December 26, 2022

The South India Paper Mills Limited: Ratings downgraded to [ICRA]BBB / [ICRA]A3+; outlook revised to Negative

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Outstanding
Fund- based – Term loan	133.50	166.77	[ICRA]BBB (Negative) downgraded from [ICRA]BBB+(Stable)
Fund-based – Working capital Facilities – Cash credit	60.00	70.00	[ICRA]BBB (Negative) downgraded from [ICRA]BBB+(Stable)
Non-fund Based – Working capital facilities – LC/BG	5.50	5.50	[ICRA]A3+ downgraded from [ICRA]A2
Unallocated units	51.00	7.73	[ICRA]BBB (Negative) downgraded from [ICRA]BBB+(Stable)
Total	**250.00**	**250.00**	

**Instrument details are provided in Annexure-1*

Rationale

The revision in the ratings with negative outlook takes into account the material weakening of the financial risk profile of The South India Paper Mills Ltd (SIPM) arising from the worsening of its cost structure leading to a sharp decline in its operating profitability and consequent deterioration of coverage indicators in H1 FY2023. This is chiefly attributable to the steep rise in energy expenses, given the elevated coal prices for its in-house generation plant. This apart, administrative delays in sourcing the grid-based power, at a relatively lower rate, have also led to underutilisation of the newly-commissioned paper plant with enhanced production capabilities. Although the company has secured the necessary grid connection at competitive rates in December 2022, its ability to ramp up its production and generate commensurate returns remains to be seen. The ratings also take note of the recent pressure on the sales realisation, driven to an extent from the declining wastepaper trend, which has also impacted the topline. The ratings also remain constrained by the weakening of the company's liquidity profile on account of lower-than-anticipated cash accruals in H1 FY2023 and near full utilisation of limits. With repayment of new loans starting from January 2023, the company has been looking to monetise its non-core assets and has resorted to unsecured loans temporarily to support its liquidity profile in the interim. Its ability to divest the non-core assets in a timely manner to improve its liquidity profile, other than through regular cash flow from operations, remains critical from a credit perspective in the near term. The ratings also continue to be constrained by production concentration risks and exposure to intense competition.

The ratings, however, continue to consider the company's extensive track record of operations, its diversified customer profile and strong distribution network spread across various parts of South India. The ratings also continue to factor in the company's forward integration into manufacturing packaging material, which supports SIPM's profitability margins to some extent.

Key rating drivers and their description

Credit strengths

Extensive experience of promoters in the paper industry – The promoters of SIPM have over five decades of experience in the kraft paper industry. This has aided the company in forging strong relationships with both its customers and suppliers.

Established and strong distributor network in southern India – SIPM has a strong distribution network with around 10-12 agents in various cities such as Bengaluru, Chennai, Kochi and Coimbatore. Its customer profile is diversified with reputed clients like Nestle, Reckitt Benckiser, Britannia and Parle Agro.

Forward integration into packaging division support profitability – The company's product portfolio constitutes kraft paper. It is also forward integrated into packaging material. This has enabled SIPM to develop an optimum in-house raw material mix at competitive costs to create high-strength packaging material, which has supported its profitability in the past.

Credit challenges

Notable deterioration in financial risk profile in the current fiscal driven by higher input costs and delay in stabilisation of the new unit due to high energy costs – The company's operating margin declined to 4.4% in H1 FY2023 compared to 14.6% in H1 FY2022 and 12.3% compared to FY2022. The same is a direct result of higher input cost coupled with the delay in stabilisation of the new plant due to high energy costs. The escalation in energy cost is attributable to the surge in coal prices which in turn resulted in high co-gen power production cost. This apart, the delay in sanctioning of adequate grid power at competitive rates accentuated the escalation in the power cost and led to underutilisation of the new unit. With worsening of the cost structure, the cash accruals fell to negative Rs.2.4 crore in H1 FY2023 compared to Rs.17.2 crore in H1 FY2022.

Vulnerability of profitability margins to volatility in wastepaper prices and forex fluctuations – SIPM's profitability remains exposed to sharp fluctuations in raw material prices—primarily wastepaper—a large portion of the wastepaper is imported, and the prices remain exposed to global demand-supply dynamics. The company's ability to fully pass on the price risk remains limited by competition in the market, which can impact it profitability metrics. Further, the company imports around 50% of its raw material requirement, making it vulnerable to movement in forex rates, with the company adopting currency hedging in a limited way.

Product-concentration risk with product portfolio limited to kraft paper and related products – Given that the product portfolio of SIPM is confined to kraft paper, it remains exposed to product concentration risks. The risk, however, is alleviated to a certain extent by the company's forward integration into the packaging segment.

Intense competition in the kraft paper industry - The kraft paper industry in India has many unorganised players and is, hence, characterised by intense competition. This results in intense pricing pressure and limits the company's ability to pass on raw material price fluctuations in a timely manner. Nonetheless, the presence of SIPM in the moderate-to-high grade kraft paper segment (20 to 40 burst factor) and its established relationships with major players in the FMCG sector are key mitigating factors for the company.

