

May 20, 2019

Kothari Petrochemicals Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Term Loan	15.00	15.00	[ICRA]A-(Stable); Reaffirmed
Long-term Fund-based Facilities	25.00	25.00	[ICRA]A-(Stable); Reaffirmed
Short-term Non-fund Based Limits	15.00	15.00	[ICRA]A2+; Reaffirmed
Total	55.00	55.00	

*Instrument details are provided in Annexure-1

Rationale

The ratings reaffirmation considers the dominant position of Kothari Petrochemicals Limited (KPL) in the domestic poly iso-butylene (PIB) market and its established relationships with feedstock suppliers, which mitigate the raw material availability risks. Feedstock availability is a key risk for PIB manufacturers in India as feedstock is increasingly used for alternative higher value-added applications these days. The company procures feedstock from Chennai Petroleum Corporation Limited (CPCL) through pipelines at relatively competitive rates; however, its margin is adversely impacted by losses from under-recoveries from selling residual feedstock (raw materials procured from non-CPCL suppliers) as liquid petroleum gas (LPG) in the open market. The company had constructed a new pipeline for CPCL in FY2017 for additional feedstock procurement to reduce the under-recoveries. Nonetheless, the operating margin in FY2019 was adversely impacted due to shutdown undertaken by CPCL in Q3 FY2019 and lower-than-expected supply from the new pipelines. The impact was, however, partly mitigated by the company's cost control measures, such as power generation through captive power plant; implementation of effluent water treatment infrastructure is expected to provide further cost savings. The ratings also consider KPL's well-established customer base, which includes major lubricant manufacturers in domestic and export markets.

ICRA notes that the healthy improvement in revenues in FY2019 was supported by increased off-take from key major customers and improvement in sales realisation. ICRA also notes KPL's efforts to develop new products like high-reactive PIB (HR-PIB) as well as target new customer segments like masterbatch manufacturers, which are expected to drive growth and provide diversification benefits. The translation of these initiatives into actual improvement in financial performance remains to be seen. However, the ratings continue to draw comfort from KPL's favourable financial risk profile, characterised by low gearing and adequate debt protection metrics.

The ratings are, however, constrained by KPL's vulnerability to commodity price cycles, forex fluctuations and import duty levels, as demonstrated by its volatile profitability metrics in the past. ICRA also notes the moderate cost competitiveness arising from the limited integration across the petrochemical value chain with moderate capacities. The ratings further consider the subdued market outlook for two-stroke (2T) oils in the medium to long term, where PIB finds major applications as an additive; although, the near-term outlook is stable. It would, hence, be imperative for KPL to currently diversify its clientele based on end applications. Moreover, ICRA notes the directive from the Ministry of Petroleum and Natural Gas (MoPNG), Government of India, stating that domestically-produced LPG should only be supplied to state-owned oil manufacturing companies (OMCs). The directive did not impact KPL in the last few years, since it uses feedstock for manufacturing purpose and not for marketing of LPG. If the directive is implemented for KPL, there might be some negative impact on feedstock availability and margins. This remains a key rating sensitivity.

Outlook: Stable

ICRA expects KPL to continue to benefit from its extensive experience and dominant market share in the PIB segment in the country. ICRA also expects the different cost control avenues undertaken to support its profitability. The outlook may be revised to Positive if substantial growth in revenue and profitability, and better working capital management strengthen the financial risk profile. The outlook may be revised to Negative if cash accrual is lower than expected, or if lower offtake from customers, impacting sales growth, weakens liquidity.

Key rating drivers

Credit strengths

Established position as largest PIB manufacturer in India - KPL enjoys a dominant position in the PIB segment with an annual production capacity of 22,000 MT. The company also benefits from decreased competition from domestic competitors due to constrained availability of raw materials, which had adversely impacted their operations. However, KPL faces competition from well-established international manufacturers, such as Daelim Corporation and BASF SE. Currently, KPL meets 60-70% of the total domestic demand. It also sells LPG and light polymers to parallel marketers. The company has diversified its revenue stream into different product categories (such as HR PIB, high molecular weight PIB and different grade variants from main grade PIB products), which will provide both customer and business diversification benefits in the medium to long term. However, revenue contribution from the same remains modest at present.

