ICRA

March 24, 2021

Phillips Carbon Black Limited: Rating revised to [ICRA]AA (Stable)

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term Loan	400.00	400.00	Revised to [ICRA]AA (Stable) from [ICRA]AA-(Stable)
Total	**400.00**	**400.00**	

Instrument details are provided in Annexure-1

Rationale

The revision in the long-term rating considers the significant improvement in Phillips Carbon Black Limited's (PCBL) sales and cash flows in 9M FY2021, owing to a turnaround in carbon black (CB) demand in both the domestic and the export market. ICRA expects the favourable momentum to sustain going forward, given the favourable demand outlook for the carbon black industry in India on the back of large capacity addition plan of the tyre manufacturers. The rating also favourably factors in the company's increasing share of specialty black (SB) sales, growing presence in the international market, focus on research and development to introduce new CB grades and implement process improvements, which would strengthen its operating profile going forward. While assigning the rating ICRA has taken cognisance of PCBL's greenfield capacity expansion plan to increase CB manufacturing capacity by ~1,50,000 MTPA at an estimated cost of ~Rs 600 crore, which is to be partly funded by debt. Nevertheless, given the expected strong cash accruals from business, PCBL's capital structure and coverage indicators would remain strong, when considered on a net debt basis.

The rating continues to factor in the long experience of the promoters and the company's position as a leading player in the domestic carbon-black industry. The company's performance remains linked to the overall fortunes of the auto tyre industry as a significant portion of its sales is made to the same. Tyre demand in the domestic market has improved both from the auto OEMs as well as the replacement market, after the slowdown in Q1 FY2021. While in 9M FY2021, PCBL's carbon black sales in the domestic market contracted by ~7%, during Q3, sales were up by a strong 19%. PCBL's export sales have also witnessed a similar trend of contraction of ~14% in 9M FY2021 but reported an increase of ~8% in Q3. The company has recently increased its specialty black (SB) manufacturing capacity, and a higher volume of SB sales, going forward, it is expected to reduce the risk of its overall business profile. In addition, the sale of surplus power generated from the company's captive power plants (CPP) provides some cushion against the cyclicality involved in the carbon black business. The rating also derives comfort from the company's status as a part of the RP-SG Group, which lends it with a considerable financial flexibility because of its established relationships with banks.

The rating, however, is constrained by the inherent cyclicality of the business and exposure of the company's margin to adverse movement in crude oil prices as the major raw material is a crude oil derivative. However, ICRA notes that the company has been able to largely pass on such increase in prices in the past, which provides some comfort. PCBL's profitability and cash flows are also exposed to foreign exchange rate fluctuation risks, given the sizeable share of its imported raw material. Its presence in the export market, coupled with the company's dedicated hedging policy, mitigates the risks arising from adverse movement in forex rates considerably. ICRA also notes that a major portion of the company's debt is towards funding of working capital requirements, which limits the annual debt repayment obligations of the company.

PCBL's capital structure is comfortable and the coverage indicators are strong, with a net gearing of ~0.3 times, interest cover of 10.9 and net debt to OPBDITA of 1.0 registered in FY2020. The financial metrics are expected to remain strong for full year FY2021 as well despite the adverse impact of the Covid-19 pandemic.

The outlook on the PCBL's long-term is Stable, given the healthy demand outlook for CB in both the domestic as well as the export markets, which would keep PCBL's sales and cash flows strong, going forward. PCBL's overall cash flows from operations are expected to remain strong that would take care of its large capex, long-term debt repayments falling due over the next one year and yet be left with a healthy surplus benefitting the overall liquidity in the company.

Key rating drivers and their description

Credit strengths

Leadership position in domestic carbon black industry; long experience of the promoters in the industry – PCBL is an established player in the domestic carbon black industry and has the highest market share in its business. It has a wide portfolio of soft, hard and specialty grades of carbon black and the company is in the process of increasing its product reach by developing new carbon black grades. Such initiatives are likely to help the company maintain its leadership position, going forward as well.

Comfortable financial risk profile – PCBL's financial credit metrics are strong, as indicated by low gearing, strong debt coverage indicators and healthy cash and liquid investment balance**.**

Higher sale of specialty carbon black and superior grades of carbon black command better margins – PCBL's product mix has been changing in the last few years with a higher share of superior grade carbon blacks and specialty carbon blacks, which resulted in a steady improvement in the contribution margin.

Sale of surplus power provides some cushion against cyclicality in the carbon black industry - The captive power plants generate significant revenues from the sale of surplus power to the power grid, contributing to the company's bottom line.

Status of the company as a part of the RP-SG Group provides financial flexibility – The company has access to bank finances at lower interest rates. In the past, PCBL got a significant portion of its term loan refinanced with an elongated repayment tenure because of the financial flexibility arising from its status of being a part of the RP-SG Group.

Credit challenges

Business growth susceptible to cyclicality in the domestic automobile industry – A significant portion of the company's revenues is generated from the domestic automotive tyre industry. While almost two-thirds of the demand for tyre manufacturers comes from the replacement market, carbon black producers like PCBL remain exposed to the cyclicality of the domestic automobile industry. PCBL is, however, making efforts to scale up production of specialty black, to further reduce the risk of cyclicality in the automobile industry.

