February 14, 2024

Thirumalai Chemicals Limited: Ratings reaffirmed; outlook revised to negative

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term fund-based – Term loan	200.00	200.00	[ICRA]A+ reaffirmed; outlook revised to Negative from Stable
Long-term – Fund-based working capital	824.00	864.00	[ICRA]A+ reaffirmed; outlook revised to Negative from Stable
Short-term – Term loan	205.00	0.00	-
Short-term – Non-fund based facilities (sublimit)	(814.00)	(854.00)	[ICRA]A1+; reaffirmed
Total	**1229.00**	**1064.00**	

**Instrument details are provided in Annexure-I*

Rationale

The revision in the outlook on the long-term rating of Thirumalai Chemicals Limited (TCL) to Negative factors in the decline in its operating margins in 9M FY2024. TCL announced its Q3 FY2024 results (material event) on February 06, 2024, to the stock exchanges. Further, the margins are expected to remain moderate for FY2024, impacting the coverage metrics. The operating margins have declined on account of the volatility in the phthalic anhydride (PAN)-orthoxylene (OX) spreads with competition from imports and a weak global scenario. Moreover, there is pressure on maleic anhydride's (MAN) realisations and margins, which is likely to continue in the near term.

The ratings continue to factor in the established track record and strong market position in the phthalic anhydride (PAN) segment in India, the diversification benefits from the sale of downstream derivative products such as esters and food acids and MAN by its subsidiary - Optimistic Organic SDN BHD (OOSB) - and the stabilisation of operations of the new unit at Dahej (phase 1). Further, the healthy capacity utilisation of the Ranipet plant, reflecting the benefit of modernisation capex in the last few years, favour the rating action. Further, ICRA notes the diversification efforts undertaken by the company to supply MAN to other countries to improve the realisations. . ICRA expects the company's medium-term performance to benefit from the favourable trade protection measures taken by the Government of India (GoI) and a positive demand outlook in the domestic end-user industry. ICRA notes that TCL's ability to withstand the downturns is better than earlier due to several cost-control initiatives taken in the last few years.

The ratings, however, remained constrained by the exposure of the profitability margins to fluctuation in raw material prices and the presence in commodity chemicals that limits TCL's pricing flexibility. ICRA also notes the company's substantial debt-funded capex plans, exerting pressure on its capital structure and coverage indicators. Due to the large capex plans, the company also remains susceptible to project execution risks. Timely completion of both the Dahej (phase II) and US projects without cost and time overruns will be a key monitorable. The projects, once completed and stabilised, are expected to offer a favourable product portfolio and the geographical diversification is likely to result in improved operating margins.

Key rating drivers and their description

Credit strengths

Extensive experience and market position in PAN - TCL is the second-largest player in India with a significant market share in the domestic PAN industry. The company's three decades of experience has resulted in established relationships with clients in key end-user industries such as plasticizers, copper phthalocyanine (CPC), paints and unsaturated polyresins (UPR). TCL also has a longstanding relationship with Reliance Industries Limited, the supplier of the raw material, OX, and operates on an assured offtake model.

Positive demand outlook in domestic end-user industries – Infrastructure investments and expansion of major end-user industries is expected to improve the demand for PAN in the domestic market in the medium term. Trade protection metrics, such as anti-dumping duty, and mandatory Bureau of Indian Standards certification for PAN imports to benefit domestic PAN manufacturers.

Diversification into related chemicals – The company produces phthalate esters and food acids, which are downstream derivatives. The contribution of these products has grown over the years. The company also produces maleic anhydride (MAN) in its Malaysian subsidiary – OOSB. The company is also setting up a greenfield integrated food ingredients production facility in the US. These initiatives would provide diversification benefits to the consolidated entity in the medium term.

Credit challenges

Presence in commodity chemical industry and competition from imports limit pricing flexibility - TCL's realisations are influenced by the overall demand-supply dynamics in a region, given the limited product differentiation and large volume of inter-regional trade of PAN. The key end-user industries of the product are plasticizers, paints and pigments, which are mainly used in the construction and automobile sectors. Hence, the demand is based on the broader economic conditions. With regard to supply, the market dynamics change significantly based on the production and consumption in key markets such as China, Korea and South East Asia. Though TCL has medium to long-term contracts with many customers, the product realisations are volatile.