Diversified customer base with major oil marketing companies and lubricant manufacturers from domestic and exports markets - The company caters to reputed customers. Its clientele comprises major lubricant manufacturers and 2T lube oil producers, including Lubrizol India Limited, Hindustan Petroleum Corporation Limited (HPCL), Bharat Petroleum Corporation Limited (BPCL) and Indian Oil Corporation Limited (IOCL), etc, in the domestic market, and Infineum Singapore PTE Limited in the overseas market. The orders are a mix of long-term contracts and tender-based orders (mainly for public sector units). KPL receives repeat orders from several of its customers and faces moderately high customer concentration risk, with its top five customers accounting for 50-70% of sales during the last few years. In FY2019, KPL witnessed strong growth in sales on account of increased off-take from key customers (such as Lubrizol India Limited, Infineum Singapore PTE Limited, BPCL and IOCL). The revenue growth in the near term is expected to be healthy.

Diversified supplier base mitigates risks related to raw material procurement - Raw material availability is a major risk for the industry and some of the company's competitors witnessed production shutdown due to constrained raw material supply. KPL has, however, demonstrated its ability to sustain operations by procuring raw materials from diversified suppliers in the last few years. While ~30-50% of its requirement was met from CPCL, it met its pending requirements from companies like Haldia Petrochemicals Limited (HPL) and Reliance Industries Limited (RIL). It added other suppliers like Vinati Organics Limited and IOCL, Panipat, when supply from the erstwhile (non-CPCL) suppliers was constrained. Nonetheless, while the residual feedstock from CPCL was sent back through pipeline, the company had to sell the residual LPG at a loss, for feedstock procured from other suppliers. In FY2017, KPL incurred capex to increase the feedstock procurement from CPCL, which led to lower residual-LPG related losses in FY2018, leading to significant improvement in margins. However, owing to procurement issues in FY2019 (due to CPCL's maintenance shutdown in Q3 FY2019 and lower-than-expected supply during the year), the procurement from RIL increased, which led to upsurge in under-recoveries in 9M FY2019. The company currently meets ~45-50% of its feedstock requirement from CPCL and the remaining from RIL.

Capital structure characterised by healthy gearing and comfortable coverage indicators - KPL's capital structure is characterised by low gearing and comfortable coverage indicators. The gearing witnessed modest improvement to 0.4 time as on March 31, 2018 from 0.5 time as on March 31, 2017, with improvement in accretion to reserves supported by profitability improvement. The gearing remained healthy as on December 31, 2018, despite increase in working capital borrowing, due to healthy accretion to reserves during the period. Going ahead, scheduled repayment of term loans (borrowed for funding capex towards setting up the power plant) and lack of any debt-funded capex plans are expected to result in incremental improvement in capital structure. The coverage indicators also remained healthy with TD/OPBDIT and interest coverage of 1.9 times and 12.5 times, respectively, in FY2018 compared to 2.8 times and 8.1 times, respectively, in FY2017.

Cost control measures to provide cost savings - The company had incurred ~Rs. 26.3-crore capex for setting up a co-generation 2-MW power plant in FY2018. The plant commenced operations from January 2018 and has provided some cost saving benefits. The company also incurred moderate capex in FY2019 for constructing water effluent treatment infrastructure, which would result in further cost savings.

