Oriental Carbon & Chemicals Limited

July 18, 2018

Summary of rated instruments

Instrument*	Previous Rated Amount(Rs. crore)	Current Rated Amount(Rs. crore)	Rating Action
Fixed- Deposit Programme	5.0	5.0	MAA- (Positive); upgraded from MA (Positive)
Term Loans	116.0	116.0	[ICRA]A+ (Positive); upgraded from [ICRA]A (Positive)
Fund-based limits	70.0	70.0	[ICRA]A+ (Positive)/[ICRA]A1+; upgraded from [ICRA]A (Positive)/[ICRA]A1
Non-fund-based limits	14.0	14.0	[ICRA]A1+; upgraded from [ICRA]A1
Total	**205.0**	**205.0**	

**Instrument details are provided in Annexure-1*

Rating action

ICRA has upgraded the long-term rating for Rs.116.0 crore term loans of Oriental Carbon & Chemicals Limited (OCCL) to [ICRA]A+ (pronounced ICRA A plus) from [ICRA]A (pronounced ICRA A). ICRA has also upgraded the short-term rating for Rs. 14.0 crore non-fund-based limits of OCCL to [ICRA]A1+ (pronounced ICRA A one plus) from [ICRA]A1 (pronounced ICRA A one). ICRA has also upgraded the long-term rating to [ICRA]A+ (pronounced ICRA A plus) from [ICRA]A (pronounced ICRA A) and short-term rating to [ICRA]A1+(pronounced ICRA A one plus) from [ICRA]A1 (pronounced ICRA A one) for the fund-based limits of Rs. 70.0 crore. The rating for Rs. 5.0 crore fixed deposit programme has also been upgraded to MAA- (pronounced M double A minus) from MA (pronounced M A). The outlook on the long-term and medium-term rating is Positive.

Rationale

The rating upgrade takes in to account favourable demand outlook for Insoluble Sulphur (IS) the domestic as well as overseas markets, healthy ramp-up of the 5,500 MTPA capacity commissioned in FY2017 and robust debt protection metrics and capital structure despite significant capex owing to healthy cash generation. The rating also factors in the timely completion of ongoing capacity expansion plan, geographical diversification of the company through successful ramp up of sales in new geographies such as the US over last two years. 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 IS supplier and strong customer base comprising of major tyre manufacturers across the globe and long-term relations with them. The ratings of OCCL also factor in the improved performance of OCCL's subsidiary Duncan Engineering Limited (DEL, (rated [ICRA]A(SO) (Positive) and [ICRA]A1(SO)) in FY2018 post sale of its loss-making tyre tube valve segment in FY2017. OCCL has extended corporate guarantee for term loans taken by DEL (the liability against the corporate guarantee is around ~Rs 4.8 crore at the end of FY2018).

The ratings, however, are constrained by risks associated with revenue being derived primarily from a single product i.e. Insoluble sulphur being supplied primarily to the automotive sector; 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, exposure to raw material price risk given sulphur prices have been volatile in past few years and high working capital intensity. Any large debt funded capex or acquisition by the company will be a key monitorable.

Outlook: Positive

The positive outlook reflects the expectations of continued high capacity utilisation of company's expanded capacity given the healthy demand outlook for the domestic as well as global tyre markets leading to increase in cash generation, and improvement in net leverage and debt protection metrics.

Key rating drivers

Credit strengths

Well experienced management and long track record of OCCL in the business of producing IS: OCCL has a long and established track record in the chemicals industry. It started operations as Dharuhera Chemicals Limited in 1978 and was later merged with Oriental Carbon Limited in 1984 to form Oriental Carbon and Chemicals Limited. It started production of insoluble sulphur in 1994 with a capacity of 3000 MTPA and has since then ramped up its capacity to 28,500MTPA presently.

Dominant market position in the domestic industry by virtue of being the only local manufacturer of Insoluble Sulphur; favourable market position as a 'Second Supplier' to major tyre companies across the world: OCCL is the sole manufacturer of IS in the domestic market**.** OCCL continues to retain its leadership position in the domestic market with nearly 55%-60% of the market share and around 10% market share in the global market.

Favourable growth prospects in the domestic tyre industry driven by radialisation of tyres and capacity expansion being undertaken by tyre manufacturers in India: Insoluble sulphur is used as an input for manufacturing of tyres and with rising radialisation the consumption of insoluble sulphur is expected to rise. The outlook for demand of IS from domestic tyre industry remains positive given the healthy demand growth being witnessed and the capacity expansion being undertaken by the tyre manufacturers.

Track record of healthy plant performance and significant ramp up of newly installed capacity: OCCL's plant performance has been healthy over past few years with healthy capacity utilisation levels. Capacity utilisation post capacity addition has also remained healthy. Going forward the capacity utilisation is expected to remain healthy given the positive demand outlook for the tyre industry.

Improvement in capitalisation and coverage indicators on the back of healthy cash generation despite undertaking significant capex in the recent past: OCCL's capitalisation and coverage indicators have improved significantly over last few years despite undertaking significant capex in last three years given the healthy cash generation and lower reliance on debt. Revenue growth of OCCL was driven by volume growth in FY2018 while realisations were nearly unchanged YoY. The operating profit of the company increased to Rs. 101.5 crore in FY2018 from Rs. 88.5 crore in FY2017 owing to higher revenues and effects of operating leverage. The net profit of the company increased to Rs. 56.7 crore in FY2018 from Rs. 54.2 crore in FY2017 owing to higher operating profit partially offset by higher tax incidence. The interest coverage though moderated but was still healthy at 12.9 times in FY2018 as against 17.7 in FY2017 as interest charges that were earlier being capitalised were routed through profit and loss account in FY2018 owing to capitalisation of phase-1 of capacity expansion. Gearing of the company was unchanged at 0.3 times at the end of FY2018 as against end of FY2017.

