July 20, 2020

Oriental Carbon & Chemicals Limited: Ratings reaffirmed; rated amount enhanced

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); reaffirmed
Term Loans	130.0	160.0	[ICRA]AA- (Stable); reaffirmed/assigned
Fund-based limits	80.0	75.0	[ICRA]AA- (Stable)/ [ICRA]A1+ reaffirmed
Non-fund-based limits	14.0	29.0	[ICRA]A1+; reaffirmed/assigned
Total	**229.0**	**264.0**	

**Instrument details are provided in Annexure-1*

Rationale

For arriving at the rating, ICRA has considered the consolidated financials of the Oriental Carbon & Chemicals Limited (OCCL), including its subsidiary Duncan Engineering Limited (DEL, rated [ICRA]A+(CE)/[ICRA]A1+(CE)). The ratings factor in the long and established track record of OCCL in the business of producing Insoluble sulphur, dominant position in the domestic market and favourable position as a second supplier to all major tyre manufacturer in global markets and healthy financial risk profile characterised by large un-encumbered cash balances, adequate albeit significantly lower cash accruals in the current fiscal and low debt repayments in the near to medium term. The ratings also factor in the stable outlook for the tyre industry, which is the key consumer of Insoluble sulphur, in the medium to long term although the near-term outlook is subdued. OCCL has around 60% market share in the domestic insoluble sulphur market and ~10% market share globally. While it has dominant position in the domestic market, it has been able to position itself as the preferred / second preferred supplier to most of the global tyre makers. As a result of healthy cash accruals in the last couple of years, OCCL's credit profile has shown significant improvement, with company being net debt free at the end of FY2020. The capitalisation and coverage indicators have been healthy with net gearing (Net debt/Tangible Networth) and net leverage (Net Debt/OPBDITA) remaining nil for the company at the end of FY2020. Although, the cash accruals of the company will moderate significantly in FY2021 due to expectation of a decline in the sales volumes, the same will remain adequate to meet the debt repayments and equity funding required for the ongoing capex program. ICRA also takes note of the capacity expansion underway at 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 of which the first phase of IS capacity expansion by 5500 MTPA along with Sulphuric acid capacity at an outlay of Rs 156 crore is underway. Given the subdued outlook for the tyre industry, the ramp up of the new capacity is expected to be slower than envisaged earlier. The commissioning for the project has been pushed to Q1 FY2022 from Q3 FY2021 envisaged earlier for phase-1. Additionally, given the covid pandemic the company would take a call on the executing the second phase of expansion basis the recovery in demand. While the project commissioning has been delayed, no cost over runs are envisaged. ICRA also takes note of the fact that the company's both Mundra and Dharuhera plants had to remain shut till April 21, 2020 and May 21, 2020 respectively since the beginning of the nationwide lockdown due to the covid-19 pandemic. The manufacturing plants are now operational albeit at lower capacity utilisation. As a result, the performance in Q1 FY2021 is expected to be weak.

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 and 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 ongoing capex partly mitigated by the track record of the company in executing such projects within the budgeted timelines and capital outlay.

The Stable outlook on the long term rating reflects ICRA's opinion that OCCL will continue to benefit from its established track record of operations, favourable market position in the domestic and overseas markets, healthy financial risk profile and stable outlook for the tyre demand in the medium to long term, notwithstanding the current weakness in demand.

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 in two phases with the first phase expected to be commissioned by Q1 FY 2022, and second Phase to be taken up thereafter 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. Notwithstanding the current weakness in demand due to the Covid-19 pandemic, 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 additions have also been healthy. While currently the capacity utilisation has moderated given the auto sector slowdown, the same is expected to pickup gradually.

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 the last couple of years given the healthy cash generation and lower reliance on debt. While revenue of the company declined to Rs. 387.8 crore in FY2020 from Rs. 432.6 crore in FY2019 driven by a decline in the sales volume, the net profit of the company remained less affected at Rs. 74.8 crore in FY2020 as against Rs. 76.5 crore in FY2019. Owing to healthy cash accruals of the company over the last couple years there has been an increase in un-encumbered cash which stood at Rs. 149.8 crore at the end of FY2020 as against Rs. 91.7 crore at the end of FY2019. The company is net debt free with a negative net debt of Rs. 1.3 crore at the end of FY2020 as against Rs. 40.1 crore at the end of FY2019. The capitalisation and coverage indicators have remained healthy, with gross leverage (Total

Debt/OPBDITA) at around 1.3x and net leverage (Net Debt/OPBDITA) nil at the end of FY2020. The interest coverage of the company though moderated driven by lower operating profit and higher interest charges was still healthy at 11.7x at the end of FY2020 as against 15.1x at the end of FY2019.

Improvement in the performance of the subsidiary Duncan Engineering Limited post the closure of tyre tube valve segment in FY2017: The revenues of DEL stood at Rs. 44.4 crore for FY2020 as against Rs. 45.1 crore in FY2019. The operating profit however increased to Rs. 5.85 crore in FY2020 as against Rs. 4.85 crore in FY2019 driven by lower raw material costs. The net profit increased to Rs. 3.26 crore in FY2020 as against Rs. 2.78 crore in FY2019 despite the impact of a Rs. 1.78 crore provision made for a labour dispute which the company is contesting partially offset by lower interest and tax outgo. The performance of the company has been improving since the closure of the tyre tube valve division in FY2017.

