June 21, 2024

The South India Paper Mills Limited: Rating downgraded to [ICRA]BB+(Negative)/ [ICRA]A4+

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based – Term loan	166.77	166.77	[ICRA]BB+ (Negative) downgraded from [ICRA]BBB- (Negative)
Fund-based – Working capital facilities – Cash credit	70.00	70.00	[ICRA]BB+ (Negative) downgraded from [ICRA]BBB- (Negative)
Non-fund based – Working capital facilities – LC/BG	5.50	5.50	[ICRA]A4+ downgraded from [ICRA]A3
Unallocated limits	7.73	7.73	[ICRA]BB+ (Negative) downgraded from [ICRA]BBB- (Negative)
Total	**250.00**	**250.00**	

**Instrument details are provided in Annexure-I*

Rationale

The rating downgrade, along with the continuation of the Negative outlook on the bank lines of The South India Paper Mills Limited (SIPM), considers the company's stretched liquidity profile amid high impending debt repayments in the near to medium term, with the company yet to scale up to its optimum utilisation levels following a large capex programme that was commercialised in FY2023. SIPL’s DSCR is expected to remain subdued in the near-to-medium term, with debt repayments likely to be supported by the ongoing sale of old machineries and buffer in working capital limits, while the cash accruals may not be fully adequate to cover the debt obligations. Any infusion of equity, to shore up liquidity and support the repayments, will be a positive from a liquidity standpoint and is a key monitorable. In FY2024, SIPM reported operating income of Rs. 312.3 crore with net loss of Rs. 13.4 crore. The losses were due to suboptimal utilisation of the new capacities and high interest cost burden. While the company’s revenues improved sharply in Q4 FY2024 (in line with ICRA’s expectations), sustenance of the same and meaningful improvement in its earnings profile in the near-to-medium term remains to be seen.

The ratings, however, remain supported by the company's extensive operational track record, diversified customer profile, and strong distribution network across South India. Additionally, its forward integration into manufacturing packaging material supports SIPM's profitability margins to some extent. In the last two fiscals, the company sold non-core assets and also raised equity of Rs. 45.37 crore in FY2023 to support its liquidity profile and, thereby the repayments. ICRA expects the promoters to continue to support the entity for any large liquidity mismatches, which will remain a key monitorable for the rating.

The Negative outlook on the long-term rating reflects ICRA's opinion that the financial profile of the company will continue to remain under stress in the near term amid high impending repayments vis-à-vis cash accruals. Timely monetisation of the non-core assets or the planned fund raising will remain a critical monitorable.

Key rating drivers and their description

Credit strengths

Extensive experience of promoters in the paper industry – The promoters of SIPM have been experienced in the kraft paper industry for over five decades. This has aided the company in forging strong relationships with both its customers and suppliers. The demand for paper is expected to improve from the current fiscal, following the turbulence witnessed in the last two fiscals amid fluctuations in raw material prices and realisations, with stability seen from January 2024.

Established and strong distributor network in southern India – SIPM has a strong distribution network with around 10-12 agents across various cities such as Bengaluru, Chennai, Kochi (Kerala) and Coimbatore (Tamil Nadu). Its customer profile is diversified with reputed clients like Nestle, Reckitt Benckiser, Britannia and Parle Agro.

Credit challenges

High impending repayments in near-to-medium term continues to be a drag on financial profile – In FY2024, SIPM reported operating income of Rs. 312.3 crore with net loss of Rs. 13.4 crore, and the performance was affected by suboptimal utilisation of the new capacities and high interest cost burden. While the company's Q4 FY2024 revenues improved sharply, the sustenance of the same and meaningful improvement of its earnings profile in the near-to-medium term remain to be seen. The financial risk profile of the company is constrained by high debt repayments over the near-to-medium term against the likely cash accruals, with the company yet to reach its optimal performance levels after the large capex commercialisation. The repayment in the current fiscal is likely to be supported by ongoing old machinery sale and buffer in fund-based limits, given that cash accruals are likely to fall short to cover the full repayment. However, the DSCR is expected to improve from FY2026, with expected scale up of operations and associated margin improvement. ICRA will continue to closely monitor the performance.

