August 24, 2022

Tamil Nadu Newsprint & Papers Limited: Ratings reaffirmed; outlook revised to Stable

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Term Loans	1,679.21	1,717.05	[ICRA]A reaffirmed; Outlook revised to Stable from Negative
Long-term / Short-term, Fund / Non-fund Based Limits	700.00	700.00	[ICRA]A/[ICRA]A1 reaffirmed; Outlook revised to Stable from Negative
Long-term, Unallocated Limits	255.79	217.95	[ICRA]A reaffirmed; Outlook revised to Stable from Negative
Long-term / Short-term, Unallocated Limits	298.00	298.00	[ICRA]A/[ICRA]A1 reaffirmed; Outlook revised to Stable from Negative
Total	**2,933.00**	**2,933.00**	

**Instrument details are provided in Annexure-I*

Rationale

The revision in the rating outlook to stable considers the improvement in operational and financial profile of Tamil Nadu Newsprint & Papers Limited (TNPL) in FY2022 and Q1 FY2023 with expectations of sustained improvement in its performance, going forward. This was aided by a healthy recovery in demand for the writing and printing paper (PWP) and board segments, and sharp rise in realisations. The demand growth was led by the opening up of schools, colleges and other related end-consumer segments after Covid-led disruptions. With favourable demand, higher realisations, cost saving measures, and better working capital management, the company's earnings and cashflows improved in FY2022 and Q1 FY2023, which resulted in sharp reduction in the debt levels of the company. While the operating margins were restricted at 9.3% in FY2022 owing to high input prices, the company took price hikes in Q1 FY2023 resulting in improved margins to 14.9%. The operating margins in FY2023 are expected to be supported by improved demand and change in product mix with higher share of high margin products. The ratings remain supported by TNPL's long operational history, strong management profile, dominant market position in the domestic PWP segment, diversified sales and distribution network, likely improvement in efficiency parameters given its integrated operations with adequate in-house capacity to manufacture pulp from diversified sources and the availability of captive power plants, thus providing cost advantages.

The strengths are, however, offset by TNPL's moderate capital structure because of the large debt-funded capex incurred in the past. However, the gearing has improved to 1.4 times as on March 31, 2022 over 1.7 times as on March 31, 2021 owing to sizeable reduction in debt levels in FY2022. Moreover, the coverage indicators remain moderate due to contracted margins in FY2022; however, interest coverage improved to 2.4 times in FY2022 over 1.4 times in FY2021 owing to lower interest expense. Given the company's continued debt-funded capex, the capital structure and coverage indicators shall remain moderate in the near to medium term. The first phase of the capex (towards pulping unit at the existing board plant) is expected to be commercialised in Q2 FY2023, which should provide cost savings, as it will enable in-house pulp production, against imports. ICRA notes that the profitability remains vulnerable to cyclicality in the paper business, availability of water and raw materials, and volatility in bagasse, pulp, chemicals, international coal prices and exchange rates. The elevated prices of coal and other raw materials will restrict the expansion in profit margins in FY2023 to an extent; however, the sustenance of high realisation is expected to support the margins. The ratings also consider TNPL's large repayment obligation and debt-funded capex during FY2024–FY2025, which exposes it to refinancing and project execution risks. The quantum of debt funding remains a sensitivity. However, the absence of any major capex plans in FY2023, moderate buffer in working capital limits and healthy flexibility with lenders are expected to support the company's liquidity profile.

The Stable outlook on the rating reflects ICRA's opinion that TNPL will continue to benefit from its established position, competitive advantages in the PWP segment and healthy financial flexibility with the lenders. The Stable outlook also factors in the anticipated improvement in demand for PWP and the expected improvement in profitability after completion of the planned pulping unit.

Key rating drivers and their description

Credit strengths

Leading market position in PWP segment – The company has an operating track record of more than three decades and an established brand name in the PWP segment. The company has a well-diversified sales and distribution network across India, consisting of non-exclusive dealers who account for ~45-60% of its sales (of PWP). While the sales are directly handled by TNPL for Government and private sector entities, which account for ~18-25% of PWP sales, exports account for the remaining 20-35% of PWP sales. The company also started board production from May 2016, which drove ~28% of its operating income in FY2022.