Improvement in the performance of the subsidiary Duncan Engineering Limited post the closure of tyre tube valve segment in FY2017: DEL posted revenues of Rs. 40.7 crore in FY2018 and a net profit of Rs. 0.1 crore in FY2018 as against revenue of Rs. 34.2 crore with an associated net loss of Rs. 3.6 crore in FY2017. The improvement in performance is a result on higher demand for the company's products and closure of loss making tyre tube valve division in FY2017.

Credit challenges

Majority of revenue being derived from a single product i.e. insoluble sulphur with demand primarily from the automotive sector: Nearly 93% of OCCL's revenue is derived from the sale of insoluble sulphur which results in disproportionate reliance of the company on a single product. Additionally, the majority of demand for insoluble sulphur is derived from the automotive sector for manufacturing tyres, resulting in significant reliance on a single sector for demand and exposes the company to vulnerability of the automotive sector.

Threat of competition from Chinese players; partly mitigated by high entry barriers and inconsistent quality of products delivered and poor Environment, Health and Safety (EHS) standards: 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 inconsistent quality levels and lower EHS standards.

Vulnerable to forex rate movements; booking forward contracts mitigates the risk to an extent: OCCL derives significant share of revenues from export sales thus exposing the company to foreign exchange fluctuations. However, the risk is partially mitigated as the company hedges nearly 75% of its net exposure for 6 months using forward contracts.

Vulnerable to the volatility in raw material prices though largely mitigated by periodic price revision clauses in the contracts: Sulphur and coating oil are the major raw materials for manufacturing insoluble sulphur. Sulphur prices have been volatile over the years which exposes the company to raw material price risk. The risks are however largely mitigated given the periodic price revision clauses under contracts with the end users.

Working capital intensive nature of operations: OCCL's operations are working capital intensive given that the company maintains inventory of finished goods for around 90 days to meet the demand for the upcoming quarter. As a result, the working capital intensity of the company's business remains high.

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

Links to applicable criteria:

Corporate Credit Rating Methodology

Rating Methodology for Entities in Chemical Industry

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. The capacity for IS will further expand to 34,000MTPA by end of July 2018.

Key financial indicators (audited)

	FY2017	FY2018
Operating Income (Rs. crore)	297.8	328.7
PAT (Rs. crore)	54.2	56.7
OPBDIT/OI (%)	29.7%	30.8%
RoCE (%)	20.5%	18.7%
Total Debt/TNW (times)	0.3	0.3
Total Debt/OPBDIT (times)	1.2	1.2
Interest coverage (times)	17.7	12.9

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

	Instrument	Current Rating (FY2019)				Chronology of Rating History for the Past 3 Years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating July 2018	Date & Rating in FY2018 July 2017	Date & Rating in FY2017 August 2016	Date & Rating in FY2016 July 2015
1	Term Loans	Long Term	116.0	**84.93#**	[ICRA]A+ (Positive)	[ICRA]A (Positive)	[ICRA]A (Stable)	[ICRA]A (Stable)
2	Fund Based Limits	Long Term/Short Term	70.0	-	[ICRA]A+ (Positive)/ [ICRA]A1+	[ICRA]A (Positive)/ [ICRA]A1	[ICRA]A (Stable)/ [ICRA]A1	[ICRA]A (Stable)/ [ICRA]A1
3	Non-fund based limits	Short Term	14.0	-	[ICRA]A1+	[ICRA]A1	[ICRA]A1	[ICRA]A1
4	Fixed deposits	Medium term	5.0	-	MAA- (Positive)	MA (Positive)	MA (Stable)	MA (Stable)

 # As on March 31, 2018

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-1: Instrument Details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
-	Fixed Deposits	-	-	-	5.0	MAA- (Positive)
-	Term Loan-1	September 2013	9.60%	December 2019	0.5	[ICRA]A+ (Positive)
-	Term Loan-2	September 2013	9.60%	December 2019	6.1	[ICRA]A+ (Positive)
-	Term Loan-3	March 2017	9.60%	March 2023	37.5	[ICRA]A+ (Positive)
-	Term Loan-4#	June 2017	5%	March 2023	20.0	[ICRA]A+ (Positive)
-	Term Loan-5	June 2017	9.25%	March 2023	10.0	[ICRA]A+ (Positive)
-	Term Loan-6	February 2018	9.25%	February 2024	8.8	[ICRA]A+ (Positive)
-	Term Loan-7	March 2018	9.25%	March 2024	2.0	
-	Term Loan-Proposed	-	-	-	31.1	[ICRA]A+ (Positive)
-	Long Term/Short Term Fund based	-	-	-	70.0*	[ICRA]A+ (Positive)/[ICRA]A1+
	Non-fund based	-	-	-	14.0	[ICRA]A1+

 # US dollar denominated term loan

Source: Oriental carbon & Chemicals Limited

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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.

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For more information, visit www.icra.in

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