Imports of PAN had moderated to 94,250 MT in FY2023 from 1,21,211 MT in FY2022 due to trade protection measures on imports from several regions. Going forward, as domestic demand is higher than the domestic capacity, the offtake risk for producers like TCL is low at present and is likely to remain so in the near term. However, domestic PAN companies are undertaking significant capex. Hence, once the capacities are stable, PAN is expected to be exported for a period of 1-2 years before domestic demand matches the increased supply. Most of the end users of phthalic anhydride are in infrastructure and the Government's thrust on infrastructure is likely to improve the growth rates for phthalic anhydride in India. The company's performance also remains susceptible to the changes in Government policies and regulations regarding international trade and trade protection metrics.

Exposure of profitability margins to fluctuation in raw material price – The price of OX has been volatile and based on crude price and the demand trends for other products from the xylene stream. The company's product demand and its working capital intensity are impacted during periods of high OX prices. TCL has, however, rationalised its production lead time and inventory management in recent years, thereby strengthening its ability to pass on OX price changes to its customers. Nonetheless, the company's profit margin remains susceptible to the volatility in PAN-OX spreads, which depend on the demand-supply dynamics of PAN in the region. The operating margins were impacted in 9M FY2024 owing to the reduced PAN-OX spreads and pressure on realisations from MAN, which is expected to continue in the near term. However, ICRA notes the company's diversification efforts to supply MAN to other countries where the realisations are expected to be higher. Further, ICRA also notes that TCL's ability to withstand the above-mentioned risks is better than the earlier downturns due to several cost-control initiatives taken by the company in the last few years.

Large debt-funded capex plans and project execution risks –TCL is in the process of undertaking a large capex under a subsidiary in the US for manufacturing food acids, which will be debt funded (availed by the subsidiary but guaranteed by TCL). The project has been delayed by a year due to the disruption caused by the pandemic. The project cost for the US project is ~$140-150 million and is expected to be completed in the next two years. The company is also undertaking the second phase of the Dahej project to add a PAN capacity of ~90,000 MTPA and fumaric acid capacity of ~10,000 MT at a cost of ~Rs. 550 crore. Cost overrun, if any, is expected to be less than 5% of the estimated cost and this project is expected to be completed in the next couple of months. Part of the Fumaric acid capacity has already been commissioned. The ongoing capex at the US and the expected capex at Dahej phase 2 will expose the consolidated entity to project execution risks and put some pressure on the consolidated capital structure and coverage indicators over the near to medium term.

Environmental and Social Risks

Given the safety and environmental health-related concerns associated with chemicals, the industry is exposed to the risk of tightening regulatory norms for the production, handling, disposal, and transportation of chemical products. Further, in the event of accidents, the litigation risks and liabilities for clean-up could be high. TCL has been a zero-liquid discharge company for the past several years and has also invested in the latest technology in the water treatment facility recently. While TCL has a demonstrated track record of running its operations safely, the nature of the risk (being low frequency-high impact) weighs on its ratings.

Further, operating responsibly is an imperative and instances of non-compliance with environmental, health, and safety norms could have an adverse impact on the local community which could manifest in the form of protests, constraining the ability to operate or expand the capacity. TCL hasn't experienced/reported any incident suggestive of safety lapses in its manufacturing facilities over the past several years and its ability to maintain the manufacturing controls would be a monitorable.

Liquidity position: Strong

The company's liquidity profile is strong, supported by unencumbered cash and cash equivalents of ~Rs. 448.3 crore at the consolidated level as on September 30, 2023. The availability of unutilised working capital limits and healthy cash balances support the company's strong liquidity profile against expected debt repayment obligations of Rs. 35-40 crore in FY2025 and equity requirement for the planned capex during this period. ICRA notes the moderation of the liquidity in FY2025 owing to the ongoing capex. However, ICRA expects the liquidity to remain strong FY2026 onwards with expected healthy cash flows from the planned projects.