Environmental and Social Risks

Environmental considerations - The paper manufacturing industry is exposed to environmental risk of air, water and land pollution, with discarded paper and paperboard making up a sizeable portion of the solid municipal waste in landfills. Pulp and paper generate a notable amount of industrial air, water, and land emissions. While these risks have not resulted in any material implication so far, any breaches in waste management or higher-than-permissible emissions could have cost implications for the company. Also, water treatment is extremely important because the pulping and bleaching process can release complex organic and inorganic pollutants which need to be properly treated.

The company has installed an ETP facility in FY2021 for conserving water and meeting the pollution control norms even on the expanded capacity of the paper mill and is functioning satisfactorily. Further, the company has installed and has been operating the Electrostatic Precipitator (ESP) Systems for its boilers for controlling dust emission and dust extractor systems for controlling dust at its fuel handling system. Centrifuge and other machineries have been installed for effluent treatment.

Social considerations: Being a labour-intensive segment, entities operating in the paper industry are exposed to the risk of disruption in event of any mishandling of human capital in terms of their safety and overall well-being. Further, any significant wage rates adversely impacting the cost structure of paper manufacturing companies can impact their margin.

Liquidity position: Stretched

The company's liquidity position remains stretched resulting from weakening of operating cash flows in H1 FY2023, and near-term pressure on realisations. Furthermore, the company's fund-based utilisation remained high leading to limited buffer available in working capital limits in case of financial exigencies. To improve its liquidity profile, the company has been taking steps including divestment of its non-core assets and resorted to unsecured borrowings to temporarily bridge any funding needs. Its ability to improve its liquidity profile through any asset sale, other than through regular operational improvements which supports the cash flow, will remain key rating sensitivities.

Rating sensitivities

Positive factors – Given the negative outlook, any near-term upgrade is unlikely. Ramp up of operations at the recently enhanced capacities, along with stabilisation of cost structure leading to improvement in earnings, along with improvement in liquidity levels and coverage indicators will be a credit positive.

Negative factors – Negative pressure on SIPM's rating could arise if there is delay in recovery in operating performance in absence of optimal utilisation of new capacity or any demand moderation which will materially impacts the margin and coverage indicators. Inability to timely monetise its non-core assets to improve the liquidity profile on a sustained basis or through better cash accruals or better working capital management, will also be a negative for the rating.

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 standalone financial profile of the company.

About the company

Incorporated in 1959, SIPM operates a kraft paper manufacturing unit along with a packaging division at Nanjangud in the Mysore district of Karnataka. SIPM also has an 11-MW captive cogeneration power plant. Its key products include kraft liners, test liners, machine-glazed kraft paper, corrugated boards and wraparound boxes. The manufacturing facility has an installed production capacity of 151,800 MT/year for the paper division and 36,000 MT/year for the packaging division. About 45-50% of paper manufactured is captively consumed in the packaging division.

Key financial indicators (audited)

Standalone	FY2021	FY2022
Operating income (Rs. crore)	226.8	305.4
PAT (Rs. crore)	19.0	21.7
OPBDIT/OI (%)	16.7%	12.3%
PAT/OI (%)	8.4%	7.1%
Total outside liabilities/Tangible net worth (times)	0.8	1.3
Total Debt/OPBDIT (times)	2.7	5.3
Interest coverage (times)	8.3	6.4

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
					Dec 26, 2022	Aug 08, 2022	Jan 27, 2022	Oct 30, 2020	Apr 05, 2019
1	Fund based term loans	Long term	166.77	151.69	[ICRA]BBB (Negative)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]A- (Negative)
2	Fund-based-Working capital facilities	Long term	70.00	-	[ICRA]BBB (Negative)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]A- (Negative)
3	Non-fund based - Working capital facilities	Short term	5.50	-	[ICRA]A3+	[ICRA]A2	[ICRA]A2	[ICRA]A2	[ICRA]A2+
4	Unallocated units	Long term	7.73	-	[ICRA]BBB (Negative)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]A- (Negative)

Complexity level of the rated instruments

Instrument	Complexity Indicator
Term loans	Simple
Fund-based limits	Simple
Non-fund based facilities	Very Simple
Unallocated	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 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: Click Here

Annexure I: Instrument details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	**Term Loans 1**	Oct-2014	-	Dec-2024	40.00	[ICRA]BBB (Negative)
NA	**Term Loans 2**	Oct-2015	-	Jan- 2026	126.77	[ICRA]BBB (Negative)
NA	**LC/BG**	NA	NA	NA	5.50	[ICRA]A3+
NA	**Cash Credit**	NA	NA	NA	70.00	[ICRA]BBB (Negative)
NA	**Unallocated**	NA	NA	NA	7.73	[ICRA]BBB (Negative)

Source: Company

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

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

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