

February 22, 2024

Shree Ajit Pulp and Paper Limited: Ratings downgraded to [ICRA]A-(Negative)/[ICRA]A2+

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Fund-based – Cash credit	140.00	140.00	[ICRA]A- (Negative); downgraded from [ICRA]A (Negative)
Long-term fund-based – Term loan	239.25	239.25	[ICRA]A- (Negative); downgraded from [ICRA]A (Negative)
Short-term non-fund based	14.00	14.00	[ICRA]A2+; downgraded from [ICRA]A1
Short-term interchangeable	(101.00)	(101.00)	[ICRA]A2+; downgraded from [ICRA]A1
Short-term – Unallocated limits	0.75	0.75	[ICRA]A2+; downgraded from [ICRA]A1
Total	394.00	394.00	

*Instrument details are provided in Annexure-I

Material Event

Shree Ajit Pulp & Paper Limited (SAPPL/the company) announced its Q3 FY2024 results to the stock exchanges on February 14, 2024. For Q3 FY2024, SAPPL reported an operating income of Rs. 43.07 crore (50% degrowth YoY) with a net profit of Rs. 1.59 crore. For 9M FY2024, the company's operating income was Rs. 187.04 crore (37% YoY degrowth) with net profit of Rs. 5.40 crore. The revenues were affected by the delay in commissioning of Unit II and factory shutdowns in Unit I in Q3.

Impact of Material Event

ICRA has downgraded the long-term rating to [ICRA]A- (pronounced ICRA A minus) from [ICRA]A (pronounced ICRA A) and short-term rating to [ICRA]A2+ (pronounced ICRA A two plus) from [ICRA]A1 (pronounced ICRA A one) for the Rs. 394-crore bank lines of the company. The outlook on the long-term rating continues to be Negative.

Rationale

The rating action considers the delay in the commercialisation of Unit II, leading to sharp decrease in revenues and the earnings profile, and its resultant impact on the credit profile for FY2024 and FY2025, compared to earlier ICRA expectations. SAPPL's unit II commercialisation is now anticipated by September 2024, pushed back from the initial expectation of March 2024. This was due to the delay in import of specialised machinery, which was originally slated for installation by March 2024; the same is now rescheduled to July/August 2024. Despite declaring commercial production for the unit II in July 2023, the company has been operating the unit in trail mode since then, and the revenues and associated costs have been capitalised and expected to continue till its specialised machinery is delivered and installed. Given the shift in commercialisation of unit II, the revenues for FY2024 and FY2025 are expected to be notably lower than earlier expectations and will have a cascading impact on profitability, cash accruals and leverage metrics. The repayment on the term loans for the loans taken for new facility (unit II) started from January 2024. The company is expected to service the same from the cash flows of unit I and other sources like proceeds from land sale, ongoing rights issue and inflow through sale of assets in the Joint Venture. The total inflow from these sources is expected to be Rs. 55-58 crore, with part of rights issue to the extent of ~Rs. 11-12 crore to flow in FY2025, against which the repayments are ~Rs. 33 crore. The company also has buffer available in fund-based limits (10% average utilisation over the last 12 months against the sanctioned limits), which supports its liquidity profile.

The ratings however remain supported by SAPPL's extensive operational track record, its diversified customer profile and strong distribution network spread across various parts of the country. The ratings also factor in the company's mature level of capacity utilisation and its captive power plant. Also, the favourable long-term demand prospects for kraft paper supported by growing demand for packaging from e-commerce, food and food products, FMCG, textiles, automobiles and pharmaceutical sectors, augur well for SAPPL.

The ratings also factor in the vulnerability of the company's profitability to volatility in wastepaper prices along with foreign exchange (forex) fluctuations, given its sizeable dependence on imports. The ratings also remain constrained by the stiff competitive intensity in the kraft paper segment, owing to many unorganised players resulting in pricing pressure.

Key rating drivers and their description

Credit strengths

Established track record in kraft paper business – SAPPL has been manufacturing kraft paper since 1995, which has enabled the company to forge strong relationships with both customers and suppliers. Mr. Gautam Shah, Chairman and Managing Director, is a civil engineer and oversees the manufacturing, managerial, marketing and administrative aspects of the company.

Healthy long-term demand for kraft paper from end-user industries – The long-term demand prospects for kraft paper is expected to be healthy, supported by growing demand for packaging from the e-commerce, food and food products, FMCG, textiles, automobiles and pharmaceutical sectors, which augurs well for the company.

Financial profile characterised by adequate gearing and liquidity – The nature of debt in SAPPL are term debts and working capital borrowings. SAPPL's capital structure continues to be adequate, aided by healthy net worth, indicated by low gearing of 0.81 times as on March 31, 2023. Although it has slightly increased in H1 FY2024 to 0.96 times, due to ongoing debt-funded capex, it remains at healthy levels. The liquidity profile also remains adequate, driven by healthy cushion in the form of sizeable undrawn working capital limits, coupled with steps undertaken by management in the recent past to shore up liquidity through various sources including sale of non-core assets as well as ongoing rights issue.

