

September 09, 2021

Tamil Nadu Newsprint & Papers Limited: Ratings reaffirmed; outlook revised to Negative

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Term Loans	1,638.70	1,679.21	[ICRA]A reaffirmed; Outlook revised to Negative from Stable
Long-term/ Short-term, Fund-based/Non-fund Based Working Capital Facilities	700.00	700.00	[ICRA]A/ [ICRA]A1 reaffirmed; Outlook revised to Negative from Stable
Long-term, Unallocated Limits	296.30	255.79	[ICRA]A reaffirmed; Outlook revised to Negative from Stable
Long-term/Short-term, Unallocated Limits	298.00	298.00	[ICRA]A / [ICRA]A1 reaffirmed; Outlook revised to Negative from Stable
Total	2,933.00	2,933.00	

*Instrument details are provided in Annexure-1

Rationale

The revision in the rating outlook to negative factors in the continued demand pressure expected on Tamil Nadu Newsprint & Papers Limited's (TNPL) top line in the near term, given the subdued demand environment for its printing and writing paper (PWP) segment due delay in reopening schools and colleges (due to Covid), which are among the segment's largest end-consumers. The company witnessed decline (20%) in its top line in FY2021 due to the Covid-19 pandemic and related stress on PWP demand and realisations. While there was gradual, sequential recovery in volumes for PWP through the quarters in FY2021, owing to higher discounts, the operating margin contracted to 9.8% in FY2021 from 18.0% in FY2020.

The second wave of Covid-19 further impacted the recovery in TNPL's top line in Q1 FY2022, against Q4 FY2021. The pace of recovery will depend on the opening up and normalisation of operational activities in schools, colleges and other related end-consumer segments, and will be a key monitorable. In the board segment, though the production level dipped during Q1 FY2021 because of the lockdown, it rebounded to earlier levels in the remaining quarters on the back of healthy demand from pharma and FMCG segments, along with stable realisations in FY2021. Further, the realisation increased sharply in Q1 FY2022 for the board segment and is expected to support the revenue growth in FY2022 to a notable extent. The operating margins too, which fell sharply in FY2021 over FY2020, is expected to improve in FY2022 with higher demand, realisations and lower dependence on imported pulp for paper boards, given the estimated operationalisation of the pulp facility from December 2020.

TNPL's capital structure remains high because of the large debt-funded capex incurred in the past and Covid-led moderation in earnings. Moreover, the coverage indicators are subdued due to weakened profit margins in FY2021. Given the company's continued debt-funded capex, the capital structure and coverage indicators are expected to be under pressure in the near to medium term. The first phase of the capex (towards pulping unit at the existing board plant) is expected to be completed by December 2021, which should provide cost savings, as it will enable in-house pulp production, against imports. 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. The elevated prices of coal will restrict the expansion in profit margins in FY2022 to an extent.

The ratings also consider the large repayment obligation and debt-funded capex in the medium term, which exposes the company to refinancing risk. However, expected improvement in cash flows from FY2022, undrawn limits in general corporate

loans, moderate buffer in working capital limits and healthy flexibility with lenders are expected to support the company's liquidity profile.

The ratings, however, positively factors TNPL's long operational history, strong management profile, dominant market position in the domestic PWP segment, diversified sales and distribution network, likely improvement in efficiency parameters given its integrated operations with adequate in-house capacity to manufacture pulp from diversified sources and the availability of captive power plants, thus providing significant cost advantages.

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 PWP segment. The company has a well-diversified sales and distribution network across India, consisting of non-exclusive dealers that account for ~45-60% of sales (of PWP). While the sales are directly handled by TNPL for Government and private sector entities, which account for ~18-25% of PWP sales, exports account for the remaining 18-24% of PWP sales. The company also started board production from May 2016, which accounted for ~30% of the operating income in FY2021.

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 against commensurate exchange of steam or coal. Along with this, the company enters 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 FY2021, the company had 1,87,680 acres (higher from 1,67,715 acres in March 2020) under these schemes. Apart from the farm forestry programme and captive sources, significant quantities of wood are currently being procured from the two State 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 FY2021, 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.

High financial flexibility and competitive borrowing costs arising from good standing among lenders – Given its established presence in the domestic PWP segment and strong profile of the management, TNPL continues to enjoy high financial flexibility 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 at short notice to support its liquidity profile.

Credit challenges

Subdued performance in FY2021 amid Covid-19 induced stress on PWP demand and realisations – The company witnessed 20% decline in the operating income in FY2021 owing to moderation in capacity utilisation due lower demand for TNPL's writing and printing paper, triggered by shutdown of schools and colleges due to the pandemic in FY2021. With lower demand, the realisation in PWP segment was also under pressure. While the company witnessed healthy growth in volumes in Q4 FY2021, the revenue growth was restricted by lower realisations. The sales volume and realisations were further impacted in Q1 FY2022 owing to the second wave of Covid-19. The pace of recovery shall depend on the re-opening and normalisation of schools and colleges, railways, courts, etc, and all related end-consumer segments, becoming a key monitorable, going forward. The board segment, however, witnessed favourable demand from FMCG and pharma segments and the realisations increased sharply in Q1 FY2022 and, thus, will support revenue growth in FY2022. TNPL reported operating margins of 9.8% in FY2021 against 18% in FY2020 due to moderation in the scale of operations and weak realisations for PWP, along with higher dependence on high cost imported pulp for the board segment.

