May 17, 2019

Thirumalai Chemicals Limited: Ratings reaffirmed; rated amount enhanced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term Loans	-	200.00	[ICRA]A+ (Stable); Assigned
Long-term; Fund-based facilities	208.20	208.20	[ICRA]A+ (Stable); Reaffirmed
Short-term; Non-fund based facilities	407.40	407.00	[ICRA]A1+; Reaffirmed
Long-term / Short-term; Unallocated	9.40	9.40	[ICRA]A+ (Stable) / [ICRA]A1+; Reaffirmed
Total	**625.00**	**825.00**	

*Instrument details are provided in Annexure-1

Rationale

The rating reaffirmation considers the established track record and the strong market position of Thirumalai Chemicals Limited (TCL) in the Phthalic Anhydride (PAN) market and the increase in contribution from downstream derivative products such as esters and food acids, which have lent significant diversity to demand and revenue. ICRA takes note that after witnessing healthy revenue growth and margin improvement, aided by robust demand, favourable PAN-Orthoxylene (OX) spreads and reduction in production lead time, the revenue witnessed some moderation in FY2019. The profit margin too experienced steep contraction, mainly because of slowdown in demand and steep moderation in PAN-OX spreads in H2FY2019, which had witnessed healthy expansion during FY2017 to FY2018. The demand slowdown can partly be attributable to volatility in oil prices, while the contraction PAN-OX spreads was because of market correction and moderation in supply of OX due to higher demand for other derivatives of xylene stream. Nonetheless, the demand recovered and the margin improved in Q4FY2019, although it remained lower than the highs witnessed in the preceding fiscal and H1FY2019. The improving trend continued in the current fiscal. The Malaysian subsidiary of the company, Optimistic Organic SDN BHD (OOSB), witnessed some moderation in FY2019 due to unplanned shutdowns, although the performance remained healthy. OOSB had witnessed turnaround in recent years driven by driven by a shift to cheaper raw material, capacity expansion and increase in realisations of Maleic Anhydride (MAN). The moderation in the subsidiary's profit coupled with the standalone entity performance resulted in some moderation in performance of the consolidated entity.

The ratings also factor in the ongoing capacity expenditure programme being incurred by the company towards modernisation of the existing facilities, expansion of established capacities and establishment of a greenfield PAN plant in Dahej, Gujarat. The modernisation capex will improve the cost structure and TCL's ability to withstand volatility in PAN-OX spreads, whereas the increased capacity would help to maintain its market position. ICRA notes that there has been some upward increase in the capex estimates for the project and while, earlier the scheduled capex programme was planned to be entirely funded through internal accruals, the company now plans to avail Rs 200.0 crore term loans for the project, which includes reimbursement of capex already incurred for the project. ICRA notes that healthy cash accruals in the last few years had led to steep improvement in the capital structure and coverage indicators, which despite the moderation in profit margins in FY2019 remain healthy. Going forward, despite the debt-funded capex and the moderation in profitability compared to FY2018 levels, the credit metrics and liquidity position are expected to remain comfortable. Nonetheless, any large additional debt-funded capital expenditure remains a rating sensitivity factor.

The ratings remain constrained by the susceptibility of the financial performance to volatility in PAN-OX spreads, which are dependent on crude price levels, cyclicality in demand from end-user industries and competition from imports. Further, the domestic industry also remains vulnerable to changes in duty structure; moreover, competition from imports may intensify as some of the trade protection benefits enjoyed by the industry in past few years have not been renewed. Nonetheless, ICRA notes that the company's ability to withstand the above-mentioned risks are better due to improvement in financial risk profile and other initiatives taken by the company.

Outlook: Stable

ICRA believes TCL's credit profile will remain healthy supported by product demand, established market position, and healthy capital structure. The outlook may be revised to Positive if there is significant improvement in the company's cash accruals, following significant recovery in profitability. The outlook may be revised to Negative if TCL's financial profile weakens further due to lower cash accruals on account of significant drop in margins from current levels; or if higher-than-expected debt-funded capex or stretch in working capital cycle leads to pressure on capital structure.

Key rating drivers

Credit strengths

Established operating track record and market position in Phthalic Anhydride (PAN) industry – TCL is the second largest player with a significant market share in the domestic phthalic anhydride industry, which is in effect a duopoly. The company's three decades of experience has resulted in established relationship with clients in key end-user industries such as plasticizers, paints and pigments. TCL also has a longstanding relationship with Reliance Industries Limited, the supplier of raw material, Orthoxylene (OX), and operates on an assured offtake model.

