating actions since end March 2020 for ICRA rated basic chemical cos

Sr no	Company name	Previous rating	Rating action	Date	Remarks
1	Nirma Ltd	AA/Watch developing/A1+	AA/Negative/A1+	Sep-20	Negative outlook assigned due to the increased leveraging levels following acquisition and delayed deleveraging trajectory
2	Punjab Alkalies and Chemicals Ltd	BB/Stable/A4	BB-/Negative/A4	Jul-20	Downgrade and negative outlook following the weak performance of the company due to softer caustic soda prices and increased power cost
3	Thirumalai Chemicals Ltd	A+/Stable/A1+	A+/Negative/A1+	Apr-20	Negative outlook following significant weakening in the financial performance, resulting in a decline in revenue expectation and moderation in the consolidated profit margin
4	Deepak Nitrite Limited	AA-/Stable/A1+	AA-/Positive/A1+	Jun-20	Positive outlook following continued improvement in the financial profile characterised by healthy growth in revenue and profitability and improvement in the debt coverage indicators
5	Deepak Phenolics Ltd	A-/Stable/A1	A/Stable/A1	Jun-20	Significant ramp-up in capacity utlisation levels and stabilisation of sales from large project

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