

July 24, 2019

Oriental Carbon & Chemicals Limited: Ratings upgraded to [ICRA]AA- (Stable), MAA (Stable); Short term rating reaffirmed at [ICRA]A1+

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 (Stable); upgraded from MAA- (Positive)
Term Loans	116.0	116.0	[ICRA]AA- (Stable); upgraded from [ICRA]A+ (Positive)
Fund-based limits	70.0	70.0	[ICRA]AA- (Stable); upgraded from [ICRA]A+ (Positive), [ICRA]A1+ reaffirmed
Non-fund-based limits	14.0	14.0	[ICRA]A1+ reaffirmed
Total	205.0	205.0	

*Instrument details are provided in Annexure-1

Rationale

The ratings upgrade factors in the increase in the scale and cash accruals following the commissioning of additional capacities in July 2018 which are expected to increase further as new capacities ramp up owing to the healthy outlook for the Insoluble sulphur (IS) demand in the domestic as well as the export markets. Notwithstanding the current slowdown in the auto sector sales, the long-term demand outlook for the tyre industry remains favourable with growth over the next five years expected to be in the range of 7-9%. The tyre industry growth is expected to be driven by the healthy demand from the replacement markets while the demand from the Original equipment Manufacturers (OEM) is expected to remain stable though in the near term it may face some pressure. With long term demand growth intact for the tyre industry the demand growth for the IS is expected to remain stable in the domestic market driven by rising radialisation trend and capacity expansion being planned by tyre manufacturers. OCCL had commissioned 5,500 MTPA of IS capacity in July 2018 taking the total capacity to 34,000 MTPA which will lead to improvement in the scale and cash generation as the capacity ramps up in FY2020. ICRA also takes note of the capacity expansion plan of OCCL to expand the IS capacity by 11,000 MTPA and Sulphuric acid capacity by 42,000 MTPA at a total capital outlay of Rs. 216 crore at its Dharuhera facility. While the project is exposed to execution risk it is similar to the one recently commissioned by the company at its Mundra facility in July 2018 successfully without any time or cost overruns. Thus, the track record of the company in executing such projects provides comfort in project execution capabilities of the company. 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]AA-(SO) (Stable) and [ICRA]A1+(SO)) in FY2019 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 6.5 crore at the end of FY2019).

The ratings, however, are constrained by risks associated with the revenues being derived primarily from a single product i.e. Insoluble sulphur which is mostly supplied 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; high working capital intensity and the project execution risks related to the upcoming capex partly mitigated by the track record of the company in executing such projects within the budgeted timelines and capital outlay.

Outlook: Stable

The stable outlook reflects ICRA's expectation of healthy cash generation from current operations which will keep the financial risk profile of the company stable and healthy. Any material time/cost over runs in commissioning of new capacity and/or lower than expected cash generation resulting in the deterioration of the credit metrics may result in the outlook being revised to Negative. The outlook may also be revised to Negative in case the company undertakes any large debt funded acquisition leading to pressure on the financial risk profile of the company. The outlook may be revised to positive in case of significant increase in cash generation leading to improvement in the financial risk profile.

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 34,000 MTPA currently. The company is expanding its IS capacity by another 11,000 MTPA by Q3 FY2022 taking its total capacity to 45,000 MTPA.

Dominant market position in the domestic industry; 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. While the near term outlook for the tyre demand from the Original Equipment manufacturers (OEM), which is ~25-30% of the tyre market, may be subdued given the sluggish auto sales, the demand from the replacement segment which comprises nearly 70% of the tyre market is expected to remain healthy. The long-term demand growth of the domestic tyre market is expected to remain around 7-9%. With healthy growth rate for the tyre segment going forward, the demand outlook for IS is expected to remain healthy in the long term.

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 of new capacities is expected to ramp up given the healthy demand outlook for the tyre industry.

Healthy financial risk profile characterised by robust cash generation, large cash balances resulting in healthy credit metrics: 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. While the revenue growth in FY2019 was driven by combination of volume growth of 7% YoY and realisation growth of 7% YoY for IS. The operating profit of the company increased to Rs. 124.6 crore in FY2019 from Rs. 101.6 crore in FY2018 owing to higher revenue and operating leverage with the commissioning of new capacity. The net profit of the company increased

to Rs. 73.8 crore in FY2019 from Rs. 56.7 crore in FY2018 owing to higher operating profit coupled with higher non-operating income. The interest coverage improved to 15.8 times in FY2019 from 12.9 in FY2018 driven by higher operating profit. Gearing of the company was unchanged at 0.3 times at the end of FY2019 as against the end of FY2018. The Total Debt/OPBDITA also moderated to 1.0 times at the end of FY2019 vis-à-vis 1.2 times at the end of FY2018 as the increase in the operating profit offset the impact of the increase in the debt.

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. 45.1 crore in FY2019 and a net profit of Rs. 2.78 crore in FY2019 as against revenues of Rs. 40.7 crore with a net profit of Rs. 0.1 crore in FY2018. The improvement in performance is a result of 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 high 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.

Vulnerable to project execution risk with the upcoming capacity expansion partly mitigated by the track record of executing similar projects: OCCL is undertaking a Rs. 216 crore capacity expansion project for increasing its IS capacity by 11,000 MTPA and sulphuric acid capacity by 42,000 MTPA over the next two years. The IS capacity will be increased in two phases of 5500 MTPA each by the end of Q3 FY2021 and Q3 FY2022. The project will be funded with a debt equity ratio of 2:1. The project being large, exposes the company to project execution risks. Nevertheless, the company has recently commissioned a similar capacity IS plant based on the same technology without any cost or time over runs which provides comfort on its project execution capabilities.

