

August 27, 2019

Shree Ajit Pulp And Paper Limited: Ratings reaffirmed and outlook on the long-term rating revised to 'Positive'

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Fund-based -Cash Credit	57.75	50.00	[ICRA]A- (Positive); Reaffirmed, Outlook revised from Stable
Long-term Fund-based -Term Loan	95.01	41.49	[ICRA]A- (Positive); Reaffirmed, Outlook revised from Stable
Short-term Non-Fund based	02.00	02.00	[ICRA]A2+; Reaffirmed
Short-term Interchangeable	32.40	(19.64)	[ICRA]A2+; Reaffirmed,
Total	154.76	93.49	

*Instrument details are provided in Annexure-1

Rationale

The upward revision in outlook positively factors in improvement in SAPPL's profitability supported by increase in operational efficiency led by capital expenditure made towards automation/upgradation of manufacturing processes and decline in raw material prices in FY2019. The Chinese government introduced a ban on waste paper import in Q4FY2018 due to environmental issues leading to its increased global supply and consequent decline in waste paper prices.

The ratings reaffirmation continues to factor in SAPPL's long track record of over two decades in the kraft paper industry, backed by significant experience of its promoters in the kraft paper industry and the company's established distribution network across western and southern India. The ratings also take into account SAPPL's comfortable capital structure as reflected by a gearing of 0.29 times as on March 31, 2019 and healthy coverage indicators as reflected by net cash accruals/total debt of 85% and total debt/OPBDITA of 0.81 times in FY2019. Furthermore, the captive power generation from the company's co-generation unit leads to cost savings and continues to support the company's profitability.

The ratings are, however, constrained by SAPPL's exposure to product concentration risks with the product profile being confined to kraft paper and the exposure of SAPPL's profitability to fluctuations in waste paper prices, which have remained volatile during the past three fiscals. Moreover, intense competition in the kraft paper segment owing to the presence of many unorganised players, results in pricing pressure and limits the company's ability to pass on the fluctuations in raw-material prices. Further, with ~75% of the requirement of waste kraft paper, being met through imports, its margins remain vulnerable to any adverse fluctuations in foreign exchange in the absence of a firm hedging mechanism.

Outlook: Positive

ICRA expects Shree Ajit Pulp and Paper Limited to benefit from the extensive experience of its promoters and the stable demand conditions in the domestic and exports market. The 'Positive' outlook may lead to an upgrade in ratings if substantial growth in revenue and profitability, and better working capital management, strengthens the financial risk profile. Conversely, the outlook may be revised to 'Stable' or 'Negative' if cash accrual is lower than expected, or if any

major debt funded capital expenditure, or stretch in the working capital cycle, materially impacts the debt coverage indicators as well as the liquidity profile.

Key rating drivers

Credit strengths

Long track record of the company in the paper industry with an established distribution network built over the years - SAPPL has been manufacturing kraft paper since 1995 and has developed an established presence and distribution network in the industry over the past two decades.

Comfortable capital structure and healthy coverage indicators - The net worth base of the company remains healthy, which coupled with the moderate debt levels results in a comfortable capital structure as reflected by a gearing of 0.29 times as on March 31, 2019. Further, the coverage indicators have remained healthy as reflected by net cash accruals/total debt of 85% and total debt/OPBDITA of 0.81 times in FY2019.

Captive power generation from co-generation unit provides cost advantage and supports profitability - The company had commissioned a co-generation unit with an installed capacity of 1.50 MW in FY2014. The steam generated from the captive power plant is used for pulping, digesting and drying purposes. The PLF level of the co-generation unit has been steadily increasing over the past few years leading to significant cost savings for the company. Moreover, the company is in the process of entering into a power purchase agreement with two solar power companies for 25 years which will supply power at a lower price and further reduce SAPPL's costs.

Improvement in profitability due to decline in raw material prices and automation/upgradation of manufacturing processes – The company witnessed improvement in profitability with operating profits increasing to 16.40% in FY2019 from 9.79% in FY2018 led by decrease in raw material prices after the Chinese government introduced ban on import of waste paper. The profitability levels were also supported by improvement in operational efficiency led by capital expenditure made towards automation of existing manufacturing process.

