August 12, 2022

Oriental Carbon & Chemicals Limited: Ratings placed under watch with developing implications

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term loans	161.68	143.00	[ICRA]AA- &; rating placed under watch with developing implications
Long term/short term fund-based limits	85.00	85.00	[ICRA]AA- &/[ICRA]A1+ &; rating placed under watch with developing implications
Long term/short term Interchangeable#	(85.00)	(85.00)	[ICRA]AA- &/[ICRA] A1+ &; rating placed under watch with developing implications
Non-fund based limits	29.00	29.00	[ICRA]A1+ &; rating placed under watch with developing implications
Total	**275.68**	**257.00**	

**Instrument details are provided in Annexure-1; # Long term/short term interchangeable with long term/short term-fund based limits*

Rationale

The ratings of Oriental Carbon & Chemicals Limited have been placed under watch with developing implications following the proposed business restructuring under which the chemical business will be demerged into a separate entity, leaving the investment business and Subsidiary with the current entity. Both the entities are likely to have similar shareholding patterns. The scheme is subject to the approval of the requisite regulatory authorities and is likely to take around 6-9 months. Further, considering the other uncertainties related to the final financial structure of each of the entities, the ratings have been placed under watch with developing implications. ICRA will continue to monitor the developments in this regard and will take a suitable rating action as more clarity emerges on the demerger.

To arrive at the rating, ICRA has considered the consolidated financials of the Oriental Carbon & Chemicals Limited (OCCL), including its subsidiary Duncan Engineering Limited (DEL, rated [ICRA]A- @/[ICRA]A2+@), till the time the demerger is complete.

The ratings factor in the long and established track record of OCCL in manufacturing insoluble sulphur, with a favourable position in the domestic and global markets. The ratings also consider a healthy financial risk profile, characterised by large unencumbered cash balances, healthy cash generation form operations and low debt repayments in the near to medium term. The ratings also factor in the stable outlook for the tyre industry, which is the key consumer of insoluble sulphur, in the medium to long term with demand expected to grow at a steady pace.

FY2022, however, witnessed a volatile environment because of the steep hike in raw material prices, which in addition to elevated freight costs, exerted significant pressure on margins and contributions. The operating profit margins declined to 19.6% in FY2022 from 31.6% in FY2021. There was a lag in transferring the price increase to the customers due to which the company's margins were impacted materially in FY2022. However, the company has factored in the price hikes in the current fiscal and the same was reflected in the improved margins and contributions in Q1 FY2023, which is likely to continue.

OCCL's revenue grew 18.4% in FY2022 as the demand from the tyre industry improved post the sharp decline in FY2021 due to the Covid-19 lockdown, along with the increase in realisations with the hike in raw material prices. The raw material prices are elevated even now but the company has now implemented a price correction. The price hike, along with the commencement of production of the enhanced capacities, is likely to aid in a healthy revenue growth in FY2023.

The company's gearing remained low at 0.3 times at the end of FY2022, with the net gearing also being stable at 0.1 times at the end of FY2022. The gross leverage (total debt/OPBDITA) increased to 2.1 times at the end of FY2022 owing to a decline in margins and elevated debt levels amid the capex; however, the same is likely to improve, going forward. However, the net debt/OPBDITA was 0.7 times at the end of FY2022.

The ratings, however, are constrained by the risks associated with the revenues being derived primarily from a single product i.e. insoluble sulphur which is mostly supplied to the automotive sector. The threat of competition from Chinese players is partly mitigated by the high entry barriers and the challenges of maintaining superior product quality and high standards of health and safety at the plants. The profitability also remains vulnerable to foreign exchange rate movements, fluctuations in raw material prices and high working capital intensity.

Key rating drivers and their description

Credit strengths

Well-experienced management and long track record of OCCL in producing insoluble sulphur (IS) - OCCL has a long and established track record in the chemical industry. It started operations as Dharuhera Chemicals Limited in 1978 and was later merged with Oriental Carbon Limited in 1984 to form Oriental Carbon and Chemicals Limited. It started producing insoluble sulphur in 1994 with a capacity of 3,000 MTPA and has since then ramped up its capacity to 39,500 MTPA currently.