Vulnerability of profitability margins to volatility in wastepaper prices and forex fluctuations – SIPM's profitability remains exposed to sharp fluctuations in raw material prices, primarily wastepaper, wherein a large portion of the wastepaper is imported and the prices remain exposed to global demand-supply dynamics. The company's ability to fully pass on the price risk remains limited by competition in the market, which can impact its profitability metrics. Further, the company imports around 50% of its raw material requirement, making it vulnerable to movement in forex rates, with the company adopting currency hedging in a limited way.

Product concentration risk with product portfolio limited to kraft paper and related products – Given that the product portfolio of SIPM is confined to kraft paper, it remains exposed to product concentration risks. The risk is, however, alleviated to a certain extent by the company's forward integration into the packaging segment. The company also plans to manufacture value-added grades in kraft paper which is expected to act as import substitutes.

Intense competition in kraft paper industry – The kraft paper industry in India has many unorganised players and is, hence, characterised by intense competition. This results in intense pricing pressure and limits the company's ability to pass on the raw material price fluctuations in a timely manner. Nonetheless, the presence of SIPM in the moderate-to-high grade kraft paper segment and its established relationships with major players in the FMCG sector are key mitigating factors for the company.

Environmental and Social Risks

Environmental considerations: The paper manufacturing industry is exposed to environmental risk of air, water and land pollution, with discarded paper and paperboard make up a sizable share of solid municipal waste in landfills. Pulp and paper generate a notable amount of industrial air, water, and land emissions. While these risks have not resulted in any material implication so far, any breaches in waste management or higher than permissible emissions could have cost implications for the company. Also, water treatment is important because the pulping and bleaching process can release complex organic and inorganic pollutants, which need to be properly treated.

The company has an Effluent Treatment Plant (ETP) facility for conserving water and meeting pollution control norms. Further, the company has installed Electrostatic Precipitator (ESP) systems for its boilers for controlling dust emission and a dust extractor system for controlling dust at its fuel handling system. Centrifuge and other machineries have also been installed for effluent treatment.

Social considerations: Being a labour-intensive segment, entities operating in the paper industry are exposed to the risk of disruption from their inability to properly manage human capital in terms of their safety and overall wellbeing. SIPM is exposed to the shortage of skilled labour, which can impact operations. Further, any significant wage rates adversely impacting the cost structure of paper manufacturing companies can impact their margin. SIPM conducts wage negotiations on a periodic basis to manage any wage related issues.

Liquidity position: Stretched

The company's liquidity position remains stretched owing to the high debt repayments to be made in the current fiscal. It has total repayment obligations of Rs. 28.5 crore in FY2025. Since SIPM's internal accruals are likely to be inadequate to cover its repayment obligations, the near-term liquidity profile is expected to be supported by ongoing non-core asset sales and buffer in working capital limits. Any infusion of equity to support the liquidity profile, as witnessed in the recent past, will also be positive for liquidity management. The average working capital utilisation remained high at 87% against the drawing power over the past 12 months ending in May 2024.

Rating sensitivities

Positive factors – Given the Negative outlook, a rating upgrade in the near-term is unlikely. Scale up of operations from the enhanced capacities, along with stabilisation of cost structure leading to improvement in revenues and earnings, along with improvement in liquidity levels and coverage indicators on a sustained basis will be credit positive rating factors.

Negative factors – Pressure on SIPM's ratings could arise if the company is unable to scale up to its optimal levels along with continued delay in recovery of margins leading to weak cash accruals. Further, stretch in working capital cycle or inadequate cash generation on a sustained basis, which may further impact the liquidity profile, will also be a negative rating trigger.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology
Parent/Group support	Not applicable
Consolidation/Standalone	The ratings are based on the standalone financial profile of the company.