Debt-funded capex impacts capital structure and coverage indicators; high repayment obligation exposes TNPL to refinancing risks – TNPL had undertaken debt-funded capex in the last few years for setting up a 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 1.3x as on March 31, 2020 due to debt repayments, the gearing levels increased to 1.7x as on March 31, 2021 because of debt drawdown for the large capex and additional general corporate loan availed during FY2021 to support the large repayment obligations. We expect the gearing levels to remain high in the next 2-3 years given the large debt-funded capex plans, despite likely improvement in cash accruals. The coverage indicators remain weak on the back of increase in debt levels and low operating profits. 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. Any plans towards deleveraging shall be a credit positive, if it results in material reduction in debt levels.

Susceptibility to cyclical in paper industry – Paper being a commodity, is exposed to economic cycles. While demand for it is expected to be favourable 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 impacted board segment margin – The company had set up a multi-layer, double-coated board plant with a capacity of 2 lakh tonnes per annum (TPA) in Trichy district, Tamil Nadu 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 is dependent 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 FY2021 (PY: 86%). 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 December 2021, 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 (without cost overrun) and stabilisation of project will be a sensitivity factor.

Liquidity position: Adequate

In FY2021, TNPL's fund flow from operations was adversely impacted by the reduction in scale and profitability on the back of Covid-19 pandemic situation. To meet the shortfall, the company had availed fresh General corporate loan during FY2021, for Rs. 600 crore to fund the capex requirements and repayment obligations. The company had also 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.

In the current fiscal, TNPL's fund flow from operations is expected to improve because of increase in scale of operation and improved profitability with increase in realisations, commencement of pulping unit and lower dependence on high-cost import pulp. The debt repayment obligation of Rs. 429 crore in FY2022 will be met through internal generation and undrawn limit of general corporate loans.

Rating sensitivities

Positive factors – Given the substantial debt-funded capex plans over the next two years, and given the negative outlook, any rating upgrade in the near term is unlikely. ICRA could revise TNPL's rating outlook to Stable if the company demonstrates improvement in operating margin along with growth in top line. Any large fund infusion in the form of monetisation of non-

core assets or equity fund raise leading to material improvement in capital structure and coverage indicators could be a credit positive.

Negative factors – Negative pressure on TNPL’s rating could arise if the weak current demand situation for a prolonged period, results in significant moderation in revenue and profitability. The ratings might also be downgraded if there is a significant delay in project commencement or higher-than-anticipated capex incurred towards the same, leading to sustained pressure on profitability and credit metrics.

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 at Kagithapuram in Tamil Nadu has a production capacity of 4.00 lakh 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 cyclicality witnessed in newsprint prices, currently PWP accounts for 100% of TNPL’s total production. TNPL has three production units with a total manufacturing capacity of 4.00 lakh MTPA for the PWP segment. 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 (audited)

	FY2020	FY2021
Operating Income (Rs. crore)	3,471.1	2,768.2
PAT (Rs. crore)	130.0	-65.1
OPBDIT/OI (%)	18.0%	9.8%
PAT/OI (%)	3.7%	-2.4%
Total Outside Liabilities/Tangible Net Worth (times)	2.3	2.7
Total Debt/OPBDIT (times)	3.5	10.0
Interest Coverage (times)	2.8	1.4

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation, All ratios as per ICRA calculations

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2022)				Chronology of Rating History for the past 3 years			
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of Mar 31, 2021 (Rs. crore)	Date & Rating in	Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2019	
					Sept 9, 2021	Dec 29, 2020	Sept 16, 2019	Dec 7, 2018	Nov 30, 2018
1	Term Loans	Long Term	1679.21	2375.28	[ICRA]A (Negative)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Negative)	[ICRA]A (Negative)
2	Fund-based/Non-fund Based Facilities	Long-term/ Short-term	700.00	-	[ICRA]A (Negative)/ [ICRA]A1	[ICRA]A (Stable)/ [ICRA]A1	[ICRA]A (Stable)/ [ICRA]A1	-	-
3	Unallocated Limits	Long Term	255.79	-	[ICRA]A (Negative)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Negative)/ [ICRA]A1	[ICRA]A (Negative)/ [ICRA]A1
4	Unallocated Limits	Long Term/ Short Term	298.00	-	[ICRA]A (Negative)/ [ICRA]A1	[ICRA]A (Stable)/ [ICRA]A1	-	-	-

&= Under watch with developing implications

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term Term Loans	Simple
Long-term/ Short-term, Fund-based/Non-fund Based Working Capital Facilities	Simple
Long-term, Unallocated Limits	Not Applicable
Long-term/Short-term, 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 analyzing 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, is available on ICRA's website: www.icra.in

Annexure-1: Instrument details

ISIN No	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (RS Crore)	Current Rating and Outlook
NA	Term Loans	FY2018	NA	FY2027	1679.21	[ICRA]A (Negative)
NA	Fund Based/ Non-Fund Based	NA	NA	NA	700.00	[ICRA]A (Negative)/ [ICRA]A1
NA	LT: Unallocated	NA	NA	NA	255.79	[ICRA]A (Negative)
NA	LT/ST: Unallocated	NA	NA	NA	298.00	[ICRA]A (Negative)/ [ICRA]A1

Source: Company

Annexure-2: List of entities considered for consolidated analysis – Not applicable

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