

October 23, 2019

West Coast Paper Mills Ltd.: [ICRA]AA- (Stable)/A1+ ratings assigned; NCD limits reduced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible Debenture Programme	600.00	200.00	[ICRA]AA-(Stable) Reaffirmed; Rated amount reduced
Term Loan		245.00	[ICRA]AA-(Stable); Assigned
Fund-based/Non-Fund based Working Capital Facilities		105.00	[ICRA]AA-(Stable)/A1+; Assigned
Commercial Paper		50.00	[ICRA]A1+; Assigned
Total	600.00	600.00	

*Instrument details are provided in Annexure-1

Rationale

The assigned ratings take into consideration West Coast Paper Mills Ltd. (WCPL)'s 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 integrated nature of operations with adequate inhouse capacity to manufacture virgin pulp, and availability of captive power plants. The integrated operations along with its large scale helps 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 ongoing acquisition process of International Paper APPM Limited (IPAPPML). With plans of merging the acquired entity, post-acquisition, 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 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 cyclicity inherent in the paper industry, resulting in fluctuations in the profitability and cashflows 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. International paper prices have witnessed an upturn in the last two years or so, thus leading to an improvement in the profitability of players in the paper business. However, prices are likely to witness some moderation, going forward, as a result of concerns on the global macroeconomic health. Lower realisation is likely to result in a decline in WCPL's operating profit margin. Nevertheless, an improving sales mix with a higher proportion of premium products is likely to support margins at a healthy level. Notwithstanding the near-term uncertainties, the long-term demand outlook for paper in India remains favourable as a result of a low per capita consumption of paper domestically as compared to global standards and the Government of India's focus in the educational sector.

The rating also takes into account the raw material risks in the paper manufacturing business as a result of the environmental regulations on availability and industrial usage of wood and water, which are two of the 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 close proximity to river Kali, which provides adequate supply of water to the plant. Over the years WCPL has undertaken numerous technological initiatives, which has 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 to the merged entity, going forward.

Timely completion of the merger and realisation of business synergies would be critical 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 cashflows of the company. Nonetheless, ICRA expects consolidated cashflows 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 the domestic writing and printing paper industry – WCPL has developed a strong market position in the domestic writing and printing paper industry by virtue 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 specialized paper.

Integrated nature of operations with adequate pulp manufacturing capacity and captive power plants – WCPL has an integrated manufacturing set up with adequate inhouse 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 as a result 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 as a result of favourable prices as well as steady reduction in cost of production. An increase in proportion of wood procured domestically, coupled with a higher proportion of value-added products have benefitted the margins. During 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 International Paper APPM Limited to improve scale of operation and market presence – WCPL's ongoing acquisition process 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 as a result of low per capita consumption in the country as compared to global standards – Long term demand outlook for paper in the domestic market remains favourable as a result of its low per capita usage as on date as 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 a 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 is 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 of capital structure and debt coverage indicators.

Exposure of cash flows to the cyclicity in the paper industry– WCPL's cash flows are exposed to the cyclicity in the paper industry. The domestic paper industry is small as compared to the global scale and prices in India are largely determined by the international trends. Hence, global demand supply balance impacts the healthy 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 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 for the balance year repayment liabilities 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 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 concern.

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 purpose of projected numbers the consolidated financials including that with IPAPPML has been considered.

About the company

Incorporated in 1955, West Coast Paper Mills Limited (WCPL) is the flagship entity of the S K Bangur group, based out of Kolkata. WCPL is engaged in manufacturing writing and printing papers, cupstocks, etc from its 3.2 lakhs metric tonne per annum paper manufacturing plant located in Dandeli, Karnataka. The company is backward integrated with 2.47 lakh metric tonne per annum in house pulp production capacity and 75 MW of captive power plants. WCPL sales 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, during Q1 FY2020, WCPL reported a profit after tax of Rs 102.1 crore on an operating income of Rs 535.3 crore. During FY2019, the company reported a consolidated net profit of Rs. 296 crore on an operating income of Rs. 1985.6 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	Rating	FY2019	FY2018	FY2017
					23-Oct-2019	30-Aug-2019			
1	NCD	Long Term	200.0	198.00	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	NA	NA	NA
2	Term Loan	Long Term	245.00	245.00	[ICRA]AA-(Stable)				
3	Fund-based/Non-Fund based Working Capital Limits	Long Term/Short Term	105.00	-	[ICRA]AA-(Stable)/A1+				
4	Commercial Paper	Short Term	50.00	-	[ICRA] A1+				

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 www.icra.in

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE976A07028	NCD	18/20/2019	10.30%	18/10/2024	198.00	[ICRA]AA- (Stable)
NA	NCD ¹	-	-	-	2.00	[ICRA]AA- (Stable)
NA	Term Loan	FY2020	6M MCLR + 0.65%	FY2025	100.00	[ICRA]AA- (Stable)
NA	Term Loan	FY2020	10.20%	FY2025	145.00	[ICRA]AA- (Stable)
NA	Fund-based/Non-Fund based Working Capital Limits	-	-	-	105.00	[ICRA]AA- (Stable)/A1+
NA	Commercial Paper ¹	-	-	-	50.00	[ICRA] A1+

Source: West Coast Paper Mills Ltd.

Annexure-2: List of entities considered for consolidated analysis²

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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