

August 10, 2023

Shree Ajit Pulp and Paper Limited: Ratings reaffirmed; 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	120.00	140.00	[ICRA]A (Negative); reaffirmed and assigned for enhanced amount
Long-term fund-based – Term loan	245.26	239.25	[ICRA]A (Negative); reaffirmed
Short-term non-fund based	14.00	14.00	[ICRA]A1; reaffirmed
Short-term interchangeable	(101.00)	(101.00)	[ICRA]A1; reaffirmed
Short-term – Unallocated limits	-	0.75	[ICRA]A1; assigned
Total	379.26	394.00	

*Instrument details are provided in Annexure-I

Rationale

The ratings reaffirmation with continuation of Negative outlook for Shree Ajit Pulp and Paper Limited (SAPPL /the company) reflect the expected pressure on the debt protection metrics of the company in the near term, on the back of the ongoing debt-funded capex related to capacity expansion as well as improvements/upgradations made to the existing unit. The total cost of the project in the existing and newly acquired unit is estimated at around Rs. 305 crore funded through debt of ~Rs. 233 crore, and the balance from internal funds and monetisation of non-core assets. The ratings favourably consider SAPPL's extensive operational track record, 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 support its profitability margins. Also, the favourable long-term demand prospects for kraft paper supported by growing demand for packaging from the e-commerce, food and food products, FMCG, textiles, automobiles and pharmaceutical sectors, augur well for SAPPL.

The company has recently commenced commercial operations for Unit II from July 2023, with additional capex of Rs. 50 crore undertaken in the current fiscal for additional machineries, which would result in higher quality paper output. Given the recent commercialisation of Unit II and additional capex likely to be completed by FY2024 end only, the coverage indicators for FY2024 are expected to be under pressure and any meaningful recovery is anticipated in the next fiscal, once the new capacity with additional machineries for higher quality paper are commercialised. ICRA, however derives comfort from the stable demand outlook, expected improvement in margins and comfortable liquidity profile supported by sufficient buffer in fund-based limits, expected higher inflow from rights issue compared to last year's announcement, and repayments for recent capex beginning only from Q4 FY2024.

The ratings remain constrained by the vulnerability of the company's profitability to volatility in wastepaper prices and declining realisation as seen in FY2023 along with foreign exchange (forex) fluctuations, given its sizeable dependence on imports. The ratings also remain constrained by the high competitive intensity in the kraft paper segment, owing to many unorganised players resulting in pricing pressure. ICRA will continue to monitor the performance of the company and will review the ratings accordingly.

Key rating drivers and their description

Credit strengths

Established track record in 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.

Healthy long-term demand for kraft paper from end-user industries – The long-term demand prospects for kraft paper is expected to be healthy, supported by growing demand for packaging from the e-commerce, food and food products, FMCG, textiles, automobiles and pharmaceutical sectors, which augurs well for the company.

Financial profile characterised by adequate gearing and liquidity – The nature of debt in SAPPL are term debts and working capital borrowings. SAPPL's capital structure continues to be comfortable, aided by healthy net worth, indicated by low gearing of 0.81 times as on March 31, 2023, though it has slightly increased from 0.24 times as on March 31, 2022, due to debt-funded capex undertaken. Further, the company has healthy cushion in the form of sizeable undrawn working capital limits, given the moderately utilised working capital limits.

Credit challenges

Sizeable debt-funded capex to exert pressure on coverage metrics in near to medium term – At present, SAPPL is undertaking a large debt-funded capex to enhance 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. 305 crore, which is to be funded by a mix of debt (~Rs. 233 crore) and internal funds. Production at its newly acquired facility has commercialised from July 2023. The company's interest coverage moderated to 4.50 times as on March 31, 2023, from 10.1 times as of March 31, 2022, and is expected to be under pressure in the near term, given the full impact of debt and capex will only be seen by FY2024 end. Any meaningful recovery in debt protection metrics is only expected from FY2025, when full impact of new capacity and higher quality output will be visible. Lack of commensurate returns in terms of higher quality of paper leading to higher realisations or any material time and cost overruns, impacting the revenue profile will remain a key monitorable from the rating perspective.

Profitability exposed to volatility in wastepaper prices and decline in price realisations, reflected in moderation in margin in FY2023 – SAPPL's profitability remains exposed to sharp fluctuations in raw material prices—primarily wastepaper—as a large portion of wastepaper is imported, while prices remain exposed to global demand–supply dynamics. Demand–supply mismatches, lower wastepaper generation in developed markets disrupted supply across the globe, which resulted in increase in wastepaper prices. The other key raw material used in the manufacturing process is coal, which is primarily imported, remained elevated throughout most of FY2023. The company's margin hence, fell sharply in FY2023 over FY2022, given its inability to fully pass on the cost to its end customers. Thus, SAPPL's margins remain exposed to any adverse fluctuations in the wastepaper and coal prices. Further, the company uses imported wastepaper, making it vulnerable to movements in forex rates, as it has adopted currency hedging in a limited way.

Limited pricing flexibility especially in lower BF segment due to the intense competition in 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 increase 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, as its production causes air, water and land pollution. Discarded paper and paperboards also make up a sizeable portion of solid municipal waste. Thus, the entity remains exposed to the risks associated with changes in wastepaper-related regulations on availability and usage of water and other inputs in the manufacturing process.