Dominant market position in domestic industry; 'preferred supplier' to major tyre companies across the world: OCCL has a dominant position in the domestic market as the sole manufacturer of IS**.** It has also been able to position itself as the preferred/second preferred supplier to most global tyre makers. Hence, it continues to retain its leadership position in the domestic market with nearly 55-60% of the market share and around 10% share in the global market.

Healthy plant performance and significant ramp up of newly installed capacity - OCCL's plant performance has been healthy over the last few years with healthy capacity utilisation levels. The capacity utilisation, after the capacity additions, has also been healthy. The capacity utilisation has moderated in FY2020 and FY2021 due to the slowdown in the auto sector and the Covid-19 pandemic. The capacity utilisation witnessed improvement in FY2022, driven by healthy demand from the tyre industry.

Healthy financial risk profile - OCCL's capitalisation and coverage indicators have improved significantly over the last few years, despite the significant capex, because of the healthy cash generation and low reliance on debt. The net debt levels were Rs. 62.9 crore at the end of FY2022, leading to low net financial leverage (net debt/OPBDITA) of 0.7 times at the end of FY2022. The interest coverage ratio moderated to 1.8 times in FY2022 vis-à-vis 18.1 times in FY2021. ICRA expects the company's credit metrics to improve further, given the healthy cash generation and limited capex planned, going forward.

Stable performance of subsidiary - Duncan Engineering (DEL rated [ICRA]A- @/ [ICRA]A2+@, earlier known as Schrader Duncan), incorporated in 1962, was promoted as a joint venture between Schrader Bridgeport International (SB Intl, a wholly-owned subsidiary of Tomkins Plc) and the Duncan Group (managed by the Goenka family, which is promoter Group of OCCL). DEL manufactures pneumatic products such as air cylinders, valves, and accessories. OCCL holds a 50.01% stake in DEL, making it a subsidiary of OCCL. Earlier, OCCL had provided corporate guarantees, backing the bank lines of DEL, but the same were withdrawn in FY2021.

DEL's operating income increased to Rs. 55.77 crore in FY2022 from Rs. 41.48 crore in FY2021 as the sales recovered from the impact of the Covid-19 lockdown in FY2021. The operating profit was higher at Rs. 10.16 crore in FY2022 against Rs. 4.51 crore in FY2021. The entity had a long-term debt of around Rs. 0.8 crore by the end of FY2022 and around Rs. 8.0 crore of unencumbered cash.

Credit challenges

Threat of competition from Chinese players - Chinese IS manufacturers are usually able to offer the product at a lower cost and are a threat to players like OCCL. However, this risk is partly mitigated by the high entry barriers and the environment, health and safety standards (EHS). Many large tyre manufacturers are wary procurement from Chinese players due to apprehensions over inconsistent quality levels and lower EHS standards.

Vulnerable to forex rate movements; partly mitigated by hedging policy - OCCL derives a significant share of revenues from export sales, exposing the company to foreign exchange fluctuations. However, the risk is partially mitigated as the company has a policy to hedge nearly 75% of its net exposure for the forward six months using forward contracts.

Profitability vulnerable to increase in raw material prices - Sulphur and coating oil are the major raw materials for manufacturing insoluble sulphur. Sulphur prices have been volatile over the years, which exposes the company to raw material price risk. The risk is, however, largely mitigated by the periodic price revisions with the end users though there can be a lag in passing on the raw material price impact, as seen in FY2022 when the margins were impacted.

Liquidity position: Strong

OCCL's liquidity is strong backed by large unencumbered cash balances, un-utilised fund-based limits vis-à-vis the capex requirement and the debt repayments in the near to medium term. As on FY2022, the company had net debt of Rs. 62.9 crore. Going forward, the cash generation is expected to remain stable in FY2023.

Rating sensitivities

Positive factors – OCCL's rating may be revised upwards is there is a significant increase in the scale of operations with commensurate returns.

Negative factors – The rating may be downgraded if there is a significant contraction in the scale of operations for a sustained period, resulting in weak cash accruals.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	[Corporate Credit Rating Methodology] [Rating Methodology for Entities in Chemical Industry]
Parent/Group Support	Not applicable
Consolidation / Standalone	The ratings are based on the consolidated financials of the company

About the company

Oriental Carbon & Chemicals (OCCL) was incorporated in 1978 as Dharuhera Chemicals Limited (DCL). In 1983, DCL was merged with Oriental Carbon Limited (OCL), a Group company engaged in the production of carbon black, to form OCCL. In 1994, OCCL had set up a manufacturing facility to produce insoluble sulphur, which is now the flagship product of the company, as the company sold the carbon black unit to Continental Carbon Company in 2000. OCCL currently has three production units: two at Dharuhera Industrial Unit in Haryana and one at Mundra SEZ in Gujarat. The company currently produces insoluble sulphur, sulphuric acid and oleum.