Sharp increase in profitability post 2016; although moderation witnessed in FY2019 – TCL's PAN profitability is directly dependant on the spread between the price of PAN and that of OX given that OX makes up ~80% of the production cost. Orthoxylene, being a crude derivative, its price has declined in line with the sharp reduction in the crude prices in the past few years preceding FY2019. The PAN prices, however, had remained high during this period given the moderately strong demand from end-use markets such as plasticizers and paints as well as the tight supply of the product in Asia, following closure of some capacities in China because of the country's recent environment protection drive. Hence, the PAN-OX spread had widened substantially from 2016, resulting in healthy operating profitability in FY2017 and FY2018. However, in Q3FY2019 demand slowdown for PAN, due to buyers delaying purchase decision given the volatility in oil markets, impacted the volumes and moderated the PAN-OX spreads, which can be partly attributed to impact on OX

prices due to supply constraints arising from increased demand for other products from xylene stream. While, there was some recovery in demand margin in Q4 FY2019, it remained lower than earlier levels, thereby moderating revenue and profit margin during FY2019.

Diversification into other related chemicals; turnaround of Malaysian operations – The company produces phthalate esters and food acids, which are downstream derivatives; the contribution of these products have grown over the years given the improving demand in the market. Maleic Anhydride (MAN) operations at the Malaysian subsidiary, OOSB, had also turned around driven by increase in capacity utilisation and product realisations. However, in FY2019, there was some moderation in the financial performance due to some unplanned shutdowns, although the production has now been stabilised. With an increase in revenue and profit share of these products, the business risk of TCL stands moderately diversified.

Healthy financial risk profile– Due to healthy cash accruals of the standalone entity, the company has repaid its borrowings and was debt free in FY2017 and FY2018. The company availed a bridge loan of Rs. 50.0 crore in FY2019, which will be later refinanced by the proposed term loan of Rs. 200.0 crore, to avail capex funding, including reimbursement of capex already incurred on the ongoing projects. There has also been some upward revision in capex estimates for the ongoing projects. At the consolidated level also, the debt levels are modest compared to the net worth. Additionally, the debt of the Malaysian subsidiary is expected to be serviced from its own cash flows, given the improved profitability. Despite the moderation in profitability and debt funding of capex, which was earlier planned to be funded through internal sources, the credit metrics are expected to remain comfortable.

Expansion/modernisation of capacity of various product lines – The company is undertaking a large capital expenditure programme to modernise the Ranipet PAN, enhance the derivatives capacity, and set up a greenfield PAN/ derivatives project in Dahej, Gujarat. These initiatives would help the company to maintain its market position and improve its competitiveness, given that the greenfield project is located near the supplier, majority of existing customers and a potentially large export market, the Middle East.

Credit challenges

Presence in commodity chemical industry limits pricing flexibility – Limited product differentiation and large volumes of inter-regional trade of PAN have resulted in TCL's realisations being influenced by the overall demand-supply dynamics in the region. The key end-user industries of the product are plasticizers, paints & pigments, which are mainly used in the construction and automobile sectors and hence the demand is based on broader economic conditions. With regard to the supply, the market dynamics change significantly based on the production and consumption in key markets such as China, Korea and South East Asia. Hence, even though TCL has long-to medium-term contracts with a large number of its customers, the product realisations are volatile.

Increase in competitive intensity due to higher import volume – Imports of PAN into India increased to 1,30,440 MT in FY2018 (Source: DGFT) from 52,350 MT in FY2015 mainly driven by the increase in consumption, which is higher than the production of the domestic industry. The increase in imports was in spite of the anti-dumping duties (ADD) imposed in 2012 on producers from countries such as Korea and Taiwan. In September 2018, the Director General of Trade Remedies recommended discontinuation of the ADD and this could result in higher imports in the long term.

Though Indian manufacturers are currently more competitive than other Asian exporters, any sudden change in the consumption trends in other countries in the region would result in more import volumes in India and impact the PAN pricing and margins. Hence, the business remains susceptible to any significant regulatory changes.

Raw material price volatility impacts product demand and margins – The price of orthoxylene has remained highly volatile in the past, depending on crude price as well as demand trends for other products from xylene stream. The company's product demand as well as its working capital intensity are impacted during periods of high OX prices. In H2FY2019, the moderation in PAN-OX consequently eroded the company's profitability. The company has, however, rationalised its production lead time and inventory management, strengthening its ability to pass on OX price changes to its customers.

