

July 18, 2023^(Revised)

Oriental Carbon & Chemicals Limited: Continues on rating watch with developing implications

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term loans	143.00	110.00	[ICRA]AA-; continues on rating watch with developing implications
Long term/short term fund-based limits	85.00	110.00	[ICRA]AA-; continues on rating watch with developing implications /[ICRA]A1+; continues on rating watch with developing implications
Long term/short term Interchangeable#	(85.00)	(110.00)	[ICRA]AA-; continues on rating watch with developing implications /[ICRA]A1+; continues on rating watch with developing implications
Non-fund based limits	29.00	34.00	[ICRA]A1+; continues on rating watch with developing implications
Total	257.00	254.00	

*Instrument details are provided in Annexure-1; # Long term/short term interchangeable with long term/short term-fund based limits

Rationale

The ratings of Oriental Carbon & Chemicals Limited were placed under watch with developing implications following the proposed business restructuring under which the chemical business was proposed to be demerged into a separate entity, leaving the investment business and the subsidiary with the current entity. Both the entities are likely to have similar shareholding patterns. The scheme is subject to the approvals of the requisite regulatory authorities and is likely to take 3-6 months. Further, considering the other uncertainties related to the final financial structure of each of the entities, the ratings have been placed under watch with developing implications. ICRA will continue to monitor the developments in this regard and will take a suitable rating action as more clarity emerges on the demerger.

To arrive at the ratings, ICRA has considered the consolidated financials of Oriental Carbon & Chemicals Limited (OCCL), including its subsidiary Duncan Engineering Limited (DEL, rated [ICRA]A-/[ICRA]A2+; under rating watch with negative implications), till the time the demerger is complete.

The ratings factor in the long and established track record of OCCL in manufacturing insoluble sulphur, with a favourable position in the domestic and global markets. The ratings also consider a strong financial risk profile, characterised by large, unencumbered cash balances and healthy cash generation from operations. The ratings also factor in a stable outlook for the tyre industry, which is the key consumer of insoluble sulphur, in the medium to long term with demand expected to grow at a steady pace.

However, the margins had come under pressure in FY2022 and FY2023 because of a steep hike in raw material prices and elevated freight and power costs. Though the operating profit margin improved to 20.5% in FY2023 from 19.6% in FY2022, it was lower than 31.6% in FY2021. The uncertainties brought in by the geo-political situation led to a significant spike in raw material prices while there was a lag in passing on the price increase to the customers. However, the company has been achieving better contribution margins in the current fiscal as raw material prices have started ebbing as also freight and power costs.

OCCL's revenue grew in FY2023 as realisations rose with the increase in raw material prices. The realisations increased ~20.8% YoY in FY2023, driven by the elevated prices of sulphur. Going forward, the revenue growth is expected to remain muted owing to a moderation in realisations, even as the volumes are expected to grow.

The company's gearing remained low at 0.3 times at the end of FY2023, with the net gearing also being steady at 0.03 times at the end of FY2023. The gross leverage (total debt/OPBDITA) improved to 1.5 times at the end of FY2023 owing to the improvement in operating profits and reduced debt levels. The leverage is likely to improve further, going forward. The net debt/OPBDITA was 0.2 times at the end of FY2023.

The ratings, however, are constrained by the concentration of the revenues on a single product i.e. insoluble sulphur which is mostly supplied to the automotive sector. The threat of competition, especially from Chinese players, can be partly mitigated by maintaining superior product quality and high standards of health and safety at the plants. The profitability also remains vulnerable to foreign exchange rate movements, fluctuations in raw material prices and high working capital intensity.

Key rating drivers and their description

Credit strengths

Well-experienced management and long track record of OCCL in producing insoluble sulphur (IS) – OCCL has a long and established track record in the chemical 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 producing insoluble sulphur in 1994 with a capacity of 3,000 MTPA and has since then ramped up its capacity to 39,500 MTPA.

