July 27, 2017

Oriental Carbon and Chemicals Limited

Summary of rated instruments

Instrument	Amount in Rs. Crore[1]	Rating Action
Fixed-Deposit Programme	5.00	MA reaffirmed; Outlook revised to Positive from Stable
Term Loans	116.00 (enhanced from Rs. 86 crore)	[ICRA]A reaffirmed; Outlook revised to Positive from Stable
Fund Based Limits	70.00 (enhanced from Rs 60 crore)#	[ICRA]A reaffirmed; Outlook revised to Positive from Stable
Non-Fund Based Limits	14.00	[ICRA]A1 reaffirmed

**Instrument details provided in Annexure-1*

The long term fund based limits are fully interchangeable with the short term fund based limits which are rated at [ICRA]A1

Rating action

ICRA has reaffirmed the long term rating of [ICRA]A (pronounced ICRA A)[2] for Rs 146 crore fund based bank limits of Oriental Carbon & Chemicals Limited (OCCL). ICRA has also reaffirmed the short term rating for Rs 14 crore non-fund based bank facilities of OCCL. ICRA has also reaffirmed the rating of MA (pronounced M A) for the Rs 5 crore fixed deposit programme of OCCL. ICRA has also assigned long term rating of [ICRA]A to the enhanced portion of Rs. 30 crore term loans and Rs. 10 crore of fund based limits. The outlook on the long term rating and medium-term rating has been revised to Positive from Stable.

Rationale

The revision in outlook takes into account anticipated improvement in scale and financial performance of the company following completion of capacity expansion by 5500 MT by Q2 FY2019 and increased geographical diversification due to ongoing efforts of the company. The revision in outlook also factors in healthy capacity utilisation on the incremental capacity of 5500 MT added in FY2017 which should enable increase in scale going forward. The reaffirmation of the ratings reflects the favourable domestic demand outlook for Insoluble Sulphur (IS), the company’s major product, driven by increasing radialisation of the domestic tyre market besides modest outlook on overseas demand. The reaffirmation also factors in healthy capital structure and debt protection metrics of the company despite rise in debt levels to fund the ongoing capex due to higher profitability and healthy cash accruals. The ratings continue to factor in the experienced management and long track record of OCCL in the business of producing IS, its established market position in the domestic industry by virtue of being the leading domestic supplier of IS and the strong customer base comprising major tyre manufacturers across the world and long-term relations with them.

The ratings, however, are constrained by risks associated with the demand being derived primarily from the automotive segment; threat of competition from Chinese players partly mitigated by high entry barriers as well as challenge of maintaining high quality of products and high standards of health and safety at plants; vulnerability to foreign exchange rate movements and high working capital intensity.

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[1] *Rs 100 lakh=Rs 1 crore= Rs 1 million*

[2] For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications

The ratings of OCCL also factor in corporate guarantee (the liability against the corporate guarantee is around ~Rs 9 crore at the end of FY2017) extended to its subsidiary Duncan Engineering Limited (DEL) (erstwhile Schrader Duncan Limited – rated [ICRA]A (SO) (Stable) and [ICRA]A1 (SO)], which has reported weak performance over the last few years on account of decline in revenues and the losses incurred in the automotive business. DEL continued to incur losses in FY2017 on account of lower demand for its products and one-time expense related to closure of the pneumatic tube valve segment.

Key rating drivers
Credit strengths

- Well experienced management and long track record of OCCL in the business of producing Insoluble Sulphur (IS)
- Dominant market position in the domestic industry by virtue of being the only local manufacturer of Insoluble Sulphur; Favorable market position as a preferred supplier to major tyre companies across the world
- Increase in share of value-added products which have high entry barriers
- Favorable growth prospects in the domestic tyre industry driven by radialisation of tyres and adoption of new technologies
- Improved financial risk profile driven by increase in profits resulting from improved economies of scale, coverage indicators and cash flows and decline in borrowings

