

July 25, 2019

## Duncan Engineering Limited: Long Term Rating upgraded to [ICRA]AA-(SO)(Stable); Short term rating reaffirmed at [ICRA]A1+(SO)

### Summary of rated instruments

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund based – Working capital facility (SO)	9.00	9.00	[ICRA]AA-(SO) (Stable); upgraded from [ICRA]A+(SO) (Positive)
Short term – Non-Fund based (SO)	0.81	0.81	[ICRA]A1+(SO); reaffirmed
<b>Total</b>	<b>9.81</b>	<b>9.81</b>	

\*Instrument details are provided in Annexure-1

### Rationale

The upgrade in the long term rating reflects the upgrade in the long term rating of the parent Oriental Carbon & Chemicals Limited (OCCL, rated [ICRA]AA-(Stable)/[ICRA]A1+) as the ratings of Duncan Engineering Limited (DEL) are based on an irrevocable and unconditional corporate guarantee from OCCL and Cosmopolitan Investments Limited (CIL) for the Rs. 9.81 crore facilities of DEL and an undertaking from the guarantors to ensure that the debt obligations are serviced on or prior to the due date, irrespective of the invocation of the guarantee by the beneficiary.

### Outlook: Stable

The outlook on the rating is Stable given the outlook on the guarantor's long-term rating.

### Key rating driver- DEL

**Unconditional and irrevocable corporate guarantee from parent backing the bank lines of the company:** OCCL and CIL have furnished an unconditional irrevocable corporate guarantee for the Rs. 9.81 crore facilities of DEL and an undertaking from the guarantors to ensure that the debt obligations are serviced on or prior to the due date, irrespective of the invocation of the guarantee by the beneficiary.

### Key rating drivers for the Guarantor-OCCL

#### Credit strengths

**Well experienced management and long track record of OCCL in the business of producing IS:** OCCL has a long and established track record in the chemicals 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 production of insoluble sulphur in 1994 with a capacity of 3000 MTPA and has since then ramped up its capacity to 34,000 MTPA currently. The company is expanding its IS capacity by another 11,000 MTPA by Q3 FY2022 taking its total capacity to 45,000 MTPA.

**Dominant market position in the domestic industry; favourable market position as a 'Second Supplier' to major tyre companies across the world:** OCCL is the sole manufacturer of IS in the domestic market. OCCL continues to retain its

leadership position in the domestic market with nearly 55%-60% of the market share and around 10% market share in the global market.

**Favourable growth prospects in the domestic tyre industry driven by radialisation of tyres and capacity expansion being undertaken by tyre manufacturers in India:** Insoluble sulphur is used as an input for manufacturing of tyres and with rising radialisation the consumption of insoluble sulphur is expected to rise. While the near term outlook for the tyre demand from the Original Equipment manufacturers (OEM), which is ~25-30% of the tyre market, may be subdued given the sluggish auto sales, the demand from the replacement segment which comprises nearly 70% of the tyre market is expected to remain healthy. The long-term demand growth of the domestic tyre market is expected to remain around 7-9%. With healthy growth rate for the tyre segment going forward, the demand outlook for IS is expected to remain healthy in the long term.

**Track record of healthy plant performance and significant ramp up of newly installed capacity:** OCCL's plant performance has been healthy over past few years with healthy capacity utilisation levels. Capacity utilisation post capacity addition has also remained healthy. Going forward the capacity utilisation of new capacities is expected to ramp up given the healthy demand outlook for the tyre industry.

**Healthy financial risk profile characterised by robust cash generation, large cash balances resulting in healthy credit metrics:** OCCL's capitalisation and coverage indicators have improved significantly over last few years despite undertaking significant capex in last three years given the healthy cash generation and lower reliance on debt. While the revenue growth in FY2019 was driven by combination of volume growth of 7% YoY and realisation growth of 7% YoY for IS. The operating profit of the company increased to Rs. 124.6 crore in FY2019 from Rs. 101.6 crore in FY2018 owing to higher revenue and operating leverage with the commissioning of new capacity. The net profit of the company increased to Rs. 73.8 crore in FY2019 from Rs. 56.7 crore in FY2018 owing to higher operating profit coupled with higher non-operating income. The interest coverage improved to 15.8 times in FY2019 from 12.9 in FY2018 driven by higher operating profit. Gearing of the company was unchanged at 0.3 times at the end of FY2019 as against the end of FY2018. The Total Debt/OPBDITA also moderated to 1.0 times at the end of FY2019 vis-à-vis 1.2 times at the end of FY2018 as the increase in the operating profit offset the impact of the increase in the debt.

**Improvement in the performance of the subsidiary Duncan Engineering Limited post the closure of tyre tube valve segment in FY2017:** DEL posted revenues of Rs. 45.1 crore in FY2019 and a net profit of Rs. 2.78 crore in FY2019 against revenues of Rs. 40.7 crore with a net profit of Rs. 0.1 crore in FY2018. The improvement in performance is a result of higher demand for the company's products and closure of loss-making tyre tube valve division in FY2017.

## Credit challenges

**Majority of revenue being derived from a single product i.e. insoluble sulphur with demand primarily from the automotive sector:** Nearly 93% of OCCL's revenue is derived from the sale of insoluble sulphur which results in high reliance of the company on a single product. Additionally, the majority of demand for insoluble sulphur is derived from the automotive sector for manufacturing tyres, resulting in significant reliance on a single sector for demand and exposes the company to vulnerability of the automotive sector.