Threat of competition from Chinese players; partly mitigated by high entry barriers and inconsistent quality of products 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 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.

Liquidity Position:

The liquidity position of the company remains healthy given the large funds parked in mutual funds along with healthy cash accruals expected. While the company will be undertaking significant capex, the project to be funded with a debt-equity ratio of 2:1 will result in accumulation of cash over the next three years leading to further improvement in the liquidity of the company. The liquidity position of the company is also supported by availability of nearly Rs. 34 crore of unutilised working capital limits and adequate drawing power. With near term repayments ranging between Rs. 19-21 crore over the next couple of years as against cash accruals of Rs. 85-90 crore, the liquidity position is expected to remain robust.

Analytical approach:

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in Chemical Industry
Parent/Group Support	Not applicable
Consolidation / Standalone	The ratings are based on the standalone financials of Oriental Carbon & Chemicals Limited

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 34,000 metric tonnes per annum (MTPA) for Insoluble Sulphur (IS), 46,200 MTPA for Sulphuric Acid & Oleum. The capacity for IS will expand to 45,000 MTPA and sulphuric acid capacity will reach 88,200 MTPA at the end of Q3 FY2022.

Key financial indicators (audited)

	FY2018	FY2019
Operating Income (Rs. crore)	328.7	388.3
PAT (Rs. crore)	56.7	73.8
OPBDIT/OI (%)	30.8%	32.1%
RoCE (%)	18.7%	21.2%
Total Debt/TNW (times)	0.3	0.3
Total Debt/OPBDIT (times)	1.2	1.0
Interest coverage (times)	12.9	15.1

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

Instrument		Current Rating (FY2020)			Chronology of Rating History for the Past 3 Years			
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating	Date & Rating	Date & Rating in FY2018	Date & Rating in FY2017
					July 2019	July 2018	July 2017	August 2016
1	Term Loans	Long Term	116.0	88.8	[ICRA]AA-(Stable)	[ICRA]A+(Positive)	[ICRA]A (Positive)	[ICRA]A (Stable)
2	Fund Based Limits	Long Term/Short Term	70.0	-	[ICRA]AA-(Stable) / [ICRA]A1+	[ICRA]A+(Positive) / [ICRA]A1+	[ICRA]A (Positive) / [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 (Stable)	MAA-(Positive)	MA (Positive)	MA (Stable)

As on March 31, 2019

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 (Stable)
-	Term Loan-1	FY2018	NA	FY2023	31.5	[ICRA]AA- (Stable)
-	Term Loan-2	FY2018	NA	FY2023	15.5	[ICRA]AA- (Stable)
-	Term Loan-3	FY2018	NA	FY2023	7.5	[ICRA]AA- (Stable)
-	Term Loan-4	FY2019	NA	FY2025	17.6	[ICRA]AA- (Stable)
-	Term Loan-5	FY2019	NA	FY2025	8.4	[ICRA]AA- (Stable)
-	Term Loan-6	FY2019	NA	FY2026	8.4	[ICRA]AA- (Stable)
-	Term Loan-Proposed	-	-	-	27.2	[ICRA]AA- (Stable)
-	Long Term/Short Term Fund based	-	-	-	70.0*	[ICRA]AA- (Stable)/ [ICRA]A1+
-	Non-fund based	-	-	-	14.0	[ICRA]A1+

Source: Oriental carbon & Chemicals Limited

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Not applicable		

ANALYST CONTACTS

K Ravichandran
044-4596 301
ravichandran@icraindia.com

Prashant Vasisht
0124-4545 322
prashant.vasisht@icraindia.com

Varun Gogia
0124-4545 373
varun.gogia@icraindia.com

RELATIONSHIP CONTACT

Jayanta Chatterjee
+91 80 4332 6401
jayantac@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

Corporate Office

Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002

Tel: +91 124 4545300

Email: info@icraindia.com

Website: www.icra.in

Registered Office

1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001

Tel: +91 11 23357940-50

Branches

Mumbai + (91 22) 24331046/53/62/74/86/87
Chennai + (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,
Kolkata + (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008,
Bangalore + (91 80) 2559 7401/4049
Ahmedabad+ (91 79) 2658 4924/5049/2008
Hyderabad + (91 40) 2373 5061/7251
Pune + (91 20) 2556 0194/ 6606 9999

© Copyright, 2019 ICRA Limited. All Rights Reserved.

Contents may be used freely with due acknowledgement to ICRA.

ICRA ratings should not be treated as recommendation to buy, sell or hold the rated debt instruments. ICRA ratings are subject to a process of surveillance, which may lead to revision in ratings. An ICRA rating is a symbolic indicator of ICRA's current opinion on the relative capability of the issuer concerned to timely service debts and obligations, with reference to the instrument rated. Please visit our website www.icra.in or contact any ICRA office for the latest information on ICRA ratings outstanding. All information contained herein has been obtained by ICRA from sources believed by it to be accurate and reliable, including the rated issuer. ICRA however has not conducted any audit of the rated issuer or of the information provided by it. While reasonable care has been taken to ensure that the information herein is true, such information is provided 'as is' without any warranty of any kind, and ICRA in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness or completeness of any such information. Also, ICRA or any of its group companies may have provided services other than rating to the issuer rated. All information contained herein must be construed solely as statements of opinion, and ICRA shall not be liable for any losses incurred by users from any use of this publication or its contents