Credit challenges

Vulnerability of profitability margins to volatility in waste paper prices - The main raw material used in the manufacturing process is waste kraft paper, which accounts for ~85% of the total raw material costs. The operating profit margins of the company remain vulnerable to fluctuations in waste paper prices, which have remained volatile during the past three fiscals. The waste paper prices increased during FY2017 and FY2018, which the company was unable to pass on to its customers. Hence, the operating profit margin declined to 8.88% and 9.79% in FY2017 and FY2018 respectively. However, the raw material prices have been declining since Q4FY2018 due to restrictions introduced by the Chinese government on import of waste paper leading to its increased global supply and consequent decline in waste paper prices. ICRA notes that although the operating profit margin has improved to 16.40% in FY2019, it has again declined to 13.40% in Q1FY2020 due to pass through of raw material price decline to its customers. Nonetheless, profitability continues to remain healthy. The stability of margins remains a key rating sensitivity here and will be closely monitored going forward.

Exposure to changes in waste paper handling regulations locally as well as internationally: Recently, the Chinese government imposed ban on import of waste paper which increased global supply and led to decline in waste paper prices. This reduced the company’s raw material prices leading to increase in its profitability. However, in future, any reversal in Chinese policies or introduction of similar ban on import of waste paper in India can affect SAPPL’s profitability adversely. Furthermore, in FY2019, Maharashtra Government imposed a ban on plastic which increased the demand for corrugated boxes made from kraft paper which, in turn, led to improvement in the company’s sales volume. Since the company uses waste paper as raw materials to manufacture kraft paper, its revenues and profitability remain vulnerable to regulatory changes in the paper industry. However, going forward, the positive impact of the current ban on imported waste paper by China is likely to sustain till FY2020, which provides some comfort.

Profitability remains vulnerable to foreign exchange fluctuations - SAPPL sources waste kraft paper from both the domestic and international markets. Imports are primarily made from the USA, Middle East and Europe through various indenting agents. The company met ~75% of the waste kraft paper requirement through imports in FY2019. Thus, its margins remain vulnerable to any adverse fluctuations in foreign exchange in the absence of a firm hedging mechanism.

High competitive intensity in the kraft paper industry especially in the lower BF segment which limits the pricing flexibility - The sales mix (by volume) for the company remains skewed towards lower grade kraft paper (20 BF and lower), which contributed 62% and 56% to overall volumes in FY2017 and FY2018, respectively. SAPPL earns lower margins on these papers and also faces stiff competition from other players in the segment, which limits its pricing flexibility. However, the contribution from lower BF segment has reduced to 49% in FY2019 which provides some comfort.

Liquidity position

SAPPL had external term loans of Rs. 27.08 crore on its books as on March 31, 2019. The capital expenditure for automation/upgradation of existing processes to be incurred in FY2020 is Rs 6.00 crore. The company will avail fresh term loans worth Rs 11.25 crore for the capital expenditure partly incurred in FY2019 and the remaining to be incurred in FY2020. Post disbursal, the company would need to make annual debt repayments of Rs 8.25 crore, Rs 7.23 crore and Rs 6.08 crore in FY2020, FY2021 and FY2022 respectively. ICRA notes that the company is currently operating at high capacity utilisation levels. Any larger than anticipated debt funded capital expenditure may impact the company’s liquidity.

The fund flow from operations of the company remained healthy in FY2019 owing to healthy profitability and low incremental working capital requirements. Going forward, the cash accruals are expected to remain sufficient for debt repayments. The average working capital utilisation stood at 20% for its fund based limits in the 15-month period ending June 2019. ICRA does not foresee any major concerns on liquidity given limited capacity expansion plans besides minimal requirement of incremental working capital funding.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	Not Applicable
Consolidation/Standalone	Standalone

About the company

Shree Ajit Pulp and Paper Limited (SAPPL) was incorporated on 23rd March 1995 as M/s Ajit Pulp and Paper Private Limited. It was subsequently converted into a Public Limited Company on 13th November 1995. SAPPL is engaged in the manufacture of different varieties of kraft paper which find application in the packaging industry, particularly in the manufacturing of corrugated boxes. The company has its production facility in Vapi, Gujarat with an installed capacity of 90,000 metric tons per annum (MTPA). SAPPL has installed two wind mills in Rajkot (1.50 MW, installed in FY 2010) and Jamnagar (1.25 MW, installed in FY 2012). The company also commissioned a 1.50 MW co-generation unit at its manufacturing unit in October 2013.