Rating sensitivities

Positive Factors – A rating upgrade is unlikely in the near term owing to the Negative outlook. However, the outlook could be revised to Stable if the company demonstrates a sustained improvement in margins that would improve the coverage metrics while maintaining the working capital intensity.

Negative Factors - Pressure on the ratings could arise if there is a sustained decline in revenue and profitability, or a stretch in the working capital cycle, along with a planned debt-funded capex, which will weaken the credit profile. The ratings may be downgraded if the net debt/OPBITDA exceeds 2.0 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Chemicals
Parent/Group support	Not Applicable
Consolidation/Standalone	The ratings are based on the consolidated financial profile of the company. The details of consolidation are provided in Annexure II

About the company

TCL started its operations in 1976 at Ranipet in Tamil Nadu as a single-product petrochemical company, manufacturing phthalic anhydride, with a production capacity of 6,000 TPA. The company is a part of the Thirumalai Group, which has business interests in chemicals, surfactants, pigments and education. Over the years, TCL has expanded its total PAN manufacturing capacity to ~1,72,000 TPA, including Dahej phase 1, and has added other products to its portfolio, which includes food additives such as maleic acid and fumaric acid, and PAN derivatives such as di-ethyl phthalate (DEP) and phthalimide (PID). TCL caters to customers in the construction, auto, paint, food, personal care and pharma industries. It also has a maleic anhydride (MAN) manufacturing facility in Malaysia, under its step-down subsidiary, Optimistic Organic Sdn. Bhd. (OOSB).

Key financial indicators (audited)

TCL Consolidated	FY2022	FY2023	9MFY2024
Operating income	1,998.3	2,133.2	1556.7
PAT	281.2	89.8	-18.3
OPBDIT/OI	22.12%	8.77%	3.0%
PAT/OI	14.07%	4.21%	-1.2%
Total outside liabilities/Tangible net worth (times)	0.7	1.0	-
Total debt/OPBDIT (times)	0.4	2.7	-
Interest coverage (times)	21.7	6.0	-

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2024)					Chronology of rating history for the past 3 years		
		Type	Amount rated (Rs. crore)	Amount outstanding as on Mar 31, 2023 (Rs. crore)	Date & rating in FY2024		Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021
					Feb 14, 2024	Aug 04, 2023	May 17, 2022	Apr 22, 2021	Apr 07, 2020
1	**Term loans**	Long term	200.00	76.00	**[ICRA]A+ (Negative)**	**[ICRA]A+ (Stable)**	**[ICRA]A+(Stable)**	**[ICRA]A+ (Positive)**	**[ICRA]A+ (Negative)**
2	**Fund-based limits**	Long term	864.00	-	**[ICRA]A+ (Negative)**	**[ICRA]A+ (Stable)**	**[ICRA]A+(Stable)**	**[ICRA]A+ (Positive)**	**[ICRA]A+ (Negative)**
3	**Non-fund based facilities**	Short term	-	-	-	-	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**
4	**Unallocated**	Long term	-	-	-	-	**[ICRA]A+(Stable)**	**[ICRA]A+ (Positive)**	-
5	**Unallocated**	Short term	-	-	-	-	**[ICRA]A1+**	**[ICRA]A1+**	-
6	**Unallocated**	Long term/ Short term	-	-	-	-	-	**[ICRA]A+ (Positive)/ [ICRA]A1+**	**[ICRA]A+(Negative)/ [ICRA]A1+**
7	**Non-fund based facilities (sub limit)**	Short term	(854.00)	-	**[ICRA]A1+**	**[ICRA]A1+**	-	-	-

8	**Short-term term loans**	Short term	-	-	-	**[ICRA]A1+**	-	-	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term fund-based – Term loan	Simple
Long-term – Fund-based limits	Simple
Short-term non-fund based limits	Very Simple