Project risks with regards to new capacities being set up – TCL's large ongoing capital expenditure is aimed at enhancing the production capacities of its various products. Timely commissioning of these projects, without major cost overruns, and early stabilisation of the capacities would be critical to achieve growth. The company also has significant long-term capacity expansion plans for its new products; however, these plans are currently in the incipient stage and the nature and funding plan for the same would determine the long-term credit profile.

Liquidity position:

The company's liquidity position is supported by strong cash accruals (despite moderation in profitability), unutilised working capital funds and healthy cash and investments of ~Rs. 93.0 crore. The proposed term loans will also provide liquidity support in the near term as they are expected to have a repayment tenure of seven years, including a two-year moratorium.

Analytical approach:

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for entities in the Chemical Industry
Parent/Group Support	Not applicable
Consolidation / Standalone	Consolidated

About the company:

TCL started its operations in 1976 at Ranipet in Tamil Nadu as a single product petrochemical company manufacturing Phthalic Anhydride, with a production capacity of 6000 TPA. The company is part of the Thirumalai Group, which has business interests in chemicals, surfactants, pigments and education. Over the years, the company has expanded the PAN manufacturing capacity to ~145000 TPA and has also added other products to its portfolio, which includes food additives such as Malic Acid and Fumaric Acid; PAN derivatives such as Di-ethyl Phthlate (DEP) and Pthalimide (PID), and caters to customers in construction, auto, paint, food, personal care and pharma industries. The company has developed low energy process, which enables it to meet ~90% of its power requirements through waste heat recovery.

The company also has a Maleic Anhydride manufacturing facility in Malaysia, under its step-down subsidiary, Optimistic Organic Sdn. Bhd. (OOSB).

The company, on a standalone basis, reported an operating income of Rs 994.3 crore and a net profit of Rs 96.1 crore in FY2019 against an operating income of Rs 1011.6 crore and a net profit of Rs 144.0 crore in FY2018. At the consolidated level, the company reported an operating income of Rs. 1261.0 crore and a net profit of Rs. 113.6 crore in FY2019 compared to Rs, 1312.0 crore and Rs. 170.4 crore in FY2018.

Key financial indicators (audited) - Consolidated

	FY2018	FY2019
Operating Income (Rs. crore)	1312.0	1261.0
PAT (Rs. crore)	170.4	113.6
OPBDIT/OI (%)	22.6%	16.3%
RoCE (%)	48.2%	28.5%
Total Debt/TNW (times)	0.1	0.1
Total Debt/OPBDIT (times)	0.2	0.4
Interest coverage (times)	23.1	16.9

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

		Current Rating (FY2020)				Chronology of Rating History for the Past 3 Years		
	Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating May 2019	Date & Rating in FY2019 Oct 2018	Date & Rating in FY2018 -	Date & Rating in FY2017 -
1	Term Loans^	Long Term	200.0	**200.0**	**[ICRA]A+(Stable)**	-	-	-
2	Fund based facilities	Long Term	208.2*	-	**[ICRA]A+ (Stable)**	**[ICRA]A+ (Stable)**	-	-
3	Non Fund based facilities	Short Term	407.4*	-	**[ICRA]A1+**	**[ICRA]A1+**	-	-
4	Unallocated	Long Term / Short Term	9.4		**[ICRA]A+ (Stable) / [ICRA]A1+**	**[ICRA]A+ (Stable) / [ICRA]A1+**	-	-

^Proposed facility; * Partial interchangeability between fund based and non fund based facilities

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	Proposed Term Loan	-	-	-	200.0	[ICRA]A+ (Stable)
NA	Cash Credit	-	-	-	208.2	[ICRA]A+ (Stable)
NA	Non fund based facilities (LC / BG)	-	-	-	407.4	[ICRA]A1+
NA	Unallocated	-	-	-	9.4	[ICRA]A+ (Stable) / [ICRA]A1+

Source: TCL

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Lapiz Europe Ltd.	100.00%	Full Consolidation
Cheminvest Pte Ltd.	100.00%	Full Consolidation
Optimistic Organic Sdn Bhd.	100.00%	Full Consolidation

ICRA

ANALYST CONTACTS

K.Ravichandran
+91 44 4596 4301
ravichandran@icraindia.com

Sai Krishna
+91 44 4596 4304
sai.krishna@icraindia.com

Raghunath.T
+91 44 4596 4304
raghunath.t@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