**Vulnerable to project execution risk with the upcoming capacity expansion partly mitigated by the track record of executing similar projects:** OCCL is undertaking a Rs. 216 crore capacity expansion project for increasing its IS capacity by 11,000 MTPA and sulphuric acid capacity by 42,000 MTPA over the next two years. The IS capacity will be increased in two phases of 5500 MTPA each by the end of Q3 FY2021 and Q3 FY2022. The project will be funded with a debt equity ratio of 2:1. The project being large, exposes the company to project execution risks. Nevertheless, the company has recently commissioned a similar capacity IS plant based on the same technology without any cost or time over runs which provides comfort on its project execution capabilities.

**Threat of competition from Chinese players; partly mitigated by high entry barriers and inconsistent quality of products and poor Environment, Health and Safety (EHS) standards:** Chinese IS manufacturers are usually able to offer their product at a lower cost and are a threat to players like OCCL. However, large tyre manufacturers do not procure from Chinese players mainly due to the inconsistent quality levels and lower EHS standards.

**Vulnerable to forex rate movements; booking forward contracts mitigates the risk to an extent:** OCCL derives significant share of revenues from export sales thus exposing the company to foreign exchange fluctuations. However, the risk is partially mitigated as the company hedges nearly 75% of its net exposure for 6 months using forward contracts.

**Vulnerable to the volatility in raw material prices though largely mitigated by periodic price revision clauses in the contracts:** 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 risks are however largely mitigated given the periodic price revision clauses under contracts with the end users.

**Working capital intensive nature of operations:** OCCL's operations are working capital intensive given that the company maintains inventory of finished goods for around 90 days to meet the demand for the upcoming quarter. As a result, the working capital intensity of the company's business remains high.

### Liquidity Position-Guarantor:

The liquidity position of the company remains healthy given the large funds parked in mutual funds along with healthy cash accruals expected. While the company will be undertaking significant capex, the project to be funded with a debt-equity ratio of 2:1 will result in accumulation of cash over the next three years leading to further improvement in the liquidity of the company. The liquidity position of the company is also supported by availability of nearly Rs. 34 crore of unutilised working capital limits and adequate drawing power. With near term repayments ranging between Rs. 19-21 crore over the next couple of years as against cash accruals of Rs. 85-90 crore, the liquidity position is expected to remain robust.

### Analytical approach:

Analytical Approach	Comments
Applicable Rating Methodologies	<a href="#">Approach for rating debt instruments backed by third-party explicit support</a>
Parent/Group Support	The ratings are based on an irrevocable and unconditional corporate guarantee from OCCL (rated [ICRA]AA-(Stable)/[ICRA]A1+) and Cosmopolitan Investments Limited (CIL)
Consolidation / Standalone	The ratings are based on the standalone financials of Oriental Carbon & Chemicals Limited

### About the company:

Duncan Engineering Limited, incorporated as Schrader Duncan Limited in 1962, was promoted as a joint venture between Schrader Bridgeport International (SB International, a wholly owned subsidiary of Tomkins Plc), and the Duncan group (managed by the J P Goenka family). DEL is into manufacture of automotive tyre valves and pneumatic products such as air cylinders, valves, and accessories. The company shut down its tyre valves division in May 2016 following continual losses incurred by the division and focusses on the pneumatic products division.

### About the guarantors:

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 for the production of Insoluble Sulphur, which is now the flagship product of the company as the company sold carbon black unit to Continental Carbon Company in 2000. OCCL currently has three production units: two at Dharuhera Industrial Unit in Haryana and one at Mundra SEZ in Gujarat. The company is currently engaged in the production of Insoluble Sulphur, Sulphuric Acid and Oleum. The production capacity of OCCL stands at 34,000 metric tonnes per annum (MTPA) for Insoluble Sulphur (IS), 46,200 MTPA for Sulphuric Acid & Oleum. The capacity for IS will expand to 45,000 MTPA and sulphuric acid capacity will reach 88,200 MTPA at the end of Q3 FY2022.

Cosmopolitan Investments Limited (CIL) is the other guarantor which has extended irrevocable corporate guarantee to the debt lines of DEL. CIL is a promoter entity for OCCL as well and has nearly 19.09% stake in OCCL at the end of June 2019.

### Key financial indicators (audited)

	FY2018	FY2019
Operating Income (Rs. crore)	40.7	44.5
PAT (Rs. crore)	0.1	2.8
OPBDIT/OI (%)	8.1%	10.9%
RoCE (%)	5.9%	14.9%
Total Debt/TNW (times)	0.6	0.4
Total Debt/OPBDIT (times)	2.8	1.4
Interest coverage (times)	2.1	6.5

### Status of non-cooperation with previous CRA: Not applicable

### Any other information: None

### Rating history for last three years:

Current Rating (FY2019)					Chronology of Rating History for the Past 3 Years				
Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating	Date & Rating in FY2019			Date & Rating in FY2018	Date & Rating in FY2017 January
					July 2019	July 2018	July 2018	August 2017	2017
1 Cash Credit (SO)	Long Term	9.00	-	[ICRA]AA-(SO) (Stable)	[ICRA]A+(SO) (Positive)	[ICRA]A(SO) (Positive)	[ICRA]A(SO) (Positive)	[ICRA]A(SO) (Positive)	[ICRA]A(SO) (Stable)
2 Non Fund Based (SO)	Short Term	0.81	-	[ICRA]A1+(SO)	[ICRA]A1+(SO)	[ICRA]A1(SO)	[ICRA]A1(SO)	[ICRA]A1(SO)	[ICRA]A1(SO)

### 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](http://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	NA	-	NA	9.00	[ICRA]AA-(SO) (Stable)
NA	Non Fund Based facility – Letter of Credit, Bank Guarantee, Derivative / Forward Contract/CEL	NA	-	NA	0.81	[ICRA]A1+(SO)

Source: Duncan Engineering Limited

### Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Not applicable		

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