Credit weaknesses

- Threat of competition from Chinese players; partly mitigated by high entry barriers as well as the fact that Chinese companies have inconsistent quality of products and lower environment, health and safety standards (EHS)
- Vulnerable to forex rate movements; booking forward contracts mitigates the risk to an extent
- Working capital intensive nature of operations characterized by inventory build up at the year end
- Weakness in performance of the subsidiary, namely DEL, engaged in manufacture of pneumatic products and automotive tyre valves; partly mitigated by recent sale of the tube valve segment which was losing cash
- Weak growth in global commercial tyre industry; though long term growth prospects remain intact

Description of key rating drivers
ICRA while rating OCCL's bank lines takes into consideration the long and established track record of the management in the business of manufacturing insoluble sulphur. OCCL continues to retain its leadership position in the domestic market with nearly 60% of the market share and a 10% market share in the global market. With increasing share of value added products OCCL should be able to defend and expand its market share against Chinese players trying to make inroads into the market. Sales volumes of IS in domestic market are expected to improve in the near term as radialisation of tyres picks up. With new capacities coming online OCCL should benefit from improvement in economies of scale leading to further improvement in the financial profile of the company.

Chinese IS manufacturers are usually able to offer their product at a lower cost and are a threat to the organised players like OCCL. However, large tyre manufacturers do not procure from Chinese players mainly due to the lower quality levels and lower EHS standards. The operations of the company are working capital intensive as inventory levels build-up towards year end. Duncan Engineering Ltd. (earlier known as Schrader Duncan Ltd.) the subsidiary of OCCL has been making losses in past few years and had closed one of its loss making business in FY2016 thus weakening performance of OCCL at consolidated level. While there has been some weakness in the global tyre industry, the long term demand prospects remain intact as pockets of the market have started showing improvement.

During FY2017, OCCL completed first phase of its capacity expansion resulting in an increase of IS manufacturing capacity from 23,000 MT to 28,500 MT. The capacity utilisation remains healthy and the revenue growth in FY2017 was driven by volume growth partially tempered by decline in realisations. OCCL continues to derive nearly 92% of its revenues from the sale of IS. Strong growth in the domestic as well export markets drove the volume growth. Realisations continued to decline in FY2017 as the company had to pass on the benefit of lower raw material prices.

During FY2017, the standalone operating income of the company increased to Rs. 298 crore as against Rs 275 crore in FY2016 driven mainly by volume growth partially tempered by decline in realisations. The operating profits of the company increased to Rs 89 crore in FY2017 from Rs 83 crore in FY2016 on account of higher sales volumes. The net profit of the company in FY2017 was Rs 53.4 crore nearly same as that in FY2016 due to higher tax expense. As profitability has remained healthy coverage and capitalisation ratios have remained robust in FY2017 despite an increase in debt availed for funding capex. The gearing of the company was stable at 0.31 times in FY2017 same as FY2016 while Total Debt/OPBDITA increased marginally to 1.16 times in FY2017 from 1.04 times in FY2016.

The company is undertaking capacity expansion at its Mundra SEZ plant wherein the capacity would increase by 5500 MT taking the total overall capacity to 34,000 MT. The total expected outlay on the project is Rs 62 crore and the commissioning is expected to be completed by Q2 FY2019.

Duncan Engineering Ltd. posted a net loss of Rs. 5.89 crore for an operating income of Rs 37 crore in FY2017 while during FY2016 company had posted a net loss of Rs 6.92 crore for an operating income of Rs. 64 crore. The losses in FY2017 were mainly due to lower demand for the company’s product and one-time expenses related to closure of the pneumatic valve division. The total debt of the company reduced to Rs 15 crore in FY2017 from Rs. 19 crore in FY2016. With sale of the loss making segment of the business, DEL operating performance should witness improvement in near to medium term.