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
-	**Term loan I**	Aug 03, 2019	NA	Aug 31, 2025	100.00	[ICRA]A+(Negative)
-	**Term loan II**	Jul 31, 2019	NA	Jul 31, 2026	100.00	[ICRA]A+(Negative)
-	**Fund-based limits**	NA	NA	NA	864.00	[ICRA]A+(Negative)
-	**Non-fund based facilities (sublimit)**	NA	NA	NA	(854.00)	[ICRA]A1+

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

Annexure II: List of entities considered for consolidated analysis

Company Name	TCL Ownership	Consolidation Approach
Cheminvest Pte. Ltd.	100.00%	Full Consolidation
Optimistic Organic Sdn Bhd.	100.00%	Full Consolidation
Lapiz Europe Ltd	100.00%	Full Consolidation
TCL Global B V	100.00%	Full Consolidation
TCL INC	100.00%	Full Consolidation
TCL SPECIALTIES LLC	100.00%	Full Consolidation
TCL Intermediates Pvt Ltd	100.00%	Full Consolidation

Source: Company

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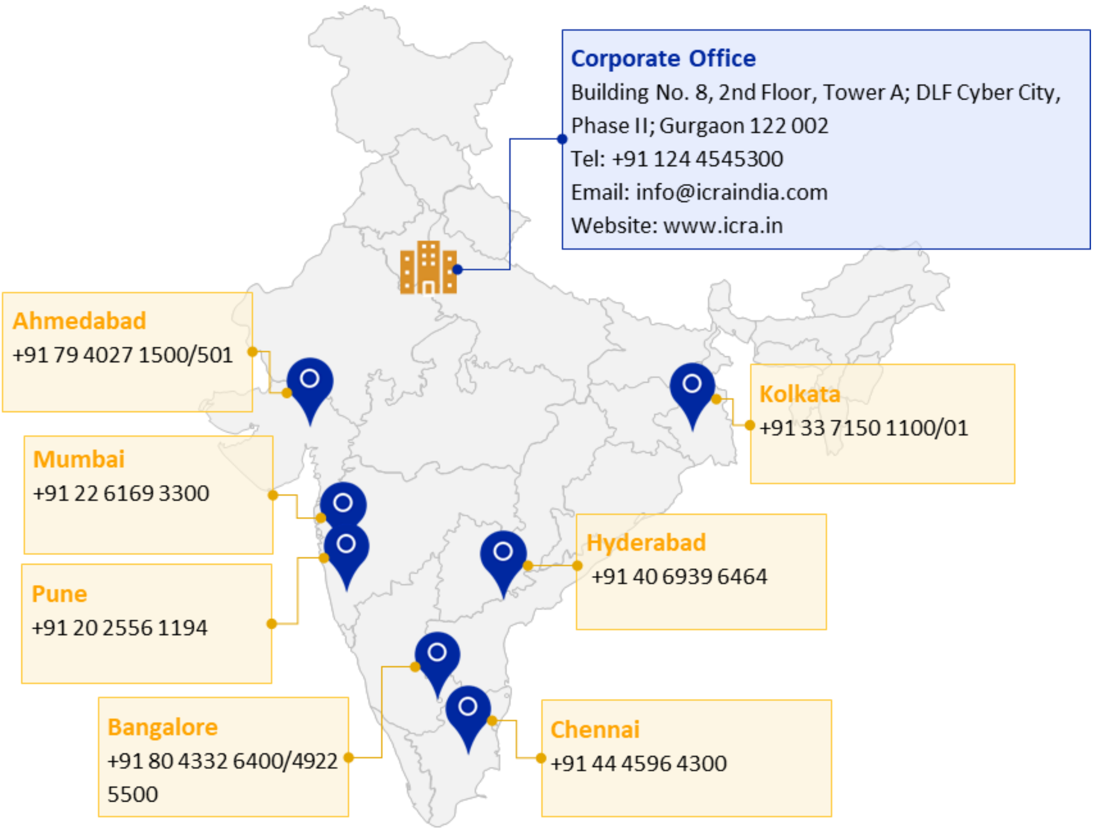

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