SAPPL has two group concerns, viz. Shree Samrat Pulp and Paper Private Limited (Shree Samrat) and Shree Samrudhi Industrial Papers Private Limited (Shree Samrudhi). The company holds 50% stake in Shree Samrat, which manufactures low burst factor (BF) kraft paper. Shree Samrudhi is a fully owned subsidiary, which is intended to act as a marketing arm for SAPPL.

In FY2019, the company reported a net profit of Rs. 22.68 crore on an operating income of Rs. 269.48 crore as compared to a net profit of Rs 8.25 crore on an operating income of Rs 249.26 crore in FY2018. Further, in Q1FY2020, SAPPL reported a net profit of 5.71% on an operating income of Rs 62.46 crore.

Key financial indicators (audited)

	FY2018	FY2019
Operating Income (Rs. crore)	249.26	269.48
PAT (Rs. crore)	08.25	22.68
OPBDIT/OI (%)	9.83%	16.40%
RoCE (%)	11.71%	22.10%
Total Debt/TNW (times)	0.50	0.29
Total Debt/OPBDIT (times)	2.08	0.81
Interest coverage (times)	4.30	8.58
NWC/OI	18%	14%

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

		Current Rating (FY2020)			Chronology of Rating History for the Past 3 Years				
Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating August 2019	Date & Rating in FY2019 September 2018	Date & Rating in FY2018		Date & Rating in FY2017	
						Nov 2017	Sep 2017	Mar 2017	Mar 2017
1 Cash Credit	Long - Term	50.00	-	[ICRA]A- (Positive)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Negative)
2 Term Loan	Long - Term	41.49	27.08*	[ICRA]A- (Positive)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Negative)
3 Non-fund based	Short - Term	02.00	-	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+
4 Interchangeable limits	Short - Term	(19.64)	-	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+

*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
NA	Cash Credit	-	-	-	28.00	[ICRA]A-(Positive)
NA	Cash Credit	-	-	-	22.00	[ICRA]A-(Positive)
NA	Term Loan 1	April 2012	10.75%	January 2019	14.88	[ICRA]A-(Positive)
NA	Term Loan 2	April 2012	10.75%	January 2019	7.08	[ICRA]A-(Positive)
NA	Term Loan 3	March 2019	10.75%	June 2027	5.60	[ICRA]A-(Positive)
NA	Term Loan 4	May 2015	10.65%	April 2020	0.56	[ICRA]A-(Positive)
NA	Term Loan 5	May 2016	10.65%	May 2022	4.40	[ICRA]A-(Positive)
NA	Term Loan 6	August 2016	10.65%	August 2022	2.56	[ICRA]A-(Positive)
NA	Term Loan 7	July 2017	10.65%	September 2025	0.76	[ICRA]A-(Positive)
NA	Term Loan 8	March 2019	10.65%	June 2027	5.65	[ICRA]A-(Positive)
NA	Letter of Credit	-	-	-	(10.00)*	[ICRA]A2+
NA	Credit Exposure Limit	-	-	-	(01.64)*	[ICRA]A2+
NA	Letter of Credit	-	-	-	(08.00)*	[ICRA]A2+
NA	Letter of Guarantee	-	-	-	02.00	[ICRA]A2+

Sub-limits within cash credit

Source: SAPPL

Annexure-2: List of entities considered for consolidated analysis: Not applicable

ANALYST CONTACTS

K. Ravichandran

+91 44 4596 4301

ravichandran@icraindia.com

Suprio Banerjee

+91 22 6114 3443

supriob@icraindia.com

Rupa Pandey

+91 22 6114 3456

rupa.pandey@icraindia.com

Viraj Kadwadkar

+91 22 6114 3457

viraj.kadwadkar@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

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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

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