Dominant market position in domestic industry; preferred supplier to major tyre companies across the world – OCCL has a dominant position in the domestic market as the sole manufacturer of IS. It has also been able to position itself as the preferred/second preferred supplier to most global tyre makers. Hence, it continues to retain its leadership position in the domestic market with 55-60% of the market share and around 10% share in the global market.

Healthy financial risk profile with comfortable margins and strong debt protection metrics – OCCL's capitalisation and coverage indicators have improved significantly over the last few years, despite the significant capex, because of the healthy cash generation and low reliance on debt. The net debt levels were Rs. 21.7 crore at the end of FY2023, leading to low net financial leverage (net debt/OPBDITA) of 0.2 times at the end of FY2023. The interest coverage ratio moderated to 8.4 times in FY2023 vis-à-vis 14.8 times in FY2022. ICRA expects the company's credit metrics to improve further, given the healthy cash generation and limited capex planned, going forward.

Stable performance of subsidiary – Duncan Engineering (DEL rated [ICRA]A-/ [ICRA]A2+; rating under watch with negative implications, earlier known as Schrader Duncan), incorporated in 1962, was promoted as a joint venture between Schrader Bridgeport International (SB Intl, a wholly-owned subsidiary of Tomkins Plc) and the Duncan Group (managed by the Goenka family, which is the promoter Group of OCCL). DEL manufactures pneumatic products such as air cylinders, valves, and accessories. OCCL holds a 50.01% stake in DEL, making it a subsidiary of OCCL. Earlier, OCCL had provided corporate guarantees, backing the bank lines of DEL, but the same were withdrawn in FY2021.

DEL's operating income increased to Rs. 70.10 crore in FY2023 against Rs. 55.77 crore in FY2022, driven by improvement in volumes and realisation due to the rise in steel and aluminum prices. The operating profit was higher at Rs. 13.1 crore in FY2023 against Rs. 9.2 crore in FY2022. The entity had a long-term debt of Rs. 1.5 crore by the end of FY2023 and around Rs. 28.8 crore of cash and other investments.

Credit challenges

Threat of competition from Chinese players – Chinese manufacturers are usually able to offer insoluble sulphur at a lower cost and are a threat to players like OCCL. However, this risk is partly mitigated by the high entry barriers and the environmental, health and safety standards (EHS). Many large tyre manufacturers are wary of procuring from Chinese players due to apprehensions over inconsistent quality levels and lower EHS standards.

Vulnerable to forex rate movements; partly mitigated by hedging policy – OCCL derives a significant share of revenues from export sales, 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 six months using forward contracts.

Profitability vulnerable to increase in raw material prices – 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 risk is, however, largely mitigated by the periodic price revisions with the end users though there can be a lag in passing on the raw material price impact, as seen in FY2022 and FY2023 when the margins were impacted.

Liquidity position: Strong

OCCL's liquidity is strong, backed by sizeable unencumbered cash balances, unutilised fund-based limits vis-à-vis the capex requirement and the debt repayments in the near to medium term. As of FY2023, the company had net debt of Rs. 21.7 crore. Going forward, the cash generation is expected to remain comfortable.

Rating sensitivities

Positive factors – ICRA will resolve the watch as more clarity emerges on the proposed demerger. OCCL's rating may be revised upwards if the company is able to demonstrate a significant increase in the scale of operations with commensurate returns, while maintaining healthy liquidity and debt coverage indicators.

Negative factors – ICRA will resolve the watch as more clarity emerges on the proposed demerger. The ratings may be downgraded if there is a significant contraction in the scale of operations for a sustained period, resulting in weak cash accruals and weakening of liquidity and debt coverage metrics.