Access to diversified raw material sources and integrated production facility – The company has a long-term tie-up with several sugar mills near its manufacturing unit/s for the supply of bagasse against commensurate exchange of steam or coal. Additionally, TNPL enters short-term tie-ups with other sugar mills during periods of reduced availability of bagasse. The prices of bagasse are dependent on sugar cane production in Tamil Nadu and cost of coal, mainly imported. It has also been using wood for pulping. To ensure availability of wood, TNPL initiated farm forestry and captive plantation schemes in FY2005. Apart from the farm forestry programme and captive sources, significant quantities of wood are currently being procured from the two State Government of Tamil Nadu entities—TAFCORN and PCCF. Procurement of raw materials from diversified sources mitigates raw material availability risks. Earlier, the company used to enjoy stronger profitability than its peers, mainly because of predominant usage of bagasse as a key raw material, which is cheaper than wood or imported pulp. Further, availability of wood from captive sources at competitive rates also aids comfort in raw material procurement cost. In FY2022, with increase in prices and low availability of coal, the bagasse prices also increased significantly, along with other raw material prices, which impacted the company's operating margins of 9.3% in FY2022 (from 9.8% in FY2021). However, TNPL took significant price hikes in Q1 FY2023, which resulted in healthy operating margins of 14.9% over 10.0% in the corresponding previous quarter.

High financial flexibility and competitive borrowing costs from healthy standing among lenders – Given its established presence in the domestic PWP segment and strong profile of its management, TNPL continues to enjoy high financial flexibility with lenders, evident from the competitive borrowing costs and its ability to borrow ad hoc working capital limits over and above the sanctioned facilities, as well as avail fresh general corporate loans at short notice to support its liquidity profile.

Demand dynamics remain favourable amid healthy demand for paper and board from end-user sectors – The demand for writing and printing paper and boards has witnessed a surge in recent times, supported by the opening up and normalisation of operations in schools, colleges and other related end-consumer segments after the pandemic disruptions and growing demand for packaging from e-commerce, food and food products, FMCG, textiles and pharmaceutical sectors, which augurs well for the company.

Credit challenges

Leveraged capital structure and average debt coverage indicators; high repayment obligation exposes TNPL to refinancing risks – TNPL had undertaken debt-funded capex in the last few years for setting up a new board plant, expanding its cement plant and new pulp unit, which impacted its gearing and coverage indicators. The gearing levels improved to 1.4 times as on March 31, 2022 (over 1.7 times as on March 31, 2021) owing to reduction in debt levels supported by sizeable prepayment of term loans. However, ICRA expects the gearing levels to remain high in the next 2- 3 years given the large debt-funded capex plans, despite likely improvement in cash accruals. Although, the coverage indicators improved to 2.4 times in FY2022 (from 1.4 times in FY2021) and total debt/ OPBITDA to 6.0 times in FY2022 (from 10.0 times in FY2021), it remains moderate on the back of low operating profits. Further, with high repayment obligations in the near to medium term, the company remains exposed to refinancing risk. However, its flexibility with lenders mitigates the risk to some extent.

Susceptibility to cyclicality in paper industry – Paper being a commodity, is exposed to economic cycles. While demand for it is expected to be favourable in India because of a low per-capita consumption of paper in domestic markets compared to global standards, there could be aberrant years, given the cyclical nature of the industry. Any increase in imported coal prices and reduced availability of bagasse and wood at competitive rates can offset the advantage enjoyed by TNPL with respect to its operating profit margins. Steep volatility in imported coal prices or reduced availability of wood or bagasse at competitive rates could lead to erosion of the competitive advantage enjoyed by the company and adversely impact margins as witnessed in the recent period.

Margins remain exposed to fluctuations in input costs, primarily bagasse, pulp and coal – The profitability of the company remains vulnerable to cyclicality in the paper business, availability of water and raw materials, and volatility in bagasse, pulp, chemicals, international coal prices and exchange rates. The same is reflected by a dip in operating margins to 9.3% in FY2022 from 9.8% in FY2021. Further, with significant price hike in Q1 FY2023, enabled the company to achieve operating margins of 14.9% in Q1 FY2023. The elevated prices of coal and other raw materials are expected to limit the expansion in operating margins in FY2023 to an extent. However, the sustenance of high realisation, change in product mix with higher share of high margin products and benefits arising from new pulp unit are expected to support the margins, going forward.

Large debt funded capex from FY2024 exposes company to project execution risks – TNPL is planning to set up a manufacturing unit at an estimated cost of ~Rs. 1,400–1,500 crore over FY2024–FY2025 towards capacity enhancement of the board/ PWP plant. Through the capacity expansion, TNPL intends to enhance its production capacity by ~1,65,000 MTPA, which will enable it to cater to the growing domestic demand and increase its market share in the paper industry. Given the sizeable capex in relation to the gross block, it is exposed to project execution risk. Further, timely commencement of the project without any cost overrun remains a key rating monitorable. The project cost is proposed to be funded through a mix of term loan and internal accruals. With the onboarding of the debt, the capital structure and debt-coverage metrics are likely to moderate over FY2024–FY2025. The company's ability to achieve financial closure at favourable terms to keep capital structure and coverage indicators under check, will remain a key rating sensitivity, going forward.