About the company

Incorporated in 1959, SIPM operates a kraft paper manufacturing unit and a packaging division at Nanjangud in Mysore district of Karnataka. SIPM also has an 11-MW captive cogeneration power plant. Its key products include kraft liners, test liners, machine-glazed kraft paper, corrugated boards and wraparound boxes. The manufacturing facility has an installed production capacity of 115,500 MT/year for the paper division and 36,000 MT/year for the packaging division. About 40-45% of the company's manufactured paper is captively consumed by its packaging division.

Key financial indicators (audited)

Standalone	FY2022	FY2023	FY2024*
Operating income	305.4	287.9	312.3
PAT	21.7	-16.7	-13.4
OPBDIT/OI	12.3%	-2.2%	5.5%
PAT/OI	7.1%	-5.8%	-4.3%
Total outside liabilities/Tangible net worth (times)	1.3	1.1	1.1
Total debt/OPBDIT (times)	5.3	-30.8	11.5
Interest coverage (times)	6.4	-0.4	0.9

*Source: Company, ICRA Research; * Audited Results; All ratios as per ICRA's calculations; Amount in Rs. Crore; PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2025)				Chronology of rating history for the past 3 years				
		Type	Amount rated (Rs. crore)	Amount outstanding as of March 31, 2024 (Rs. crore)	Date & rating in FY2025	Date & rating in FY2024		Date & rating in FY2023		Date & rating in FY2022
					Jun 21, 2024	Jun 21, 2023	Jun 05, 2023	Dec 26, 2022	Aug 08, 2022	Jan 27, 2022
1	Fund based - term loans	Long-term	166.77	133.12	[ICRA]BB+ (Negative)	[ICRA]BBB- (Negative)	[ICRA]BBB (Negative)	[ICRA]BBB (Negative)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)
2	Fund-based Working Capital facilities	Long-term	70.00	-	[ICRA]BB+ (Negative)	[ICRA]BBB- (Negative)	[ICRA]BBB (Negative)	[ICRA]BBB (Negative)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)
3	Non-fund based - Working capital facilities	Short-term	5.50	-	[ICRA]A4+	[ICRA]A3	[ICRA]A3+	[ICRA]A3+	[ICRA]A2	[ICRA]A2
4	Unallocated Limits	Long-term	7.73	-	[ICRA]BB+ (Negative)	[ICRA]BBB- (Negative)	[ICRA]BBB (Negative)	[ICRA]BBB (Negative)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)

Complexity level of the rated instruments

Instrument	Complexity Indicator
Term loans	Simple
Fund-based limits	Simple
Non-fund-based facilities	Very Simple
Unallocated	Not Applicable

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	**Term Loans**	FY2015	-	FY2029	166.77	[ICRA]BB+ (Negative)
NA	**LC/BG**	NA	NA	NA	5.50	[ICRA]A4+
NA	**Cash Credit**	NA	NA	NA	70.00	[ICRA]BB+ (Negative)
NA	**Unallocated**	NA	NA	NA	7.73	[ICRA]BB+ (Negative)

Source: Company

Please click here to view details of lender-wise facilities rated by ICRA

Annexure II: List of entities considered for consolidated analysis – Not applicable

ANALYST CONTACTS

Shamsher Dewan
+91 124 4545 300
shamsherd@icraindia.com

Srikumar Krishnamurthy
+91 44 4596 4318
ksrikumar@icraindia.com

Suprio Banerjee
+91 022 6114 3443
supriob@icraindia.com

Roshan Dugar
+91 20 6606 9924
roshan.dugar@icraindia.com

RELATIONSHIP CONTACT

L. Shivakumar
+91 22 6114 3406
shivakumar@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

ICRA Limited

Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001
Tel: +91 11 23357940-45

Branches