June 28, 2022

Shree Ajit Pulp and Paper Limited: Ratings reaffirmed; outlook revised to Negative from Stable; rated amount enhanced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Fund-based – Cash Credit	50.00	120.00	[ICRA]A reaffirmed; Outlook revised to Negative from Stable
Long-term Fund-based – Term Loan	41.49	245.26	[ICRA]A reaffirmed; Outlook revised to Negative from Stable
Short-term Non-Fund based	2.00	14.00	[ICRA]A1 reaffirmed
Short-term Interchangeable	(19.64)	(101.00)	[ICRA]A1 reaffirmed
Total	**93.49**	**379.26**	

**Instrument details are provided in Annexure-1*

Rationale

The reaffirmation of the rating along with revision in outlook to Negative for Shree Ajit Pulp and Paper Limited (SAPPL or the company) reflects the expected moderation in capitalisation and coverage indicators in the near to medium term, given the debt-funded acquisition of a unit from NR Agarwal Industries Limited as well as incremental capex planned in the same unit in FY2023. Moreover, the company is also in middle of a capacity augmentation exercise at its existing facility, which also will be largely funded by debt. The total cost of the upcoming projects in the existing and newly acquired unit is estimated at ~Rs. 254 crore and is expected to be funded largely by a sizable debt of ~Rs. 176 crore and the balance through internal funds. The financial closure for these projects was achieved with a term loan sanction in place from the bank, hence the funding risk remains nominal for its ongoing projects. In addition, proceeds from the sale of stake in a joint venture or any other fund-raising avenues is also expected to provide incremental support to the liquidity profile in the near term.

ICRA notes that timely achievement of commercial operations within the budgeted time and cost, with steady ramp of operations remains critical for the credit profile and will remain a key rating monitorable. Moreover, any higher than anticipated debt funded capex, which puts further stress on coverage metrics in the near to medium term will also remain a key rating sensitivity. This apart, the ratings continue to remain constrained by the vulnerability of the company's profitability to volatility in wastepaper prices along with foreign exchange (forex) fluctuations, given its sizable dependence on imports. Consequently, the steep rise in wastepaper prices due to demand and supply mismatch along with higher coal prices resulted in moderation of SAPPL's operating margin in FY022, which is further likely to put pressure on its operating profitability in the near term. The ratings also remain constrained by the high competition intensity in the kraft paper segment, owing to many unorganised players that results in pricing pressure.

The ratings, however, favourably continues to consider the extensive track record of operations, its diversified customer profile and strong distribution network spread across various parts of the country. The ratings also continue to factor in the company's mature level of capacity utilisation and its captive power plant, which together supports its profitability margins. Also, the favourable demand for kraft paper supported by growing demand for packaging from ecommerce, food and food products, FMCG, textiles, automobiles and pharmaceutical sectors, augurs well for SAPPL.

Key rating drivers and their description

Credit strengths

Established track record in the kraft paper business - SAPPL has been manufacturing kraft paper since 1995, which has enabled the company to forge strong relationships with both customers and suppliers. Mr. Gautam Shah, Chairman and Managing Director, is a civil engineer and oversees the manufacturing, managerial, marketing and administrative aspects of the company.

Financial profile characterised by comfortable gearing and satisfactory coverage indicators - The nature of debt in SAPPL are term debts and working capital borrowings. SAPPL's capital structure continues to remain comfortable aided by healthy net worth as indicated by low gearing of 0.3X as on March 31, 2022, though it has slightly increased from 0.2X as on March 31, 2021, due to higher working capital borrowings. Although the company's interest coverage has moderated to 10.1X as on March 31, 2022, over 12.9X as on March 31, 2021, it continues to remain comfortable. Also, Total debt/ EBITDA remain satisfactory at 1X as on March 31, 2022. However, given the large debt-funded capex SAPPL is undergoing, the coverage indicators are expected to moderate in the near to medium term, and improve with incremental cash flows from the newly added capacity.