Credit challenges

Margins vulnerable to commodity price cycles, especially spread between PIB and LPG/C4 rich feedstock - PIB being a commodity chemical, its prices move mainly in line with the international demand-supply scenario and are subject to considerable volatility, depending on crude oil price movements. KPL has generally two types of sales arrangements - relatively long-term contract/tender-based supply and spot market sales. On account of the volatilities witnessed in the prices of the major raw material (which is linked to LPG prices), KPL primarily has a formula-based pricing mechanism for its long-term agreements to better insulate its profit margins. Most of KPL's sales are on contract/tender-basis with product delivery spread over relatively long periods. In such cases, the PIB prices are linked to the underlying prices of either LPG or naphtha. For spot market sales, KPL notifies its selling prices on a monthly basis, once its suppliers fix their prices.

Although margins on PIB sales are protected to some extent by formula-linked pricing, the company has to dispose of the balance un-reacted feedstock from non-CPCL suppliers in the market, as returning the balance feedstock would not be economical due to high freight cost involved. The company incurs loss on such disposal, which adversely impacts margins as the case in 9M FY2019. The margins also remain vulnerable to commodity price cycles (especially the spread between PIB and LPG/C4 rich feedstock), forex fluctuations and import duty levels.

Potential restriction on sale of indigenously-produced LPG to parallel marketers; however, no near-term impact expected - The MoPNG periodically directs gas-producing companies (both state-owned as well as private) to sell indigenously-produced LPG only to state-owned OMCs. If this directive is implemented for KPL, there would be an adverse impact on raw material availability and its margins. However, ICRA notes that despite the directive being in place for some years, the same has not been implemented by KPL's suppliers; the developments on this front will be monitored.

Declining demand prospects for 2T oils over medium to long term - PIB currently finds major application in the lubricant manufacturing sector and as an additive in 2T oils, which are facing declining demand prospects in the medium to long term; although, the same are expected to remain stable or witness marginal growth in the near term. KPL is trying to mitigate the risk by trying to diversify its end-customer segments and has started catering to masterbatch manufacturers. It is also trying to develop new products, like HR PIB. However, the translation of these efforts into improved performance remains to be seen.

Liquidity position

The liquidity remains adequate due to healthy cash accruals. Cash and bank balances, along with undrawn working capital facilities, are expected to remain sufficient to overcome repayment obligations.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	Not applicable.
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the standalone financials of KPL.

About the company

Kothari Petrochemicals Limited is the largest manufacturer of PIB in the country, with an installed manufacturing capacity of 22,000 TPA. The company also sells LPG, a by-product of the PIB manufacturing process, to parallel marketers of LPG. KPL is a part of the HC Kothari Group, based in Chennai. The promoter Group's shareholding in KPL was 70.97% as on December 31, 2018.

KPL was established in 1989, with a manufacturing unit for caustic soda. This unit was set up as a backward integration initiative for the nitro chloro benzene (NCB) business of Kothari Sugars and Chemicals Limited (KSCL). The promoters eventually sold off its chlor-alkali unit in Karaikal, Pondicherry, to Chemplast Sanmar Limited. Post this, KPL remained a shell company without any significant business interests, except marginal trading operations. With effect from April 1, 2006, KPL was merged with Primetra Technologies Private Limited (PTPL), a Group company involved in PIB manufacturing. With the merger, PIB became KPL's major business line. KPL has a plant in Manali (Tamil Nadu), located adjacent to the CPCL refinery. Using raw material input from CPCL, HPL, and the Hazira plant (Gujarat) of RIL, it manufactures PIB of varying grades with specific applications in lube oil, plastic, paint and rubber industries. Earlier, the company used to procure raw materials from the Panipat plant (Haryana) of IOCL and Vinati Organics Limited. LPG is both a raw material and by-product of the manufacturing process of PIB. The leftover LPG is sold by KPL to various parallel marketers of LPG on an ex-works basis. KPL also sells light polymers, by-products of the PIB manufacturing process.

In FY2018, the company reported a net profit of Rs. 9.6 crore on an operating income of Rs. 194.7 crore, compared to a net profit of Rs. 5.8 crore on an operating income of Rs. 219.8 crore in the previous year.