Environment and Social Risks

Environmental considerations: The paper manufacturing industry is exposed to environmental risks, given the production function leads to air, water and land pollution and discarded paper and paperboard make up a sizeable portion of solid municipal waste. Pulp and paper generate a notable amount of industrial air, water, and land emissions. While these risks have not resulted in any material implications 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 here because the pulping and bleaching process can release complex organic and inorganic pollutants in effluent which needs to be properly treated. Presently, SAPPL operates a fully automated effluent treatment plant to treat water before discharge. However, any disruptions in measures taken for appropriate treatment of wastewater could result in significant penalties, while also causing prolonged adverse impact to operations in case the authorities take any strict action.

Social considerations: Being a labour-intensive segment, the entities operating in the paper industry are exposed to the risk of disruption due to inability to properly manage human capital in terms of their safety and overall well-being. Further, any significant wage rates adversely impact the cost structure of paper manufacturing companies, impacting their margins. SAPPL is also exposed to the shortage of skilled labourers, which can impact operations. However, at present, SAPPL has taken measures towards employee welfare including a social accountability policy in place.

Liquidity position: Adequate

The liquidity position of the company is adequate, with stable operational cash flows and healthy cushion in the form of sizeable undrawn working capital limits, given the moderately utilised working capital limits. The company has also enhanced its working capital limit to Rs. 140 crore from March 2023 from Rs. 120 crore. Also, the term loan taken towards the capex incurred in Unit II has a one-year moratorium till December 2023, while its existing repayments are limited. Further, the company expects cash flows from the proceeds on sale of assets in joint venture and inflow from the planned rights issue, to shore up its liquidity profile in the near term.

Rating sensitivities

Positive factors – Any near-term upgrade in the ratings is unlikely, given the rating has a Negative outlook. The long-term rating can be moved to Stable, if the company demonstrates 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 – The ratings may be downgraded upon any material time or cost overruns or sub-optimal utilisation of new capacities upon commissioning, which will adversely impact the credit profile. Further, any sustained pressure on revenues and earnings or deterioration of its working capital cycle, which would adversely impact the credit metrics and liquidity position could also result in a downgrade. Specific credit metrics, which may lead to a downgrade, will include interest coverage of less than 4.0 times, on a sustained basis.

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 consolidated financial profile of the company. As on March 31, 2023, SAPPL had one subsidiary and one joint venture, which are enlisted in Annexure 2.

About the company

Shree Ajit Pulp and Paper Limited (erstwhile M/s Shree Ajit Pulp and Paper Private Limited), incorporated in March 1995, manufactures different varieties of kraft paper, which find application in the packaging industry, particularly in manufacturing corrugated boxes. The company's production facility is in Vapi, Gujarat, with an installed manufacturing capacity of 1,20,000 metric tonnes 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 a 50% stake in Shree Samrat was previously involved in manufacturing of low BF kraft paper. However, Shree Samrat's core assets were sold off in FY2023. 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 (audited)

Consolidated	FY2022	FY2023
Operating income	418.3	371.9
PAT	25.1	11.3
OPBDIT/OI	11.0%	7.9%
PAT/OI	6.0%	3.0%
Total outside liabilities/Tangible net worth (times)	0.5	1.1
Total debt/OPBDIT (times)	1.0	5.8
Interest coverage (times)	10.1	4.5

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

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument	Type	Current Rating (FY2024)			Chronology of Rating History for the past 3 years				
		Amount Rated (Rs. crore)	Amount Outstanding as of March 31, 2023 (Rs. crore)	Date & Rating in FY2024	Date & Rating in FY2023	Date & Rating in FY2022		Date & Rating in FY2021	
				Aug 10, 2023	Jun 28, 2022	Oct 26, 2021	Mar 25, 2021	Oct 01, 2020	
1	Cash credit	Long-term	140.00	-	[ICRA]A (Negative)	[ICRA]A (Negative)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A- (Positive)
2	Term loan	Long-term	239.25	151.30	[ICRA]A (Negative)	[ICRA]A (Negative)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A- (Positive)
3	Bank Guarantee/ Credit Exposure Limit	Short-term	14.00	-	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A2+
4	Unallocated limits	Short-term	0.75	-	[ICRA]A1	-	-	-	-
5	Interchangeable	Short-term	(101.00)	-	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1	[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 – Non fund based	Very Simple
Short -term – Interchangeable	Very Simple
Unallocated limits	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	Cash Credit	NA	NA	NA	140.00	[ICRA]A (Negative)
NA	Term Loan (existing)	FY2019	NA	FY2031	6.25	[ICRA]A (Negative)
NA	Term Loan (new)	FY2022	NA	FY2031	233.00	[ICRA]A (Negative)
NA	Bank Guarantee	NA	NA	NA	10.00	[ICRA]A1
NA	Credit Exposure Limit	NA	NA	NA	4.00	[ICRA]A1
NA	Interchangeable	NA	NA	NA	(101.00)	[ICRA]A1
NA	Unallocated	NA	NA	NA	0.75	[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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