Mature level of capacity utilisation levels – At present, SAPPL's plant is operating at a mature level of utilisation at ~95% of the installed capacity. This is attributed to the firm demand for kraft paper from domestic, end user industries. In addition, timely replacement and maintenance capex undertaken by the company have enhanced its production capabilities, enabling its plants to operate at a near to full capacity utilisation.

Demand dynamics remain favourable given the healthy demand for Kraft paper from end user industry – The demand for kraft paper has witnessed a surge in the recent past supported by growing demand for packaging from e-commerce, food and food products, FMCG, textiles, automobiles and pharmaceutical sectors, which augurs well for the company.

Credit challenges

Sizeable debt-funded capex to exert pressure on coverage metrics in near to medium term – SAPPL is currently in the middle of a debt-funded capex to increase its kraft manufacturing capacity in its existing units as well as undertake modification/ conversion capex at its newly acquired unit from N R Agarwal industries Limited. The total cost of the project is estimated at ~Rs. 254 crore, which is to be funded by a mix of debt (~Rs. 176 crore) and internal funds. Production at its newly acquired facility is expected to be commercialised with partial capacity from January 2023 and with full capacity by April 2023. The ongoing debt-funded capex is likely to keep coverage indicators, mainly Total debt / EBITDA, under check in the near to medium term. Hence, achievement of commercial operations without any material time and cost overruns, coupled with commensurate returns from the capex will remain a key monitorable from the rating perspective.

Profitability exposed to volatility in wastepaper prices and forex movements in the absence of any firm hedging policy – SAPPL's profitability remains exposed to sharp fluctuations in raw material prices—primarily waste paper—since a large portion of waste paper is imported, while prices remain exposed to global demand–supply dynamics. The raw material prices declined in FY2019 and FY2020, due to surplus supply scenario following the ban on waste paper imports by China. However, demand–supply mismatches, lower wastepaper generation in developed markets and the resurgence of Covid-19 in the leading pulp producing countries disrupted supply across the globe, which resulted in waste paper prices going up in FY2022. The company`s margin hence fell sharply in FY2022 over FY2021, given its inability to fully pass on the cost to its end-customers. Further, the company imports more than 80% of its raw material requirement, making it vulnerable to movement in forex rates, since it has adopted currency hedging in a limited way.

Limited pricing flexibility especially in lower BF segment due to the intense competition in the kraft paper industry – The kraft paper industry in India has a large number of unorganised players and is, hence, characterised by intense competition.

Also, there is heightened competition in the lower burst factor (BF) grade kraft paper, given the limited product differentiation. This results in high pricing pressure and limits the company's ability to pass on raw material price fluctuations in a timely manner.

Exposure to changes in wastepaper related regulations – SAPPL's profitability margins remain vulnerable to any regulatory changes in the kraft paper industry. The paper manufacturing industry is exposed to environmental risks, since its production causes air, water and land pollution. Discarded paper and paperboards also make up a sizable portion of solid municipal waste in landfill sites. Thus, the entity remains exposed to the risk associated with changes in waste paper related regulations on availability and usage of water and other inputs in the manufacturing process.

Liquidity position: Adequate

The liquidity position of the company remains adequate with availability of cushion in the form of sizable undrawn working capital limits given the moderately utilised working capital limits. Moreover, the company's fund-based working capital limits have been recently enhanced. Also, the new term loan in the business will have a one-year moratorium, while its existing repayments are lower than its existing net cash accruals. Further, the company expects cash flows from the proceeds of a stake sale in a joint venture and is also looking at different avenues to shore up liquidity as and when needed for business requirements.

Rating sensitivities

Positive factors – Any near-term upgrade in the ratings is unlikely, given the rating are on negative outlook. The ratings can be moved to stable if the company demonstrates timely funding closure in terms of equity infusion and divestment of investments, along with better-than-expected ramp-up in operations along with sustained improvement in profitability, which leads to an improvement in credit metrics and liquidity at the consolidated level. Specific credit metrics such as Total Debt/ OPBDITA at less than 2.0 times on a sustained basis will be considered favourably.