Liquidity position: Adequate

During FY2022, the fund flow from operations improved to ~Rs. 209.0 crore (PY: Rs. 78 crore) along with significant improvement in the free cash flows of the company on account of judicious working capital management, which was also supported by prepayment of term loans that reduced TNPL's overall debt levels. The company has sizeable repayments of Rs. 236.0 crore in FY2023, which is expected to be sufficiently funded from internal accruals. TNPL is not planning any additional borrowings in FY2023.

In the current fiscal, TNPL's fund flow from operations is expected to improve on account of increase in scale of operations and improved profitability with commencement of the pulping unit and lower dependence on high cost import pulp. Further, the absence of any major capex plans in FY2023 and sufficient buffer in working capital borrowings are expected to support the liquidity profile of the company, in addition to healthy flexibility with lenders.

Rating sensitivities

Positive factors – ICRA could upgrade TNPL's rating if the company demonstrates significant improvement in operating margins along with growth in top line on a sustained basis, leading to an improvement in capital structure and coverage indicators.

Negative factors – Negative pressure on TNPL's rating could arise if there is significant moderation in revenue and profitability. The ratings might also be downgraded if there is a significant delay in the new board/ PWP plant commencement or higher-than-anticipated capex incurred towards the same, leading to sustained pressure on profitability and credit metrics.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology
Parent/Group support	Not Applicable
Consolidation/Standalone	Rating is based on standalone financial statements

About the company

TNPL was promoted by the State Government of Tamil Nadu and the Industrial Development Bank of India (IDBI) in 1979 to manufacture newsprint and PWP, using bagasse as the principal fibre source. Its plant at Kagithapuram in Tamil Nadu has a production capacity of 4.00 lakh tpa. The plant is the largest single location paper plant in India. Following the sale of IDBI's stake, the Tamil Nadu government is now the single largest shareholder with a stake of 35.32%. Though the company has the manufacturing capability for newsprint too, owing to unfavourable economics of manufacturing newsprint in India and the significant cyclicality witnessed in newsprint prices, PWP currently accounts for 100% of TNPL's total production. TNPL has three production units with a total manufacturing capacity of 4.00 lakh MTPA for the PWP segment. The company has also set up a new board plant near Trichy, with an annual capacity of 2.00 lakh MTPA, which commenced production from May 2016.

Key financial indicators (audited)

	FY2021	FY2022
Operating income	2,768.2	4,020.3
PAT	-65.1	14.3
OPBDIT/OI	9.8%	9.3%
PAT/OI	-2.4%	0.4%
Total outside liabilities/Tangible net worth (times)	2.7	2.6
Total debt/OPBDIT (times)	10.0	6.0
Interest coverage (times)	1.4	2.4

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 (FY2023) Type	Amount rated (Rs. crore)	Amount outstanding as of March 31, 2022 (Rs. crore)	Date & rating in FY2023 August 24, 2022	Chronology of rating history for the past 3 years: Date & rating in FY2022 September 09, 2021	Date & rating in FY2021 December 29, 2020	Date & rating in FY2020 September 16, 2019
1	Term loans	Long term	1717.05	1840.8	[ICRA]A(Stable)	[ICRA]A (Negative)	[ICRA]A(Stable)	[ICRA]A (Stable)
2	Fund /Non fund Based-Limits	Long term and short term	700.00	--	[ICRA]A(Stable)/ [ICRA]A1	[ICRA]A (Negative)/ [ICRA]A1	[ICRA]A(Stable)/ [ICRA]A1	[ICRA]A (Stable)/ [ICRA]A1
3	Unallocated Limits	Long term	217.95	--	[ICRA]A(Stable)	[ICRA]A (Negative)	[ICRA]A(Stable)	[ICRA]A (Stable)
4	Unallocated Limits	Long term and short term	298.00	--	[ICRA]A(Stable)/ [ICRA]A1	[ICRA]A (Negative)/ [ICRA]A1	[ICRA]A(Stable) /[ICRA]A1	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term Term Loans	Simple
Long-term/ Short-term, Fund/Non fund-Based Limits	Simple
Long-term, Unallocated Limits	Not Applicable
Long-term/Short-term, Unallocated Limits	Not Applicable

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: www.icra.in

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loans	FY2018	NA	FY2027	1717.05	[ICRA]A(Stable)
NA	Fund/Non fund-Based Limits	NA	NA	NA	700.00	[ICRA]A(Stable)/[ICRA]A1
NA	Unallocated	NA	NA	NA	217.95	[ICRA]A (Stable)
NA	Unallocated	NA	NA	NA	298.00	[ICRA]A(Stable)/[ICRA]A1

Source: Company

Annexure II: List of entities considered for consolidated analysis – Not applicable

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