Credit challenges

Weak near term outlook for the tyre industry given the slowdown in the automotive sector post Covid-19 lockdowns; though long term outlook remains stable driven by replacement tyres segment and increasing radialisation: The automotive sector and as a result the tyre sector has witnessed significant headwinds due to the macroeconomic slowdown in FY2020 with the same being compounded by the Covid-19 led restrictions and subdued economy. The domestic and the global tyre industry witnessed contraction in sales volume in FY2020 and the trend is expected to continue in FY2021 as well. As a result, OCCL will have lower demand for IS in the current fiscal resulting in lower profits. However, the medium to long term outlook for IS remains stable given the stable demand from the replacement tyres market and increasing radialisation of tyres.

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.

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 it's 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 Q1 FY2022 (earlier envisaged by end of Q3 FY2021) and second phase after capacity utilisation is ramped up (earlier envisaged by Q3 FY2022). The project is being funded with a debt equity ratio of 2:1. The project being large, exposes the company to project execution risks. There is a delay in the project execution owing to the slowdown in the automotive sector and the Covid-19 led lockdowns, though no cost over runs are envisaged.

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 apprehension of 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 has a policy to hedge nearly 75% of its net exposure for the forward 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.

Liquidity Position: Strong

OCCL's liquidity is expected to remain strong owing to large un-encumbered cash balances and availability of un-utilised fund-based limits which would be comfortable to meet the capex requirements and term debt repayments in the near to medium term. The company as on FY2020 end was net debt free. While cash accruals will be meaningfully lower in FY2021, the same will be sufficient to meet the term debt repayments and equity funding for the capex.

Rating sensitivities

Positive triggers – The rating upgrade looks unlikely in the near term given the subdued outlook for the global and the domestic tyre industry which is the key consumer for the company's product.

Negative triggers – The rating may be downgraded if there is significant contraction in the scale of operations of the company for a sustained period resulting in weak cash accruals. With new capex being incurred, the weak utilisation of the new capacity may result in a negative bias on the rating.

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 consolidated financials of the company

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 post the current expansion.

Key financial indicators (audited)-Consolidated

	FY2019	FY2020
Operating Income (Rs. crore)	432.6	387.8
PAT (Rs. crore)	76.5	74.8
OPBDIT/OI (%)	30.6%	28.9%
RoCE (%)	22%	16%
Total Outside Liabilities/Tangible Net Worth (times)	0.5	0.5
Total Debt/OPBDIT (times)	1.0	1.3
Interest Coverage (times)	15.1	11.7
DSCR	4.0	3.1

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

	Instrument	Current Rating (FY2021)				Rating History for the Past 3 Years			
		Type	Amount Rated	Amount Outstanding	Rating	FY2020		FY2019	FY2018
					20-Jul-20	01-Aug-19	24-Jul-19	18-Jul-18	27-Jul-17
1	Term Loans	Long Term	160	102.1	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]A+ (Positive)	[ICRA]A (Positive)
2	Fund Based Limits	Long Term/Short Term	75	-	[ICRA]AA-(Stable) /[ICRA]A1+	[ICRA]AA-(Stable) /[ICRA]A1+	[ICRA]AA-(Stable) /[ICRA]A1+	[ICRA]A+ (Positive)/ [ICRA]A1+	[ICRA]A (Positive)/ [ICRA]A1
3	Non-fund based limits	Short Term	29	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1
4	Fixed deposits	Medium term	5	-	MAA (Stable)	MAA (Stable)	MAA (Stable)	MAA- (Positive)	MA (Positive)

 # As on March 31, 2020

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	28.1	[ICRA]AA- (Stable)
-	Term Loan-2	FY2018	NA	FY2023	13.8	[ICRA]AA- (Stable)
-	Term Loan-3	FY2018	NA	FY2023	6.0	[ICRA]AA- (Stable)
-	Term Loan-4	FY2019	NA	FY2025	15.8	[ICRA]AA- (Stable)
-	Term Loan-5	FY2019	NA	FY2025	7.3	[ICRA]AA- (Stable)
-	Term Loan-6	FY2019	NA	FY2026	6.0	[ICRA]AA- (Stable)
-	Term Loan-7	FY2020	NA	FY2026	8.4	[ICRA]AA- (Stable)
-	Term Loan-8		NA	FY2027	10.3	[ICRA]AA- (Stable)
-	Term Loan-9		NA	FY2027	6.4	[ICRA]AA- (Stable)
-	Term Loan-Proposed	-	-	-	57.9	[ICRA]AA- (Stable)
-	Long Term/Short Term Fund based	-	-	-	75.0	[ICRA]AA- (Stable)/ [ICRA]A1+
-	Non-fund based	-	-	-	29.0	[ICRA]A1+

Source: Oriental carbon & Chemicals Limited

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Duncan Engineering Limited	50.05%	Full consolidation

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