Key financial indicators (audited)

	FY2017	FY2018	6M FY2019*
Operating Income (Rs. crore)	219.8	194.7	156.8
PAT (Rs. crore)	5.8	9.6	7.2
OPBDIT/ OI (%)	5.6%	9.1%	8.4%
RoCE (%)	12.0%	14.1%	19.9%
Total Debt/ TNW (times)	0.5	0.4	0.5
Total Debt/ OPBDIT (times)	2.8	1.9	1.5
Interest Coverage (times)	8.1	12.5	8.2

*Provisional financials

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

Instrument	Type	Current Rating (FY2020)			Chronology of Rating History for the past 3 years			
		Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating May 2019	Date & Rating in FY2019 Apr 2018	Date & Rating in FY2018 May 2017	Date & Rating in FY2017 Apr 2016	
1 Term loans	Long Term	15.00	15.00	[ICRA]A-(Stable)	[ICRA]A-(Stable)	[ICRA]A-(Stable)	-	
2 Fund-based facilities	Long Term	25.00	25.00	[ICRA]A-(Stable)	[ICRA]A-(Stable)	[ICRA]A-(Stable)	[ICRA]A-(Stable)	
3 Non-fund based facilities	Short Term	15.00	15.00	[ICRA]A2+	[ICRA]A2+	[ICRA]A2	[ICRA]A2	

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

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	23-Feb-17	9.25%	FY2021	15.00	[ICRA]A-(Stable)
NA	Cash Credit	NA	NA	NA	25.00	[ICRA]A-(Stable)
NA	Bank Guarantee	NA	NA	NA	15.00	[ICRA]A2+

Source: Kothari Petrochemicals Limited

ANALYST CONTACTS

K. Ravichandran

+91 4445964301

ravichandran@icraindia.com

Prashant Vasisht

0 124 454 5322

prashant.vasisht@icraindia.com

Sai Krishna

+91 4445964300

sai.krishna@icraindia.com

Abhishwet Dhete

+91 4442974312

abhishwet.dhete@icraindia.com

RELATIONSHIP CONTACT

Jayanta Chatterjee

+91 80 4332 6401

jayantac@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani

Tel: +91 124 4545 860

communications@icraindia.com

Helpline for business queries:

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

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.

For more information, visit www.icra.in

ICRA Limited

Corporate Office

Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002

Tel: +91 124 4545300

Email: info@icraindia.com

Website: www.icra.in

Registered Office

1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001

Tel: +91 11 23357940-50

Branches

Mumbai + (91 22) 24331046/53/62/74/86/87

Chennai + (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,

Kolkata + (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008,

Bangalore + (91 80) 2559 7401/4049

Ahmedabad+ (91 79) 2658 4924/5049/2008

Hyderabad + (91 40) 2373 5061/7251

Pune + (91 20) 2556 0194/ 6606 9999

© Copyright, 2019 ICRA Limited. All Rights Reserved.

Contents may be used freely with due acknowledgement to ICRA.

ICRA ratings should not be treated as recommendation to buy, sell or hold the rated debt instruments. ICRA ratings are subject to a process of surveillance, which may lead to revision in ratings. An ICRA rating is a symbolic indicator of ICRA's current opinion on the relative capability of the issuer concerned to timely service debts and obligations, with reference to the instrument rated. Please visit our website www.icra.in or contact any ICRA office for the latest information on ICRA ratings outstanding. All information contained herein has been obtained by ICRA from sources believed by it to be accurate and reliable, including the rated issuer. ICRA however has not conducted any audit of the rated issuer or of the information provided by it. While reasonable care has been taken to ensure that the information herein is true, such information is provided 'as is' without any warranty of any kind, and ICRA in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness or completeness of any such information. Also, ICRA or any of its group companies may have provided services other than rating to the issuer rated. All information contained herein must be construed solely as statements of opinion, and ICRA shall not be liable for any losses incurred by users from any use of this publication or its contents