November 23, 2021

Himadri Speciality Chemical Limited: Ratings downgraded to [ICRA]A+/[ICRA]A1; outlook revised to be Stable

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Fund-based – Term Loan	112.30	162.30	Downgraded to [ICRA]A+ from [ICRA]AA-; Outlook revised to Stable from Negative
Long-term– Fund Based	805.83	290.00	
Long-term Unallocated Limits	32.73	239.56	
Long-term/ Short -term – Non Fund Based	865.00	644.00	Downgraded to [ICRA]A+/[ICRA]A1 from [ICRA]AA-/[ICRA]A1+; Outlook revised to Stable from Negative
Long Term / Short Term – Fund based/ Non Fund Based	-	480.00	
Commercial Paper	300.00	300.00	Downgraded to [ICRA]A1 from [ICRA]A1+
Total	**2,115.86**	**2,115.86**	

**Instrument details are provided in Annexure-1*

Rationale

The ratings downgrade factors in the continued moderation in Himadri Speciality Chemical Limited's (HSCL) debt protection metrics due to a consistent decline in its operating margins in H1 FY2022, following a sharp decrease in FY2021 owing to reduced spreads between raw material costs and end-product realisations. Although HSCL has ramped up its enhanced capacities and is expected to achieve a volumetric growth in FY2022, pressure on the profitability is likely to result in subdued debt protection metrics and return indicators in the near term. While the run up in commodity prices has dampened the profitability, nevertheless, the company is expected to renegotiate its supply contracts due for renewal in March 2022 with certain key customers, which should improve its profitability, going forward. The long-term rating remains constrained by the cyclicality in the company's user industries viz. aluminium and steel manufacturing and weak financial position of its overseas subsidiaries. While HSCL's 60,000-MT specialty carbon black (CB) unit was commercialised in Q4 FY2020, the company is yet to manufacture value-added specialty products on a large scale and the specialty CB unit continues to manufacture the lower margin commodity grade CB. Market acceptance and the consequent scale-up of these specialty CB products would provide scope for improvement in its operating margins.

The ratings, however, continue to draw comfort from HSCL's longs track record, large scale and backward integrated nature of manufacturing operations. Further, the company benefits from its established relationships with customers and suppliers. The ratings also favourably factor in the diversified products of the company, which find usage in the aluminium, graphite, dyes, tyres, paints and other chemical-related products manufacturing industries. ICRA notes that the company's 5-lakh-metric-tonne-per-annum (MTPA) coal tar distillation plant is the largest in India that produces coal tar pitch (CTP) of various grades and naphthalene for further processing into sulphonated naphthalene formaldehyde (SNF) and is integrated with CB manufacturing lines and a 20-MW power plant. Further, in the absence of any major debt-funded capex in the near-to-medium term, the company's capital structure is likely to remain comfortable, going forward.

ICRA further notes HSCL's disclosure dated November 13, 2021 to the stock exchanges regarding clarification sought by the National Stock Exchange of India Limited (NSE) with respect to a compliant from an independent director on certain corporate governance issues. The company has sought complete details about the complaint and is expected to submit a reply in due course of time. ICRA will closely monitor developments pertaining to the said event and any adverse impact of the same on the company will also be a rating monitorable.

The Stable outlook on the long-term rating reflects ICRA's expectations that HSCL will continue to benefit from its established track record, large scale of operations and a healthy demand outlook for its products. The company's ability to reinstate its margins to historical levels through improvement in product realisations and commencement of production of specialty carbon black remains a key rating monitorable.

Key rating drivers and their description

Credit strengths

Large scale integrated operations – HSCL's scale of operation is large and integrated, starting from coal tar distillation to manufacturing of various carbon-based products and power generation.

Dominant status as operator of the single largest coal tar distillation unit in India – HSCL operates the largest coal tar distillation plant in India. The company enjoys competitive advantage due to its large scale of operations, compared to other entities that are in the similar business.

Strong market position in domestic coal tar pitch and carbon black businesses – The company has a strong market position in the domestic coal tar pitch and carbon black businesses. It has the largest market share in coal tar pitch business and the third largest market share in the carbon black business[1]. Further, it has an established track record of more than two decades in CTP manufacturing and more than a decade in CB manufacturing.