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 to produce insoluble sulphur, which is now its flagship product as the company sold the carbon black unit to Continental Carbon Company in 2000. At present, OCCL has three production units: two at Dharuhera Industrial Unit in Haryana and one at Mundra SEZ in Gujarat. The company now produces insoluble sulphur, sulphuric acid and oleum. The production capacity of OCCL stands at 39,500 metric tonnes per annum (MTPA) for insoluble sulphur (IS) and 88,200 MTPA for sulphuric acid & oleum.

The company is in the midst of a capex programme to expand the IS capacity by 11,000 MTPA at Dharuhera (of which 5,500 MTPA has been commissioned in December 2021) along with expansion of the sulphuric acid capacity by 42,000 MTPA. The schedule for the commissioning of the second phase of capacity expansion of 5,500 MTPA is yet to be decided. Further, the company has announced a business restructuring under which the chemicals business will be demerged into a separate entity, leaving the investment business and Duncan Engineering Limited as a subsidiary with the existing entity.

Key financial indicators (audited)

OCCL Consolidated	FY2022	FY2023*
Operating income	443.7	535.9
PAT	46.2	53.6
OPBDIT/OI	19.6%	20.5%
PAT/OI	10.4%	10.0%
Total outside liabilities/Tangible net worth (times)	0.5	0.4
Total debt/OPBDIT (times)	2.1	1.5
Interest coverage (times)	14.8	8.4

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

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument	Type	Current rating (FY2024)			Chronology of rating history for the past 3 years				
		Amount rated (Rs. crore)	Amount outstanding as of Mar 31, 2023 (Rs. crore)	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021		
							Jul 18, 2023	Aug 12, 2022	Jul 30, 2021
1	Term loans	110.00	103.93	[ICRA]AA-; ratings watch with developing implications	[ICRA]AA-&	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	
2	Long term/short term fund-based limits	110.00	--	[ICRA]AA-; ratings watch with developing implications / [ICRA]A1+; ratings watch with developing implications	[ICRA]AA-&/[ICRA]A1+&	[ICRA]AA-(Stable)/[ICRA]A1+	[ICRA]AA-(Stable)/[ICRA]A1+	[ICRA]AA-(Stable)/[ICRA]A1+	
3	Interchangeable#	(110.00)	--	[ICRA]AA-; ratings watch with developing implications / [ICRA]A1+; ratings watch with developing implications	[ICRA]AA-&/[ICRA]A1+&	[ICRA]AA-(Stable)/[ICRA]A1+	-	-	
4	Non-fund based limits	34.00	--	[ICRA]A1+; ratings watch with	[ICRA]A1+&	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	

								developing implications
5	Fixed deposit programme	Medium term	-	--	-	-	MAA (Stable) Withdrawn	MAA (Stable) MAA (Stable)

Long Term/Short Term interchangeable with Long Term/Short term-Fund based limits; &: Rating on watch with developing implications

Complexity level of the rated instruments

Instrument	Complexity Indicator
Term loans	Simple
Long term/short term fund-based limits	Simple
Long term/short term interchangeable#	Simple
Non-fund based limits	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
NA	Term loans	FY2018-FY2023	7.75%- 9.50%	FY2024-FY2028	110.00	[ICRA]AA-; ratings watch with developing implications
NA	Long term/short term fund-based limits	-	-	-	110.00	[ICRA]AA-; ratings watch with developing implications /[ICRA]A1+; ratings watch with developing implications
NA	Long term/short term Interchangeable#	-	-	-	(110.00)	[ICRA]AA-; ratings watch with developing implications /[ICRA]A1+; ratings watch with developing implications
NA	Non-fund based limits	-	-	-	34.00	[ICRA]A1+; ratings watch with developing implications

Source: Company

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Annexure II: List of entities considered for consolidated analysis

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

Source: OCCL

Corrigendum:

Document dated July 18, 2023 has been corrected with revisions as detailed below:

Revisions on page number 4 under “Key financial indicators”, correct Total debt/OPBDIT captured, and under “Rating history for past three years”, correct rating year captured.

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