Negative factors – Negative pressure on SAPPL's rating could arise if there is decline in revenues or moderation in profitability leading to stretch in coverage metrics. Any material delays in the ongoing projects, leading to time and cost overruns impacting the credit profile, or higher than anticipated debt-funded capex, which impacts the debt coverage metrics, will also be a negative rating trigger. Specific credit metrics, which may lead to a downgrade will include interest coverage of less than 4.0 times at a on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	[Corporate Credit Rating Methodology]
Parent/Group Support	Not applicable
Consolidation/Standalone	The rating is based on the consolidated financial profile of the company. As on March 31, 2022, SAPPL had one subsidiary and one joint venture, who are enlisted in Annexure 2.

About the company

Incorporated in March 1995, Shree Ajit Pulp and Paper Limited (erstwhile M/s Shree Ajit Pulp and Paper Private Limited) manufactures different varieties of kraft paper, which find application in the packaging industry, particularly in the manufacturing of corrugated boxes. The company's production facility is in Vapi, Gujarat, with an installed manufacturing capacity of 120,000 metric tons per annum (MTPA). SAPPL has also installed two windmills in Rajkot (1.50 MW; FY2010) and Jamnagar (1.25 MW; FY2012). The company also commissioned a 2.40-MW co-generation unit at its manufacturing unit in October 2013.

SAPPL has two group concerns, viz. Shree Samrat Pulp and Paper Private Limited (Shree Samrat) and Shree Samrudhi Industrial Papers Private Limited (Shree Samrudhi). The company holds 50% stake in Shree Samrat, which manufactures low BF kraft paper. The complete stake sale in Shree Samrat is underway and likely to be concluded soon. Shree Samrudhi is a wholly owned subsidiary, which is intended to act as a marketing arm for SAPPL and remains non-operational at present

Key financial indicators (consolidated) – (audited)

	FY2021	FY2022
Operating Income (Rs. crore)	266.61	418.25
PAT (Rs. crore)	24.68	25.07
OPBDIT/OI (%)	17.01%	10.99%
PAT/OI (%)	9.26%	6.00%
Total Outside Liabilities/Tangible Net Worth (times)	0.47	0.50
Total Debt/OPBDIT (times)	0.54	1.00
Interest Coverage (times)	12.92	10.12

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 (FY2023)					Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of March 31, 2022 (Rs. crore)	Date & Rating in	Date & Rating in FY2022	Date & Rating in FY2021		Date & Rating in FY2020
					June 28, 2022	Oct 26, 2021	March 25, 2021	October 01, 2020	August 27,2019
1	Cash Credit	Long-term	120.00	-	[ICRA]A (Negative)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A- (Positive)	[ICRA]A- (Positive)
2	Term Loan	Long -term	245.26	12.80	[ICRA]A (Negative)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A- (Positive)	[ICRA]A- (Positive)
3	Bank Guarantee	Short-term	14.00	-	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A2+	[ICRA]A2+
4	Letter of Credit/Credit Exposure/ Letter of Guarantee	Short-term	(101.00)	-	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A2+	[ICRA]A2+

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term– Fund-based Cash Credit	Simple
Long term - Fund-based Term Loan	Simple
Short -term – Letter of Credit/Credit Exposure/ Letter of Guarantee	Very Simple
Short -term – Interchangeble	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-I: Instrument details

ISIN No.	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (RS Crore)	Current Rating and Outlook
NA	Cash Credit	NA	NA	NA	120.00	[ICRA]A (Negative)
NA	Term Loan (existing)	March 2019	NA	5 years from disbursement	10.76	[ICRA]A (Negative)
NA	Term Loan (new)	March 2022	NA	8 years from disbursement	234.50	[ICRA]A (Negative)
NA	Bank Guarantee	NA	NA	NA	14.00	[ICRA]A1
NA	Letter of Credit/Credit Exposure/ Letter of Guarantee	NA	NA	NA	(101.00)	[ICRA]A1

Source: *Company*

[Please click here to view details of lender-wise facilities rated by ICRA]

Annexure-II: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Shree Samrat Pulp and Paper Private Limited	50%	Equity Method
Shree Samrudhi Industrial Papers Private Limited	100%	Full Consolidation

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