

December 29, 2020

Tamil Nadu Newsprint & Papers Limited (TNPL): Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Term Loans	1732.75	1638.70	[ICRA]A (Stable); reaffirmed
Long-term/ Short-term, Fund-based/Non-fund Based Working Capital Facilities	998.00	700.00	[ICRA]A (Stable)/ [ICRA]A1; reaffirmed
Long-term, Unallocated Limits	202.25	296.30	[ICRA]A (Stable); reaffirmed
Long-term/Short-term, Unallocated Limits	-	298.00	[ICRA]A (Stable)/ [ICRA]A1; reaffirmed
Total	2933.00	2933.00	

*Instruments details are provided in Annexure 1

Rationale

The rating reaffirmation factors in TNPL's long operating history; its dominant market position in the domestic printing and writing paper (PWP) segment; the diversified sales and distribution network; the integrated operations with adequate in-house capacity to manufacture pulp from diversified sources; and the availability of captive power plants. The company has also undertaken periodic efficiency improvement projects, which provide cost advantages. While, in FY2020, the company witnessed a ~15% revenue decline due to the moderation in PWP capacity utilisation and the dip in sales realisation in the board segment, TNPL's operating profitability improved, aided by benefits arising from integrated operations and effective use of diversified raw material sources. During FY2018 to FY2019, the use of bagasse did not provide significant cost advantage to the company, due to increase in the price of bagasse on account of availability constraints and impact of fluctuation on imported coal prices. However, during FY2020, bagasse prices witnessed considerable moderation in FY2020 on the back of reduced coal prices and better availability which aided the profitability in FY2020. Furthermore, the company's ability to source wood from its farm forestry programme at competitive prices is a cost advantage. With healthy increase in plantation acreage in recent years, the company is likely to benefit from the access to raw materials at competitive prices. The profitability of the board segment, however, continued to drag TNPL's overall profitability due to high dependence on costlier imported pulp.

ICRA also takes into account the dip in demand for TNPL's PWP segment in the current financial as the Covid-19 pandemic resulted in closure of schools and colleges, which are among the largest consumers of PWP. Consequently, the company's sales witnessed a sharp contraction in H1FY2021, which resulted in low operating profits. However, the losses were curtailed to some extent by the various cost control measures and the decline in prices of key raw materials, such as imported pulp and wastepaper because of weak global demand situation. While there has been moderate demand recovery for PWP in Q3FY2021, the pace of recovery will depend on opening up and normalisation of operational activities in segments such as schools and colleges, railways, etc. and the same will be monitored. The adverse impact is expected to be partly mitigated by higher Government contracts received by the company in the current fiscal. In the board segment, though the production level dipped during Q1FY2021 because of the lockdown, it rebounded to earlier levels in Q2FY2021 on the back of healthy demand from Pharma and FMCG segments.

TNPL's capital structure is highly geared because of large debt-funded capex incurred in the past. Moreover, the coverage indicators are subdued due to weakened profit margins. As the company undertakes another large debt-funded capex cycle, the capital structure and coverage indicators are expected to be under pressure in the medium term. The first phase of the capex (constructing a pulping unit at the existing board plant) is expected to be completed by Q1FY2022, which should provide cost savings, although the extent of the same remains to be seen. ICRA notes that the profitability remains vulnerable to cyclicalities in the paper business, availability of water and raw materials, and volatility in international coal prices and exchange rates, though the company has partly mitigated the same in the current fiscal by covering its full-year coal requirements at lower prices prevalent during H1FY2021.

The ratings are further constrained by the large repayment obligation in the medium term, which exposes the company to refinancing risk. However, expected improvement in cash flows from FY2022 and healthy flexibility with lenders are expected to support the company's liquidity profile. Further, despite the moderation in financial performance in the current fiscal, TNPL's liquidity position was supported by the moratorium opted on principal payments on its term loan facility falling due between June 2020 and August 2020 as permitted by the Reserve Bank of India (RBI) on March 27, 2020 and the financial flexibility enjoyed with lenders.

The Stable outlook on the [ICRA]A 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 printing and writing paper segment. The company has a well-diversified sales and distribution network across India, consisting of non-exclusive dealers that account for ~55-60% of sales (of PWP). While the sales are directly handled by TNPL for Government and private sector entities which account for ~18-20% of PWP sales, the PWP exports account for the remaining 18-23% of PWP sales. The company also started board production from May 2016, which accounted for ~28% of the operating income in FY2020.