OCCL now has a production capacity of 39,500 metric tonnes per annum (MTPA) for insoluble sulphur (IS) and 88,200 MTPA for sulphuric acid & oleum. The company is in the midst of a capex programme to expand IS capacity by 11,000 MTPA at Dharuhera, with 5,500 MTPA been commissioned in December 2021, along with the expansion of sulphuric acid capacity by 42,000 MTPA. The schedule for the commissioning of the second phase of capacity expansion of 5,500 MTPA is yet to be decided.

Key financial indicators (audited)

OCCL Consolidated	FY2021	FY2022
Operating income (Rs. crore)	374.6	443.7
PAT (Rs. crore)	83.0	46.2
OPBDIT/OI (%)	31.6%	19.6%
PAT/OI (%)	22.1%	10.41%
Total outside liabilities/Tangible net worth (times)	0.5	0.5
Total debt/OPBDIT (times)	1.5	2.1
Interest coverage (times)	18.1	14.8

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 on March 31, 2022 (Rs. crore)	Date & Rating in	Date & Rating in FY2022	Date & Rating in FY2021		Date & Rating in FY2020		
					12 Aug 2022	30 July 2021	24 Nov 2020	20 Jul 2020	01-Aug-2019	24-Jul-2019	
1	**Term loans**	Long Term	143.00	94.10	[ICRA]AA- &	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	
2	**Fund-based limits**	Long Term/Short Term	85.00	-	[ICRA]AA- & /[ICRA]A1+ &	[ICRA]AA- (Stable) /[ICRA]A1+	[ICRA]AA- (Stable) /[ICRA]A1+	[ICRA]AA- (Stable) /[ICRA]A1+	[ICRA]AA- (Stable) /[ICRA]A1+	[ICRA]AA- (Stable) /[ICRA]A1+	
3	**Non-fund based limits**	Short Term	29.00	-	[ICRA]A1+ &	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	
4	**Fixed deposits**	Medium term	0.00	-	-	MAA (Stable) reaffirmed and withdrawn	MAA (Stable)	MAA (Stable)	MAA (Stable)	MAA (Stable)	
5	**Long term/Short term - interchangeable#**	Long term/Short Term	(85.00)	-	[ICRA]AA- & /[ICRA]A1+ &	[ICRA]AA- (Stable) /[ICRA]A1+	[ICRA]AA- (Stable) /[ICRA]A1+	[ICRA]AA- (Stable) /[ICRA]A1+	[ICRA]AA- (Stable) /[ICRA]A1+	[ICRA]AA- (Stable) /[ICRA]A1+	

 # Long Term/Short Term interchangeable with Long Term/Short term-Fund based limits; &: Rating on watch with developing implications

Complexity level of the rated instruments

Instrument	Complexity Indicator
Term Loans-Long term	Simple
Fund Based Limits-Long Term/Short Term	Simple
Non-fund based limits-Short Term	Simple
Long term/Short Term-Interchangeable	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 analysing 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 are available on ICRA's 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
-	**Term Loans**	FY2018- FY2019	7.60%- 8.85%	FY2023- FY2026	143.00	[ICRA]AA- &
-	**Long Term/Short Term Fund based**	-	-	-	85.00	[ICRA]AA- &/ [ICRA]A1+ &
-	**Non-fund based**	-	-	-	29.00	[ICRA]A1+ &
-	**Long Term/Short Term-Interchangeable#**	-	-	-	(85.00)	[ICRA]AA- &/ [ICRA]A1+ &

Source: *Company; #: Long Term/Short Term interchangeable with Long Term/Short term-Fund based limits; &: Rating on watch with developing implications*

Annexure-2: List of entities considered for consolidated analysis

Company Name	OCCL's ownership	Consolidation Approach
Duncan Engineering Limited	50.05%	Full consolidation

Source: *OCCL*

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