

## The South India Paper Mills Limited

April 05, 2019

### Summary of rating action

Instrument	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term Loan	45.00	150.00	[ICRA]A- Reaffirmed; outlook revised from Stable to Negative
Fund-based Limits	33.00	40.00	[ICRA]A- Reaffirmed; outlook revised from Stable to Negative
Non-fund Based Limits	25.50	25.50	[ICRA]A2+ Reaffirmed
Unallocated Limits	6.50	9.50	[ICRA]A- Reaffirmed; outlook revised from Stable to Negative
<b>Total</b>	<b>110.00</b>	<b>225.00</b>	

### Rationale

The revision in the outlook takes into account the expected moderation in debt coverage metrics in the near term due to large sized capital expenditure being undertaken as well as the associated execution and market risks. The company has planned an investment of Rs. 190 crore to set up a kraft paper capacity of 350 tonnes per day (tpd), as against the existing capacity of 200 tpd and the same is proposed to be largely debt funded with expected completion in March 2020. ICRA further notes that the company's ability to successfully ramp up the utilization levels and market the incremental volumes post commissioning of the facility, given the competitive pressures will remain critical to its key credit metrics.

The reaffirmation of the ratings, however, favourably takes into account the healthy capacity utilisation levels reported in the paper and packaging units of SIPM post the end of labour strike in August 2017. The company has also signed a long-term agreement (valid until FY2022) with the labour union with respect to revision of wages, which in turn, largely mitigates the risk of labour strikes again in the medium term. The ratings also factor in the healthy contribution levels supported by forward integration into the packaging division and cost competitiveness owing to availability of captive power. The ratings further continue to positively factor in the established presence and the strong distribution network of the company in southern India.

The ratings, however, remain constrained by the exposure of SIPM's profitability to fluctuation in raw-material prices as well as movement in foreign exchange given that the company imports around 50% of its raw materials. The risk, however, is mitigated to a certain extent by appropriate reset of prices by the company. Besides, the company is exposed to product-concentration risk as its product portfolio is limited to kraft paper and related products. The risk is alleviated to a certain extent by the forward integration into the packaging division. The ratings also factor in the intense competition in the kraft paper segment owing to the presence of many unorganised players which results in pricing pressure and limits the company's ability to pass on fluctuations in raw-material costs.

### Outlook: Negative

The Negative outlook reflects ICRA's expectation that the proposed capex exposes the company to high project execution risk and will moderate the debt coverage indicators for the company in the near term. The outlook may be revised to Stable in case of satisfactory progress with timely execution of the capex within the stipulated cost coupled with lower leveraging levels & stabilisation of the operations with ramp up in the volumes. Also, the company's ability to successfully market the incremental volumes will remain critical to its key credit metrics.

## Key rating drivers:

### Credit strengths

**Experience of promoters in the paper industry** – The promoters of SIPM have over five decades of experience in the kraft paper industry and this has aided the company in forging strong relationships with both customers and suppliers. This has also helped the company in reinstating operations post the labour strike.

**Strong distribution network in southern India** – The company has a strong distribution network with around 10-12 agents in various cities such as Bangalore, Chennai, Cochin and Coimbatore.

**Forward integration into packaging division and presence of a captive power plant boost profitability** – The company's product portfolio constitutes of kraft paper and it is also forward integrated into packaging material. This has enabled SIPM to develop an optimum raw material mix in-house at competitive costs to create high-strength packaging material and has boosted profitability levels. Furthermore, the company benefits from the presence of a captive power plant, which reduces fuel costs alongside providing an additional revenue stream for the company.

### Credit challenges

**Large debt funded project capex** – The company is in the midst of expanding its installed capacity from 200 tpd to 460 tpd with an expected outlay of Rs. 190 crore which will be funded through incremental term loans of Rs. 110 crore and rest through internal accruals. The capex is expected to significantly moderate the debt coverage metrics of the company (estimated Total Debt/OBITDA of ~4 times and interest coverage of 2.4 times for FY 2021). The company will also remain exposed to high project execution risk with the commissioning of the plant targeted for March 2020, although the risk is partly mitigated by the operational expertise of the company in executing projects. Post commissioning, the company's ability to successfully market the incremental volumes will also remain critical to its key credit metrics.

