June 21, 2023

The South India Paper Mills Limited: Ratings downgraded to [ICRA]BBB-(Negative)/ [ICRA]A3

Summary of rating action

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

**Instrument details are provided in Annexure-I*

Rationale

The ratings downgrade with continuation of Negative outlook on the bank lines of The South India Paper Mills Limited (SIPM) takes into account the continued stress on operations with the entity reporting operating losses in FY2023, on the back of delayed commercial operations of its new facility for kraft paper, coupled with stabilisation issues leading to underutilisation of new capacity. ICRA expects the financial profile to be under stress in the near term, given falling realisation of kraft paper and the company being unable to achieve optimum capacity utilisation levels. Given the repayment for its loan for capex commencing from FY2024 onwards, the company raised capital worth Rs. 45.37 crores in Q4 FY2023 to fund the same as well as operating losses. Though the same provides interim relief, the ability of the company to turn around the operations and operate at optimum levels to report improvement in its overall financial and liquidity profile will be key monitorables.

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.

The Negative outlook on the long-term rating reflects ICRA's opinion that the company will continue to face near-term headwinds in terms of stabilisation of new unit, falling sales realisations and high repayments in the near term.

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 supports 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

Deterioration in financial risk profile in FY2023 driven by higher input costs and delay in stabilisation of new unit – The company's operating margin declined to -2.2% in FY2023 compared to 12.3% in FY2022. The same is a direct result of higher input cost, coupled with the delay in stabilization of the new plant due to high energy costs in H1 FY2023. The company continued to report operating losses in H2 FY2023, owing to further delay in commercialisation of the new unit, lower industry demand, raw material price volatility and the fall in the sales realisation. As a result, the cash accruals fell to negative Rs. 9.7 crore in FY2023 compared to Rs. 28 crore in FY2022. The decline in kraft paper realisations is expected to put pressure on the margins in the current fiscal, though reduction in raw material prices has somewhat supported the contribution margin. The ability of the company to operate at optimum levels, so as to absorb the fixed costs and report turnaround of operations, will remain key rating sensitivity in the near term.

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, wherein 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 its 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 is, however, alleviated to a certain extent by the company's forward integration into the packaging segment.

Intense competition in 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 the 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 make up a sizable portion of 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

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

Social considerations: Being a labor-intensive segment, entities operating in the paper industry are exposed to the risk of disruption from their inability to properly manage 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.

As per company's disclosure on social front it is having very cordial and harmonious labour relation climate. A 6 year Wage settlement agreement signed with workers' union at the Paper Mill was in force upto 31-3-2022. Negotiation for agreement for the subsequent period has commenced. In case of the Box unit, a 4 year Wage settlement agreement signed during the year with workers' union is in force upto 31-3-2024.

Liquidity position: Stretched

The company's liquidity position remains stretched, resulting from weakening of operating cash flows in FY2023, and near-term pressure on realisations. The company has total repayment obligation of Rs. 31.2 crore in FY2024, which is likely to be funded by buffer in fund-based limits (Rs. 25 crore as of May 2023 end), created through infusion of equity and internal accruals generated in FY2024. Given the generation of internal accruals is likely to be inadequate to fully cover the repayments, the near-term liquidity profile is expected to remain stretched.

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 credit positives.

Negative factors – Pressure on SIPM's ratings could arise, if there is further delay in recovery in operating performance in absence of optimal utilisation of new capacity or any demand moderation, which will materially further elongate the recovery process.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology
Parent/Group support	Not Applicable
Consolidation/Standalone	The ratings are based on the standalone financial profile of the company.

About the company

Incorporated in 1959, SIPM operates a kraft paper manufacturing unit and a packaging division at Nanjangud in 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 115,500 MT/year for the paper division and 36,000 MT/year for the packaging division. About 40-45% of paper manufactured is captively consumed in the packaging division.

Key financial indicators

Standalone	FY2022	FY2023
Operating income	305.4	287.9
PAT	21.7	-16.7
OPBDIT/OI	12.3%	-2.2%
PAT/OI	7.1%	-5.8%
Total outside liabilities/Tangible net worth (times)	1.3	1.1
Total debt/OPBDIT (times)	5.3	-30.8
Interest coverage (times)	6.4	-0.4

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore;

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2024)					Chronology of rating history for the past 3 years			
		Type	Amount rated (Rs. crore)	Amount outstanding as of March 31st, 2023 (Rs. crore)	Date & rating in FY2024		Date & rating in FY2023		Date & rating in FY2022	Date & rating in FY2021
					Jun 21, 2023	Jun 05, 2023	Dec 26, 2022	Aug 08, 2022	Jan 27, 2022	Oct 30, 2020
1	Fund based term loans	Long-term	166.77	142.55	[ICRA]BBB- (Negative)	[ICRA]BBB (Negative)	[ICRA]BBB (Negative)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)
2	Fund-based Working capital facilities	Long-term	70.00	-	[ICRA]BBB- (Negative)	[ICRA]BBB (Negative)	[ICRA]BBB (Negative)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)
3	Non-fund based - Working capital facilities	Short-term	5.50	-	[ICRA]A3	[ICRA]A3+	[ICRA]A3+	[ICRA]A2	[ICRA]A2	[ICRA]A2
4	Unallocated Limits	Long-term	7.73	-	[ICRA]BBB- (Negative)	[ICRA]BBB (Negative)	[ICRA]BBB (Negative)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)

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	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	**Term Loan-I**	Oct-2014	-	Dec-2024	40.00	[ICRA]BBB- (Negative)
NA	**Term Loan-II**	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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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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