Access to diversified raw material sources and integrated production facility – The company has a long-term tie-up with several sugar mills in the vicinity for the supply of bagasse, for commensurate exchange of steam or coal. Along with this, the company enters into 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. The company has also been using wood for pulping. To ensure availability of wood, TNPL initiated farm forestry and captive plantation schemes in FY2005. By the end of FY2020, the company had 1,67,715 acres (higher from Mar'19: 1,46,436 acres) under these schemes. Apart from the farm forestry programme and captive sources, significant quantities of wood are currently being procured from the two Government of Tamil Nadu entities—TAFCON and PCCF. Procurement of raw materials from diversified sources mitigates raw material availability risks for the company.

In the past, the company has enjoyed stronger profitability than its peer group, mainly because of predominant usage of bagasse as a key raw material, which is cheaper than wood or imported pulp. In FY2020, following the reduction in bagasse procurement prices due to better availability in Tamil Nadu and moderation in coal prices, the bagasse prices witnessed considerable reduction, lower than wood pulp prices. Further, availability of wood from captive sources at competitive rates, also aids comfort. Reduction in raw materials prices in FY2020 improved the operating margin to 18%

from 16.4% in FY2019, though TNPL's top-line witnessed decline by ~15% because of moderation in PWP capacity utilisation and decline in sales realisation in the board segment.

High financial flexibility and competitive borrowing costs arising from good standing among lenders – TNPL enjoys high financial flexibility due to its good standing with the lenders, evident from the competitive borrowing costs and its ability to borrow ad hoc working capital limits over and above the sanctioned facilities, and avail fresh general corporate loans to support its large repayment obligations.

Credit challenges

Adverse impact in market conditions post the Covid-19 pandemic – Demand for TNPL's writing and printing paper dipped in the current fiscal post the Covid-19 pandemic situation. While the board segment rebounded to earlier levels from Q2FY2021 because of healthy demand from FMCG and Pharma segments, the demand for PWP segment remained weak in H1FY2021 due to shutdown of schools and colleges. Though TNPL witnessed moderate improvement in demand, aided by execution of large Govt orders in Q3FY2021, the pace of recovery will depend on the opening up and normalisation of operational activities in segments such as schools and colleges, railways, courts, etc. and the same will be monitored.

Debt-funded capex impacts capital structure and coverage indicators; high repayment obligation exposes TNPL to refinancing risks – The company had undertaken debt-funded capex in the last few years for setting up new board plant, and expanding its cement plant and other projects, which increased the gearing to 1.7x as on March 31, 2017 from 1.3x as on March 31, 2014. Though the gearing moderated to 1.2x as on March 31, 2019 from ~1.5x as on March 31, 2018 due to debt repayments, the gearing levels witnessed increase to 1.3x as on March 31, 2020 on account of debt drawdown for the large capex and additional GCL availed during the year to support the large repayment obligations.

Going forward, the gearing levels are expected to remain high in the next three years because of the substantial debt-funded capex plans, despite large repayments and improvement in cash accruals. The coverage indicators and debt protection metrics of 2.8x (previous year: 2.9x) and 3.5x (previous year: 2.9x) continued to remain subdued in FY2020 on the back of increase in debt levels. 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 cyclical in paper industry – Paper being a commodity, is exposed to economic cycles. While demand for it is expected to be favorable 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 competitive advantage enjoyed by the company and adversely impact margins as witnessed in the recent period.

High dependence on imported pulp for board plant adversely impacts margin; expected to witness improvement by FY2022 post commissioning of captive pulping unit – The company had set up a multi-layer double-coated board plant with a capacity of 2 lakh tpa in the Trichy district, which commenced operations from May 2016. The project was envisaged to provide benefits such as diversification into the high-end packaging board segment and increase in the scale of operations. However, given the lack of in-house pulping capacity at the new unit, the company must depend on imported pulp to meet a major share of its raw material requirement. The price of imported pulp has increased in the last few years and have adversely impacted the profit margin of the unit. The company has tried to partly address the

impact by making changes in product mix, moderating the requirement of imported pulp to some extent. The capacity utilisation has also remained healthy at 86% in FY2020 (PY: 89%). Nonetheless, the company is yet to achieve break even and early achievement of the same remains a sensitivity. The company is currently in the process of setting-up a captive pulping unit. Post successful completion of pulp unit by Q1FY2022 (advanced from Q3FY2023), the profit margin of the board plant is expected to improve on the back of lower dependence on expensive imported pulp. Timely completion of capex and stabilisation of project will be a sensitivity factor.

Liquidity position - Adequate

In the current fiscal, TNPL's fund flow from operations is expected to be adversely impacted by the reduction in scale and profitability on the back of Covid-19 pandemic situation. Further, on the back of large debt repayments of Rs. 399 crore for FY2021 and the planned debt-funded capex of ~Rs. 925 crore, the company would need refinancing. However, the liquidity position is expected to be adequate, supported by moderate buffer in working capital limits, term debt tie-up for the capex and healthy financial flexibility with the lenders, which enables TNPL to borrow adhoc working capital limits and General Corporate loans, over and above the sanctioned facilities at competitive borrowing costs.