Credit challenges

Delay in commissioning of the ongoing capex project to exert pressure on credit profile – At present, SAPPL is undertaking a large debt-funded capex to enhance its kraft manufacturing capacity in its existing units as well as undertake modification/conversion capex at its newly acquired unit from N.R. Agarwal Industries Limited. The total cost of the project is estimated at ~Rs. 305 crore, which is to be funded by a mix of debt (~Rs. 233 crore) and internal funds. Although the production at its newly acquired facility has commenced from July 2023, however it remains in its trial phase, leading to capitalisation of revenues and associated costs, given the quality of paper output remaining subdued compared to expected levels. Hence, the revenues and associated profits expected for FY2024 are anticipated to be much lower than earlier expected by ICRA. The capitalisation is expected to continue till the first half of FY2025, till the specialised machinery, which the company was expecting to receive by March 2024 is installed. Consequently, the company's debt protection metrics are likely to remain under pressure in the near to medium term, given the full impact of debt and capex will only be seen by FY2025 end. Any meaningful recovery in debt protection metrics is only expected from the second half of FY2025, when full impact of new capacity and higher quality output will be visible. Lack of commensurate returns in terms of higher quality of paper leading to increased realisations or any further material time and cost overruns, impacting the revenue profile will be key monitorable.

Profitability exposed to volatility in wastepaper prices and decline in price realisations, reflected in moderation in margin in FY2023; marginal recovery visible in the current fiscal – SAPPL's profitability remains exposed to sharp fluctuations in raw material prices — primarily wastepaper — as a large portion of wastepaper is imported, while prices remain exposed to global demand–supply dynamics. Demand–supply mismatches, lower wastepaper generation in developed markets disrupted supply across the globe, which resulted in increase in wastepaper prices. The other key raw material used in the manufacturing process is coal, which is primarily imported, remained elevated throughout most of FY2023. The company's margin hence, fell

sharply in FY2023 over FY2022, given its inability to fully pass on the cost to its end customers. Thus, SAPPL's margins remain exposed to any adverse fluctuations in wastepaper and coal prices. Further, the company uses imported wastepaper, making it vulnerable to movements in forex rates, as it has adopted currency hedging in a limited way. The margin in the current year has improved with stabilisation in realisations, but still remains lower compared to FY2022 levels.

Limited pricing flexibility especially in lower BF segment due to the intense competition in kraft paper industry – The kraft paper industry in India has a large number of unorganised players and is, hence, characterised by intense competition. Also, there is heightened competition in the lower burst factor (BF) grade kraft paper, given the limited product differentiation. This results in high pricing pressure and limits the company's ability to pass on raw material price increase in a timely manner.

Exposure to changes in wastepaper-related regulations – SAPPL's profitability margins remain vulnerable to any regulatory changes in the kraft paper industry. The paper manufacturing industry is exposed to environmental risks, as its production causes air, water and land pollution. Discarded paper and paperboards also make up a sizeable portion of solid municipal waste. Thus, the entity remains exposed to the risks associated with changes in wastepaper-related regulations on availability and usage of water and other inputs in the manufacturing process.

Environment and Social Risks

Environmental considerations: The paper manufacturing industry is exposed to environmental risks, given the production function leads to air, water and land pollution and discarded paper and paperboard make up a sizeable portion of solid municipal waste. Pulp and paper generate a notable amount of industrial air, water, and land emissions. While these risks have not resulted in any material implications so far, any breaches in waste management or higher-than-permissible emissions could have cost implications for the company. Also, water treatment is extremely important here because the pulping and bleaching process can release complex organic and inorganic pollutants in effluent which needs to be properly treated. Presently, SAPPL operates a fully-automated effluent treatment plant to treat water before discharge. However, any disruptions in measures taken for appropriate treatment of wastewater could result in significant penalties, while also causing prolonged adverse impact to operations in case the authorities take any strict action.

Social considerations: Being a labour-intensive segment, the entities operating in the paper industry are exposed to the risk of disruption due to inability to properly manage human capital in terms of their safety and overall well-being. Further, any significant wage rates adversely impact the cost structure of paper manufacturing companies, impacting their margins. SAPPL is also exposed to the shortage of skilled labourers, which can impact operations. However, at present, SAPPL has taken measures towards employee welfare including a social accountability policy in place.

Liquidity position: Adequate

The liquidity position of the company is adequate, with healthy cushion in fund-based limits, given the moderately utilised working capital limits. The company has a debt repayment obligation of Rs. 33-34 crore p.a over the next three fiscals starting FY2025 and towards the balance capex to be incurred in Unit II. The company has already tied up the debt for the balance capex and shored up its liquidity profile, through various measures including rights issue and sale of non-core assets. The total inflow from these sources is expected to be in the range of ~Rs. 45 crore in FY2024 and Rs. 11-12 crore in FY2025. Hence, the near-term debt repayment is expected to be met though these liquidity measures as well as buffer available in fund-based limits, other than the cash flow from the presently running Unit I. Over the medium term, the cash flows from the new Unit are expected to adequately match the debt repayment.