Comfortable capital structure – The capital structure continues to be comfortable, as indicated by a gearing of 0.4 times as on March 31, 2021 and September 30, 2021 though the same moderated from 0.3 times as on March 31, 2020.

Credit challenges

Weakened profitability and debt coverage indicators – The operating profitability and debt protection metrics continue to remain subdued due to a consistent decline in the operating margins in H1 FY2022, following a sharp decrease in FY2021, owing to reduced spreads between raw material costs and end-product realisations. The operating margins further declined to 5.5% in H2 FY2022 from 7.9% in FY2021 and is likely to remain subdued in the near term. Consequently, HSCL's coverage indicators remain subdued as indicated by Total Debt/OPBDIT of 5.2 times, interest coverage of 4.2 times and NCA/Total Debt of 14.1% in H2 FY2022. Further, the company's RoCE continued to remain low in FY2021 and H2 FY2022.

While the run up in commodity prices has impacted the profitability, nevertheless, the company is expected to renegotiate its supply contracts due for renewal in March 2022 with certain key customers, which should improve the profitability, going forward.

Exposed to business cycles – More than 50% of HSCL's sales volume are derived from the cyclical aluminium and graphite electrode industries, which expose its cash flows to business cycles. This results in variations in return indicators. Stability in business returns at a healthy level is a key rating sensitivity.

Exposed to foreign exchange fluctuation risk – The major raw material for CTP manufacturing is coal tar while manufacturing CB, HSCL uses a mix of CBFS and carbon black oil (CBO). CBFS is a crude oil derivative and is mainly imported, thus exposing HSCL to the forex risk. The risk is mitigated to a certain extent as it follows a hedging policy and derives revenue through export. However, HSCL continues to be net importer.

Weak overseas subsidiaries – The financial positions of HSCL's overseas subsidiaries are weak, which resulted in the company writing off a sizeable investment in these subsidiaries in FY2020.

[1] HSCL -Investor Presentation and Media Release Q4 FY2021

Liquidity position: Adequate

HSCL's liquidity is **adequate** with 73% average utilisation of fund-based working capital limits against the drawing power between April 2021 and October 2021. The company has annual debt repayment obligation of Rs. 40.8 crore, Rs. 42.6 crore and Rs. 45.0 crore in FY2022, FY2023 and FY2024, respectively which can be comfortably met through internal accruals. Given its limited long-term debt repayment obligations, along with no major capex planned in the near to medium term, the company's overall liquidity position is likely to be adequate.

Rating sensitivities

Positive factors – The rating may be upgraded if there is a sustained improvement in EBDITA/MT and in sales volumes resulting in healthy operating margins and improvement in scale. Specific credit metric which may lead to ratings upgrade include Total debt/OPBDITA less than 1.5 times on a sustained basis.

Negative factors – Pressure on HSCL's ratings could arise if the company's business volumes/margins and cash flows decline further, adversely impacting its financial metrics. A large debt-funded capital expenditure or any adverse regulation in the industry may also result in ratings downgrade. Specific credit metric which may lead to ratings downgrade include interest coverage of less than 5 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Chemical Industry Consolidation and Rating Approach
Parent/Group Support	Not Applicable
Consolidation/Standalone	The rating is based on the consolidated financial profile of the company. As on March 31, 2021, the company had one operating overseas subsidiary and one stepdown subsidiary, which have been enlisted in Annexure 2. Given the accumulated losses in the books of the subsidiaries, HSCL wrote off its investments in these companies in FY2020.

About the company

Himadri Speciality Chemical Limited (HSCL) is an integrated manufacturer of various carbon-based products starting from coal tar. The company operates a 5,00,000-MTPA coal tar distillation unit in West Bengal. Various distillates of the plant are used to manufacture coal tar pitch (CTP), various types of carbon blacks (CB), sodium naphthalene formaldehyde (SNF) and other advanced carbon-based materials. The coal tar distillation unit is the single largest such facility in India and the company commands a leading position in the domestic CTP and CB markets.