**Vulnerability of profitability margins to volatility in waste paper prices and foreign exchange fluctuations** – SIPM's profitability remains exposed to sharp fluctuations in raw material prices. Since the company imports around 50% of its raw material requirement, it is vulnerable to movement in foreign exchange. However, the same is mitigated to a certain extent by appropriate price resets at regular intervals.

**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 a large number of unorganised players and is hence characterised by intense competition. This results in high pricing pressure and limits the company's ability to pass on raw material-price fluctuations.

### Liquidity position

The company's liquidity position remains comfortable with free cash of Rs. 7.8 crore as on end September 2018 along with unutilised working capital limits of ~ 33 crore. The drawing power for the company has remained higher than the sanctioned working limits which provides liquidity buffer by allowing the company for any working capital enhancements, if required.

## Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	<a href="#">Corporate Credit Rating Methodology</a>
Parent/Group Support	-
Consolidation/Standalone	Standalone

## About the company:

Incorporated in 1959, SIPM manufactures paper and paper products. The company also has an 11-MW (upgraded from 7.8-MW) captive cogeneration power plant. Its products include kraft liners, test liners, machine-glazed kraft paper, corrugated boards and wrap-around boxes. SIPM operates a manufacturing facility at Nanjangud, Mysore, which has an installed capacity of 66,000 MT/year in the paper and pulp division and 36,000 MT/year in the printing and packaging division.

## Key financial indicators (Audited)

	FY2017	FY2018	9M FY2019
Operating Income (Rs. crore)	195.27	134.66	184.90
PAT (Rs. crore)	11.96	0.95	14.68
OPBDIT/OI (%)	15.61%	9.23%	15.52%
RoCE (%)	6.12%	0.71%	-
Total Debt/TNW (times)	0.32	0.38	-
Total Debt/OPBDIT (times)	1.49	4.26	-
Interest Coverage (times)	7.85	2.60	8.43

Status of non-cooperation with previous CRA: Not applicable

## Any other information: None

### Rating history for last three years:

Current Rating (FY2019)					Chronology of Rating History for the past 3 years				
Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating	Date & Rating in FY2018		Date & Rating in FY2017	Date & Rating in FY2016	
				April 2019	February 2018	June 2017	January 2017	September 2015	
1	Term Loan	150.00	37.86	[ICRA]A-(Negative)	[ICRA]A-(Stable)	[ICRA]A-placed on watch with negative implications	[ICRA]A-(Stable)	[ICRA]BBB+(Stable)	
2	Fund Based – Cash Credit	40.00	0.15	[ICRA]A-(Negative)	[ICRA]A-(Stable)	[ICRA]A-placed on watch with negative implications	[ICRA]A-(Stable)	[ICRA]BBB+(Stable)	
3	Non-Fund Based Limits	25.50	24.00	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+ placed on watch with negative implications	[ICRA]A2+	[ICRA]BBB+(Stable)	
4	Unallocated Limits	9.50	-	[ICRA]A-(Negative)	[ICRA]A-(Stable)	[ICRA]A2+ placed on watch with negative implications	[ICRA]A2+	[ICRA]BBB+(Stable)	

### Complexity level of the rated instrument:

ICRA has classified various instruments based on their complexity as “Simple”, “Complex” and “Highly Complex”. The classification of instruments according to their complexity levels is available on the website [www.icra.in](http://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
NA	Term Loan 1	Oct-2014	10.15%	Dec-2024	6.00	[ICRA]A- (Negative)
NA	Term Loan 2	Oct-2015	10.15%	Jan- 2026	8.00	[ICRA]A- (Negative)
NA	Term Loan 3	Oct-2015	9.95%	Sep-2026	8.00	[ICRA]A- (Negative)
NA	Term Loan 4	Oct-2015	9.95%	Dec-2024	18.00	[ICRA]A- (Negative)
NA	Term Loan 4	Proposed	-	-	110.00	[ICRA]A- (Negative)
NA	LC	NA	NA	NA	25.00	[ICRA]A2+
NA	Cash Credit	-	-	-	40.00	[ICRA]A- (Negative)
NA	Bank Guarantee	NA	NA	NA	0.50	[ICRA]A2+
NA	Unallocated	NA	NA	NA	9.50	[ICRA]A- (Negative)

Source: The South India Paper Mills Limited

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