The production and sales volumes of OCCL are expected to increase going forward on account of healthy demand prospects from the existing and new overseas markets and higher domestic demand driven by increasing trend of radialisation of tyres. Higher-than-anticipated debt funded capex or substantial fall in profitability leading to significant deterioration in debt protection metrics would be the key rating sensitivities. The ability of the company to maintain healthy utilisation levels from the existing and upcoming capacity will continue to remain a key rating sensitivity. Further, ICRA would also keep monitoring the operational performance of DEL and its impact on consolidated financials.

Table: Key Financial Indicators

	FY2016	**FY2017**
Operating income (Crores)	275	298
PAT (Crores)	53	53
OPBDIT/ OI (%)	30.2%	29.9%
RoCE (%)	21.4%	20.1%
Total Debt/ TNW (times)	0.30	0.31
Total Debt/ OPBDIT (times)	1.04	1.16
Interest coverage (times)	13.08	17.34
NWC/ OI (%)	38.7%	34.7%

Analytical approach: For arriving at the ratings ICRA has applied its rating methodologies as mentioned below.

Links to applicable criteria:
Corporate Credit Rating Methodology

About the company: Oriental Carbon & Chemicals (OCCL) was incorporated in 1978 as Dharuhera Chemicals Limited (DCL) and in 1983 DCL was merged with Oriental Carbon Limited (OCL), a group company engaged in the production of Carbon Black, to form OCCL. In 1994, OCCL had set-up a manufacturing facility for the production of Insoluble Sulphur, which is now the flagship product of the company as the company sold carbon black unit to Continental Carbon Company in 2000. OCCL currently has three production units: two at Dharuhera Industrial Unit in Haryana and one at Mundra SEZ in Gujarat. The company is currently engaged in the production of Insoluble Sulphur, Sulphuric Acid and Oleum. The production capacity of OCCL stands at 28,500 metric tonnes per annum (MTPA) for Insoluble Sulphur (IS), 46,200 MTPA for Sulphuric Acid & Oleum.

In FY2017, OCCL's standalone net profit was Rs 53.4 crore on an operating income of Rs 298 crore as against Rs. 53.00 on an operating income of Rs. 275 crore in FY2016.

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating history for last three years:
Table:
Rating history for last three years:

S No	Instrument	Current Rating (FY2018)			Chronology of rating history for past three years		
		Type	Amount Rated (Rs crore)	Month year & rating	Month year & rating (FY2017)	Month year & rating (FY2016)	Month year & rating (FY2015)
				July 2017	July 2016	July 2015	August 2014
1	Term Loans	Long Term	116	[ICRA]A (Positive)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A- (Stable)
2	Fund Based Limits	Long Term	70^	[ICRA]A (Positive)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A- (Stable)
3	Non fund Based limits	Short Term	14	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A2
4	Fixed Deposits	Medium Term	5	MA (Positive)	MA(Stable)	MA(Stable)	MA- (Stable)

^ The long-term fund based limits are fully interchangeable with the short-term fund-based limits, which are rated at [ICRA]A1

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-I

Instrument Details

ISIN	Instrument	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
-	Fixed Deposit	-	-	-	5.00	MA (Positive)
-	Term Loan-1	September 2013	-	December 2018	2.7	[ICRA]A(Positive)
-	Term Loan-2	September 2013	-	December 2018	16.4	[ICRA]A(Positive)
-	Term Loan-3	June 2017	-	March 2023	37.5	[ICRA]A(Positive)
-	Term Loan-4	June 2017	-	March 2023	20.0	[ICRA]A(Positive)
-	Term Loan-5	June 2017	-	March 2023	10.0	[ICRA]A(Positive)
-	Term Loan, Proposed	-	-	-	29.4	[ICRA]A(Positive)
-	Fund Based	-	-	-	70.00~	[ICRA]A(Positive)
-	Non-fund Based	-	-	-	14.00	[ICRA]A1

~ The long-term fund based limits are fully interchangeable with the short-term fund-based limits, which are rated at [ICRA]A1

Source: Company info

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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.

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