The company had opted for moratorium on the principal payments on its term loan facility falling due between June 2020 and August 2020 as permitted by the Reserve Bank of India (RBI) on March 27, 2020. Further, in the current year, to shore-up the liquidity position, the company is planning to avail fresh GCL during Q4FY2021.

Rating sensitivities

Positive triggers – Given the substantial debt-funded capex plans over the next three years, any rating upgrade in the near term is unlikely. ICRA could upgrade TNPL's rating if the company demonstrates further improvement in operating margin and sustained improvement in board plant capacity utilisation. Specific credit metrics that could lead to an upgrade of TNPL's rating include RoCE over 15% on a sustained basis.

Negative triggers – Negative pressure on TNPL's rating could arise if the weak current demand situation on account of the Covid-19 pandemic persists for a prolonged period, resulting in significant moderation in revenue in profitability. The ratings might also be downgraded if there is a delay in project implementation or stabilisation or higher-than-anticipated capex is incurred towards the same, leading to sustained pressure on profitability and credit metrics. Specific credit metrics that could lead to a downgrade of TNPL's rating include Total Debt/OPBDITA of over 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	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 is at Kagithapuram in Tamil Nadu has a production capacity of 4.00 lakh tonne per annum (tpa). The plant is the largest single location paper plant in India. Following the sale of IDBI's stake, the Tamil Nadu Government is 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 cyclicity witnessed in newsprint prices, currently PWP accounts for

100% of TNPL's total production. In January 2011, TNPL commissioned a Rs 1,000-crore Mill Expansion Plan (MEP), which increased its annual production capacity from 2.45 lakh tpa to 4.00 lakh tpa. 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 – TNPL (audited)

	FY2019	FY2020	H1FY2021
Operating Income (Rs. crore)	4,082.7	3,471.1	1,093.4
PAT (Rs. crore)	94.4	130.0	-48.8
OPBDIT/OI (%)	16.4%	18.0%	14.3%
Total Outside Liabilities/Tangible Net Worth (times)	2.35	2.26	2.53
Total Debt/OPBDIT (times)	2.91	3.48	6.84
Interest Coverage (times)	2.87	2.81	1.57
DSCR	1.06	0.90	0.51

(Amounts in Rs. crore)

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

		Current Rating (FY2021)			Chronology of Rating History for the past 3 years					
Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating 29-Dec-2020	Date & Rating in FY2020 16-Sep-2019	Date & Rating in FY2019 07-Dec-2018	Date & Rating in FY2019 30-Nov-2018	Date & Rating in FY2018 24-Aug-2017	Date & Rating in FY2018 12-Apr-2017	
1	Term Loans	1638.70	1338.70	[ICRA]A (Stable); reaffirmed	[ICRA]A (Stable)	[ICRA]A (Negative)	[ICRA]A (Negative)	[ICRA]A (Negative)	[ICRA]A (stable)	
2	Fund-based/Non-fund Based Facilities	700.00	-	[ICRA]A (Stable)/[ICRA]A1; reaffirmed	[ICRA]A (Stable)/[ICRA]A1					
3	Unallocated Limits	296.30	-	[ICRA]A (Stable); reaffirmed	[ICRA]A (Stable)	[ICRA]A (Negative)/[ICRA]A1	[ICRA]A (Negative)/[ICRA]A1	[ICRA]A (Negative)/[ICRA]A2+	[ICRA]A (stable)/[ICRA]A1	
4	Unallocated Limits	298.00	-	[ICRA]A (Stable)/[ICRA]A1; reaffirmed	-	-	-			

Source: TNPL

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	Term Loans	Sep 2017	NA	Sep 2026	1638.70	[ICRA]A (Stable)
NA	Fund Based/Non Fund Based	NA	NA	NA	700.00	[ICRA]A (Stable)/ [ICRA]A1
NA	LT: Unallocated	NA	NA	NA	296.30	[ICRA]A (Stable)
NA	LT/ST: Unallocated	NA	NA	NA	298.00	[ICRA]A (Stable)/ [ICRA]A1

Source: TNPL

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

Analyst Contacts

K. Ravichandran

+91 44 4596 4301

ravichandran@icraindia.com

Sai Krishna

+91 44 4596 4304

sai.krishna@icraindia.com

Krithi Guban K

+91 44 45964340

krithi.guban@icraindia.com

Relationship Contact

L. Shivkumar

+91 22 6114 3400

shivkumar@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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