Large greenfield capex to be undertaken – PCBL would be undertaking a greenfield capex entailing an expenditure of ~Rs 600 crore to be partly funded by debt. While the expansion would be exposed to typical project execution risks, the same is unlikely to face any funding challenges, given the ample liquidity in the company

Exposed to movement in crude oil prices – The major raw material is carbon black feedstock (CBFS), which is a crude oil derivative and is mainly imported. As a result, PCBL is exposed to adverse movements in crude oil prices. The company, however, has been able to largely pass on the change in prices of CBFS, given the pricing mechanism that the industry works on.

Exposed to foreign exchange fluctuation risk – The company imports a significant portion of its raw materials and thus is exposed to the forex risk. However, the risk is mitigated to a considerable extent as exports account for ~20% of the company's revenue and it also follows a hedging policy.

Liquidity position: Strong

PCBL's liquidity position is strong on account of its heathy cash balance of over Rs. 250 crore and steady cash flow from operations. It has long-term debt repayment liabilities of ~Rs. 95 crore in FY2022, which the company is expected to comfortably meet from its operational cash flows. ICRA also notes that PCBL has a headroom in terms of unutilised working capital facilities.

Rating sensitivities

Positive factors – A further upgrade in the near to medium term looks unlikely. However, PCBL's long-term rating may be upgraded if there is a sustained improvement in the financial metrics and a meaningful improvement in sales volumes and mix towards value-added products as well as diversification of the customer base. An improvement in the core RoCE to 25% with a Net Debt/EBITDA below 0.5 times on a sustainable basis could be a trigger for a rating.

Negative factors – The company's rating may be downgraded or the outlook changed to Negative if weakness in the domestic market leads to a contraction in sales on a sustained basis. Consistent Net Debt/EBITDA of over 1.5x could also be a trigger for a rating downgrade.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	Not Applicable
Consolidation/Standalone	The rating is based on limited consolidation with PCBL's wholly-owned subsidiary PCBL (TN) Ltd which has recently been incorporated to undertake a Greenfield CB capacity expansion project. As on date the subsidiary has not started operations. The details are enlisted in Annexure 2.

About the company

Incorporated in 1960, PCBL manufactures carbon black across four plants located in Durgapur (West Bengal), Mundra (Gujarat), Palej (Gujarat) and Kochi (Kerala) with an aggregate capacity of 6,03,000 MTPA. The company also operates 84-MW co-generation power plants based on waste gas generated in the carbon black manufacturing process. PCBL is a part of the Kolkata-based RP-SG Group.

In 9M FY2021, PCBL reported a standalone EBITDA of Rs. 328.4 crore and a PAT of Rs. 184.9 crore on an operating income of Rs. 1,792.8 crore. For the full year FY2020, PCBL registered a net profit of Rs. 283.5 crore on the back of net sales of Rs. 3,243.5 crore.

Key financial indicators (audited, Standalone)

Balco	FY2019	FY2020	9M FY2021 (Provisional)
Operating Income (Rs. crore)	3,528.6	3,243.5	1,792.8
PAT (Rs. crore)	388.5	283.5	184.9
OPBDIT/OI (%)	18.1%	15.4%	18.3%
PAT/OI (%)	11.0%	8.7%	10.3%
Total Outside Liabilities/Tangible Net Worth (times)	1.0	0.9	
Total Debt/OPBDIT (times)	1.2	1.2	
Interest Coverage (times)	17.4	10.9	12.7

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation

Key financial indicators (audited, Consolidated)

Balco	FY2019	FY2020	9M FY2021 (Provisional)
Operating Income (Rs. crore)	3,528.6	3,243.5	1,792.8
PAT (Rs. crore)	382.7	287.5	186.2
OPBDIT/OI (%)	17.4%	14.3%	18.7%
PAT/OI (%)	10.8%	8.9%	10.4%
Total Outside Liabilities/Tangible Net Worth (times)	1.0	0.9	
Total Debt/OPBDIT (times)	1.3	1.3	
Interest Coverage (times)	16.7	10.1	13.0

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	Current Rating (FY2021)					Chronology of Rating History for the past 3 years				
		Type	Amount Rated (Rs. crore)	Amount Outstanding as on date (Rs. crore)	Date & Rating in FY2021		Date & Rating in FY2020	Date & Rating in FY2019	Date & Rating in FY2018		
					Mar-24-2021	May-04-2020	-	Mar-28-19	Feb-05-18	Nov-16-17	May-19-17
1	Term Loan	Long Term	400.0	135.0	[ICRA] AA (Stable)	[ICRA] AA- (Stable)	-	[ICRA] AA- (Positive)	[ICRA] AA- (Stable)	[ICRA] A+ (Positive)	[ICRA] A+ (Stable)

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 Loan	Mar-2017 to Apr-2018	7.55% to 8.75%	FY2023	400	[ICRA]AA (Stable)

Source: *Company*

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

Company Name	Ownership	Consolidation Approach
PCBL (TN) Ltd	100%	Full Consolidation

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About ICRA Limited:

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Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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