August 30, 2019

West Coast Paper Mills Limited: [ICRA]AA-(Stable) rating assigned

Summary of rating action

Instrument*	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible Debenture Programme	600.00	[ICRA]AA-(Stable); Assigned
Total	**600.00**	

**Instrument details are provided in Annexure-1*

Rationale

The long-term rating takes into consideration West Coast Paper Mills Limited's (WCPL) strong market position in the domestic writing and printing paper industry, technical capabilities in manufacturing a wide variety of wood free paper, cupstocks, special grade papers etc and an integrated nature of operations with an adequate in-house capacity to manufacture virgin pulp, and availability of captive power plants. The integrated operations along with its large scale help the company maintain cost competitiveness vis-a-vis its domestic peers and provide some resilience to price shocks. While assigning the rating, ICRA has factored in WCPL's proposed acquisition of International Paper APPM Limited (IPAPPML). With plans of merging the acquired entity, subject to necessary approvals, ICRA has considered the likely future performance of the merged entity while arriving at the rating. While WCPL's capital structure is conservative and debt coverage indicators are strong at present, the proposed debt-funded acquisition of IPAPPML would result in a deterioration in capital structure and moderation of debt coverage indicators at the standalone level. Nonetheless, on a consolidated basis, capital structure and debt coverage indicators would remain strong given the debt free status of IPAPPML at present and healthy profitability of its operations. ICRA also takes into cognisance the likely synergies between the two companies and their complimentary product portfolios.

The above strengths are, however, partially offset by the cyclicality inherent in the paper industry, resulting in fluctuations in profitability and cash flows of paper manufacturing companies including WCPL. Also, with imports accounting for a substantial portion of the domestic demand, prices in India are largely determined by international trends. Global paper prices have witnessed an upturn in the last two years or so, leading to an improvement in the profitability of players in the paper business. However, prices are likely to witness some moderation, going forward, because of concerns on the global macroeconomic health. Lower realisation is likely to result in a decline in operating profit margin of the industry. Nevertheless, an improving sales mix with a higher proportion of premium products is likely to support WCPL's margins at a healthy level. Notwithstanding the near-term uncertainties, the long-term demand-supply outlook for paper in India remains favourable because of a low per-capita consumption of paper in domestic markets compared to global standards, the Government of India's focus in the education sector, and limited incremental supply in the near term.

The rating also considers the raw material price risks in the paper manufacturing business because of environmental regulations on availability and industrial usage of wood and water, which are two critical inputs in the manufacturing process. ICRA notes that domestic availability of wood has improved due to adequate plantations in the last few years, which in turn has resulted in a steady decrease in WCPL's consumption of imported woods at high costs. Moreover, WCPL's paper manufacturing unit is in proximity to river Kali, which provides adequate supply of water to the plant. Over the years, WCPL has undertaken numerous technological initiatives, which resulted in a decrease in water consumption per unit of paper produced. Moreover, IPAPPML undertakes large and regular plantations, which would provide adequate raw material security at competitive cost to the merged entity, going forward.

Timely completion of the merger and realisation of business synergies would be important for servicing the acquisition debt comfortably and is therefore a key rating sensitivity. Also, any sizeable capex in IPAPPML, post-acquisition, would have a bearing on the cash flows of the company. Nonetheless, ICRA expects consolidated cash flows to remain strong relative to debt service obligations, even under a scenario of lower profitability than the current levels.

Key rating drivers and their description

Credit strengths

Strong market position in domestic writing and printing paper industry – WCPL has developed a strong market position in the domestic writing and printing paper industry because of its long presence in the industry, extensive dealer network across the country and the technical capability to manufacture a wide variety of writing paper, cupstocks and specialised paper.

Integrated nature of operations with adequate pulp manufacturing capacity and captive power plants – WCPL has an integrated manufacturing set-up with an adequate in-house capacity to manufacture pulp and captive power plants. Moreover, the integrated operations help the company recover a substantial portion of chemicals used in the manufacturing process and generate energy from waste, which in turn results in a competitive cost structure vis-a-vis domestic peers.

Sustained improvement in contribution margin because of improved realisation and competitive cost of production – WCPL's contribution margin in the paper business has witnessed a sustained improvement in the last five years because of favourable prices as well as steady reduction in cost of production. An increase in proportion of wood procured in domestic markets, coupled with a higher proportion of value-added products have benefitted the margins. In FY2019, WCPL's operating margin increased to ~26.5% from ~21.5% in FY2018. Similarly, IPAPPML's operating margin improved to ~26.6% in FY2019 from ~17.9% registered in FY2018.

Acquisition of IPAPPML to improve scale of operation and market presence – WCPL's proposed acquisition of IPAPPML would help the company increase its market presence in terms of a wider product reach, operational synergy and lead to a higher scale. A higher scale may help in further reduction of costs, going forward.

Favourable outlook for domestic paper demand– Long-term demand outlook for paper in the domestic market remains favourable as a result of its low per-capita usage as on date compared to global standards. The Government of India's focus in the education sector and substitution of plastic products with paper are two of the positive demand drivers for increased usage of paper.