Rating sensitivities

Positive factors – The long-term rating can be moved to Stable from Negative, if better-than-expected ramp-up in operations along with sustained improvement in profitability, leads to an improvement in credit metrics and liquidity, at the consolidated level. A specific credit metric for an upgrade is if Total Debt/OPBDITA is less than 2.0 times, on a sustained basis.

Negative factors – The ratings may be downgraded upon any further material time or cost overruns or sub-optimal utilisation of new capacities upon commissioning, which will adversely impact the credit profile. Further, any sustained pressure on revenues and earnings or deterioration of its working capital cycle, which would adversely impact the credit metrics and liquidity position could also result in a downgrade. A specific credit metric for a downgrade is if interest coverage is less than 4.0 times, on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology
Parent/Group support	Not applicable
Consolidation/Standalone	The ratings are based on the consolidated financial profile of the company. As on March 31, 2023, SAPPL had one subsidiary and one joint venture, which are enlisted in Annexure II.

About the company

Shree Ajit Pulp and Paper Limited (erstwhile M/s Shree Ajit Pulp and Paper Private Limited), incorporated in March 1995, manufactures different varieties of kraft paper, which find application in the packaging industry, particularly in manufacturing corrugated boxes. The company's production facility is in Vapi, Gujarat, with an installed manufacturing capacity of 1,20,000 metric tonnes per annum (MTPA). SAPPL has also installed two windmills in Rajkot (1.50 MW; FY2010) and Jamnagar (1.25 MW; FY2012). The company also commissioned a 2.40-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 a 50% stake in Shree Samratwas, previously involved in manufacturing of low BF kraft paper. However, Shree Samrat's core assets were sold off in FY2023. Shree Samrudhi is a wholly-owned subsidiary, which is intended to act as a marketing arm for SAPPL and remains non-operational at present.

Key financial indicators (audited)

Consolidated	FY2022	FY2023	9M FY2024 [^]
Operating income	418.3	371.9	187.0
PAT	25.1	11.3	5.4
OPBDIT/OI	11.0%	7.9%	8.2%
PAT/OI	6.0%	3.0%	2.9%
Total outside liabilities/Tangible net worth (times)	0.5	1.1	-*
Total debt/OPBDIT (times)	1.0	5.8	-*
Interest coverage (times)	10.1	4.5	5.6

Source: Company, ICRA Research; [^] Unaudited results * Not available; All ratios as per ICRA's calculations; Amounts in Rs. crore

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

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument	Type	Amount Rated (Rs. crore)	Current Rating (FY2024)		Chronology of Rating History for the past 3 years				
			Amount Outstanding as of December 31, 2023 (Rs. crore)	Date & Rating in FY2024		Date & Rating in FY2023	Date & Rating in FY2022	Date & Rating in FY2021	
				Feb 22, 2024	Aug 10, 2023	Jun 28, 2022	Oct 26, 2021	Mar 25, 2021	Oct 01, 2020
1 Cash credit	Long-term	140.00	-	[ICRA]A- (Negative)	[ICRA]A (Negative)	[ICRA]A (Negative)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A- (Positive)
2 Term loan	Long-term	239.25	189.60	[ICRA]A- (Negative)	[ICRA]A (Negative)	[ICRA]A (Negative)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A- (Positive)
3 Bank guarantee/ Credit exposure limit	Short-term	14.00	-	[ICRA]A2+	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A2+
4 Unallocated limits	Short-term	0.75	-	[ICRA]A2+	[ICRA]A1	-	-	-	-
5 Interchangeable	Short-term	(101.00)	-	[ICRA]A2+	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A2+

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term– Fund-based cash credit	Simple
Long-term - Fund-based term loan	Simple
Short -term – Non fund based	Very Simple
Short -term – Interchangeable	Very Simple
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: [Click Here](#)

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Cash credit	NA	NA	NA	140.00	[ICRA]A- (Negative)
NA	Term loan (existing)	FY2019	NA	FY2031	6.25	[ICRA]A- (Negative)
NA	Term loan (new)	FY2022	NA	FY2031	233.00	[ICRA]A- (Negative)
NA	Bank guarantee	NA	NA	NA	10.00	[ICRA]A2+
NA	Credit exposure limit	NA	NA	NA	4.00	[ICRA]A2+
NA	Interchangeable	NA	NA	NA	(101.00)	[ICRA]A2+
NA	Unallocated	NA	NA	NA	0.75	[ICRA]A2+

Source: Company

[Please click here to view details of lender-wise facilities rated by ICRA](#)

Annexure II: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Shree Samrat Pulp and Paper Private Limited	50%	Equity Method
Shree Samrudhi Industrial Papers Private Limited	100%	Full Consolidation

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