Key financial indicators (audited)

Consolidated	FY2020	FY2021	H1 FY2022
Operating Income (Rs. crore)	1806.4	1680.7	1185.0
PAT (Rs. crore)	205.4	47.3	23.8
OPBDIT/OI (%)	16.3%	7.9%	5.5%
PAT/OI (%)	11.4%	2.8%	2.0%
Total Outside Liabilities/Tangible Net Worth (times)	0.5	0.6	0.7
Total Debt/OPBDIT (times)	1.7	5.5	5.2
Interest Coverage (times)	5.4	4.0	4.2

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation
Note: Amount in Rs. crore; All calculations are as per ICRA research
Source: Annual report, ICRA research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	FY2022					Chronology of Rating History for the past 3 years				
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of Sep 30, 2021 (Rs. crore)	Current Rating	Date & Rating in	Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2019		
					Nov 23, 2021	Aug 24, 2021	Oct 23, 2020 Oct 5, 2020	Oct 14, 2019	Sep 19, 2018	Jul 30, 2018	Jul 2, 2018
1	Term Loans	Long-term	162.30	154.2	[ICRA]A+ (Stable)	[ICRA]AA- (Negative)	[ICRA]AA- (Negative)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	-	-
2	Fund based bank facilities	Long-term	290.0	-	[ICRA]A+ (Stable)	[ICRA]AA- (Negative)	[ICRA]AA- (Negative)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	-	-
3	Non-Fund based bank facilities	Long-term and short term	644.0	-	[ICRA]A+ (Stable)/ [ICRA]A1	[ICRA]AA- (Negative)/ [ICRA]A1+	[ICRA]AA- (Negative)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+	-	-
4	Fund based/ Non-Fund based bank facilities	Long-term and short term	480.0	-	[ICRA]A+ (Stable)/ [ICRA]A1						
5	Commercial Paper	Short Term	300.0	50.0	[ICRA]A1	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
6	Non-convertible Debenture	Long-Term	-	-	-	[ICRA]AA- (Negative) Withdrawn	[ICRA]AA- (Negative)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	-

7	Unallocated	Long-Term	239.56	-	[ICRA]A+ (Stable)	[ICRA]AA- (Negative)	-	-	-	-	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term Fund-based – Term Loan	Simple
Fund Based Working Capital	Simple
Non Fund Based Working Capital	Very Simple
Commercial Paper	Very Simple

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/Banker Name	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. Crore)	Current Rating and Outlook
-	Term Loan-I	Oct 2020	NA	Sep 2024	105.6	[ICRA]A+(Stable)
-	Term Loan-II	Aug 2017	NA	Aug 2022	6.7	[ICRA]A+(Stable)
-	Term Loan-III	Sep 2021	NA	Sep 2026	50.0	[ICRA]A+(Stable)
-	Fund based working capital	NA	NA	NA	290.0	[ICRA]A+(Stable)
-	Non-Fund based working capital	NA	NA	NA	644.0	[ICRA]A+(Stable)/ [ICRA]A1
-	Fund based and Non-fund based working capital	NA	NA	NA	480.0	[ICRA]A+(Stable)/ [ICRA]A1
INE019C14573	Commercial paper	7-Jul-2021	NA	5-Oct-2021	20.0	[ICRA]A1
INE019C14581	Commercial paper	23-Jul-2021	NA	21-Oct-2021	30.0	[ICRA]A1
*	Commercial paper	NA	NA	7-365days	250.0	[ICRA]A1
-	Unallocated limits	NA	NA	NA	239.56	[ICRA]A+(Stable)

Source: *Company; * Yet to be placed as on September 30, 2021;*

Annexure-2: List of entities considered for consolidated analysis

Company Name	HSCL Ownership	Consolidation Approach
Himadri Speciality Chemical Limited	100.00% (rated entity)	Full Consolidation
AAT Global Limited	100.0%	Full Consolidation
Shandong Dawn Himadri Chemical Industry Limited	94.0%	Equity Method

Source: *HSCL annual report*

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About ICRA Limited:

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