Credit challenges

Debt-funded acquisition to temporarily result in deterioration of standalone capital structure and debt coverage indicators– WCPL's debt-funded acquisition of IPAPPML would result in a deterioration of the company's capital structure and debt coverage indicators in the near term. Nonetheless, on a consolidated basis, capital structure and debt coverage indicators would continue to remain strong given the debt-free status of IPAPPML at present and healthy profitability of its operations. Moreover, the additional cash accruals from IPAPPML's existing paper business are likely to offset the acquisition debt in the near to medium term. While no further capex is envisaged in IPAPPML, any large outflow for capex, contrary to expectations would have an impact on the capital structure and debt coverage indicators.

Exposure of cash flows to cyclicality in paper industry – WCPL's cash flows are exposed to the cyclicality in the paper industry. The domestic paper industry is small compared to the global scale and prices in India are largely determined by the international trends. Hence, global demand-supply balance impacts the health of the domestic industry.

Status of being a price taker as domestic paper prices are largely determined by international trends – Domestic paper prices are largely determined by international trends. Hence WCPL is a price taker in the industry despite its large market share.

Liquidity position: Strong

WCPL's liquidity is **strong** with healthy annual cash flow from operations of nearly Rs. 280-340 crore, a liquid investment balance of Rs. 220 crore as on March 31, 2019 and moderate working capital limit utilisation levels of around 50%. Moreover, the company has already tied up the required debt for acquisition of IPAPPML and a capex commitment of ~Rs. 75 crore for the current financial year. Year to date, WCPL has already met a significant portion of its debt repayment liabilities for FY2020 and repayment liabilities for the balance year are low. In FY2021, the company would have repayment commitments of ~Rs. 100 crore. From FY2022, debt repayment is likely to increase depending on the maturity profile of the acquisition debt. Overall, ICRA expects WCPL to be able to comfortably meet its near-term commitments through internal accruals and yet be left with sufficient cash surpluses.

Rating sensitivities

Positive triggers – ICRA could upgrade WCPL's rating if the consolidated RoCE remains above 20% on a sustained basis given the cyclical nature of the business. Also, the debt service indicators need to be sustained at the current level.

Negative triggers – Negative pressure on WCPL's rating could arise if the company fails to complete the merger with IPAPPML before the onset of large repayments and achieve desired benefits of the acquisition. Any large capex in the acquired plant, or cash outflows in IPAPPML due to operational challenges post-acquisition and / or any fund infusion into any other Group companies of WCPL could also be areas of concerns.

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 consolidated financial profile of the company. As on March 31, 2019, the company had one operating subsidiary that is enlisted in Annexure 2. ICRA's base case also assumes that the acquisition of IPAPPML is completed in the current financial year and for the projected numbers, the consolidated financials, including that with IPAPPML, have been considered.

About the company

Incorporated in 1955, West Coast Paper Mills Limited (WCPL) is the flagship entity of the Kolkata-based S K Bangur Group. WCPL manufactures writing and printing papers, cupstocks etc at its 3.2-lakh-metric-tonne-per-annum (mtpa) paper manufacturing plant located in Dandeli, Karnataka. The company is backward integrated with 2.47 lakh mtpa in-house pulp production capacity and 75 MW of captive power plants. WCPL sells its products across India through its dealer network. The company has recently entered into a share purchase agreement and made an open offer to acquire a majority stake in International Paper APPM Limited.

As per provisional results, in Q1 FY2020, WCPL reported a profit after tax of Rs. 102.1 crore on an operating income of Rs. 535.3 crore. In FY2019, the company reported a consolidated net profit of Rs. 296 crore on an operating income of Rs. 1,985.6 crore.

Key financial indicators (standalone, audited)

	FY2018	FY2019
Operating Income (Rs. crore)	1716.4	1985.6
PAT (Rs. crore)	223.2	296.0
OPBDIT/OI (%)	21.54%	26.56%
RoCE (%)	23.29%	27.55%
Total Outside Liabilities/Tangible Net Worth (times)	0.9	0.7
Total Debt/OPBDIT (times)	0.9	0.7
Interest Coverage (times)	8.7	18.2
DSCR	2.0	5.1

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2020)				Rating History for the Past 3 Years		
		Type	Amount Rated	Amount Outstanding	Rating	FY2019	FY2018	FY2017
					Aug-2019			
1	NCD	Long Term	600.0	0.0	[ICRA]AA- (Stable)	NA	NA	NA

Amount in Rs. crore

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 click here

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
	NCD[1]	NA	NA	NA	600.00	[ICRA]AA- (Stable)

Source: West Coast Paper Mills Limited

Annexure-2: List of entities considered for consolidated analysis[2]

Company Name	Ownership	Consolidation Approach
West Coast Opticables Limited	100.00%	Full Consolidation

[1] Yet to be placed

[2] Assuming merger of IPAPPML into WCPL post-acquisition in FY2020

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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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