India Ratings & Research
A Fitch Group Company

India Ratings Affirms Chemplast Sanmar at `IND A-`; Outlook Stable

16

JUN 2021

By Bhavana Mhavarkar

India Ratings & Research (Ind-Ra) has affirmed Chemplast Sanmar Ltd.'s (CSL) Long-Term Issuer Rating at 'IND A-'. The Outlook is Stable. The instrument-wise rating actions are as follows:

Instrument Type	Date of issuance	Coupon Rate	Maturity Date	Size of Issue (million)	Rating	Rating Action
Non-fund-based working capital facilities*	-	-	-	INR1,000	IND A1	Affirmed
Proposed non-fund-based working capital facilities**	-	-	-	INR1,000	IND A1	Assigned

*includes INR500 million of fund-based limits as interchangeable limits/ sub-limits of non-fund-based facilities
** The provisional rating of the proposed bank facilities has been converted to final rating as per Ind-Ra's updated policy. This is because the agency notes that debt seniority and general terms and conditions of the proposed limits tend to be uniform across lenders, and are not a rating driver.

Change in Analytical Approach: Ind-Ra has taken a consolidated view of CSL and its wholly owned subsidiary, Chemplast Cuddalore Vinyls Limited (CCVL), against the earlier standalone approach, as CSL acquired 100% stake in CCVL on 31 March 2021 from Sanmar Engineering Services Limited (SESL). CSL has provided corporate guarantee towards loans of INR1,076.63 million availed by CCVL. Moreover, CCVL has significant scale and profitability, making the business strategically important to the CSL consolidated profile.

KEY RATING DRIVERS

Strong Business Profile; Balanced Mix of Specialty and Commodity Chemicals: CSL has an established position in the specialty paste polyvinyl chloride (PVC) market, and is one of the largest producers of the same in India (installed capacity of 66 kilo tonne per annum (KTPA)). The company catered to 45% (FY19: 44%) of the demand for specialty paste PVC resin in India in FY20; its market share stood at 82% (FY19: 84%) as of FY20. Meanwhile, CCVL is the second-largest manufacturer of suspension PVC resin in India and the largest manufacturer in south India (installed capacity of 300KTPA), with market share of 19% (FY19: 20%) in FY20, as per the management. CSL also manufactures chloro-methanes (installed capacity of 35KTPA), caustic soda (installed capacity of 119KTPA), refrigerant gases (installed capacity of 1.7KTPA) and hydrogen peroxide (installed capacity of 34KTPA). Additionally, CSL undertakes complex custom manufacturing (installed capacity of 1,068 metric tonnes per annum) of starting materials and intermediates for global life sciences and fine chemical end uses, leading to a diversified business profile.

Demand for PVC products in India remains robust, driven by the government's continued focus on growth in the irrigation sector, affordable housing and infrastructure projects. About 45% of India's paste PVC demand and around 56% of SPVC demand is met through imports. On the supply side, global capacity addition has been muted and adversely impacted by plant closures in China and Europe due to environmental concerns; this has benefited domestic PVC manufacturers. In FY20, at a standalone level, CSL derived about 50% of its revenues from specialty paste PVC, 19% from caustic soda, 12% from chloro- methanes, 10% from custom manufacturing, 2% from hydrogen peroxide and the balance from other products. The company commenced the production of hydrogen peroxide during FY20, bolstering the revenue base.

Integrated Manufacturing Capabilities: The company's paste PVC and non-PVC products such as caustic soda and chloro-methanes are produced by the fully-integrated operations at its Mettur (Tamil Nadu) facility. CSL has captive salt fields and a coal-based power plant, with adequate capacities to provide for in-house consumption. The electrolysis of salt leads to the production of caustic soda, hydrogen and chlorine, the latter two of which are used to produce downstream products. As of April 2021, CSL's salt field lease had expired and it was in the process of renewing the same. The company has its own marine terminal facility to import key raw materials such as ethylene. Ethylene and chlorine are used to manufacture ethylene dichloride (EDC), which is ultimately used to produce paste PVC. Imported methanol and chlorine are used to manufacture chloro-methanes. The hydrogen produced through the salt electrolysis would be used for the production of hydrogen peroxide. The highly integrated manufacturing processes has helped to reduce the raw material cost for the company, leading to higher-than-average EBITDA margins across product categories. Suspension PVC is manufactured through the vinyl chloride monomer route; which is partially susceptible to the volatility in crude oil prices.

Experienced Management; Long Operating Track-record: CSL is one of the three operating chemical companies of the Sanmar group, which has a global footprint, with operations in the US, Mexico, Egypt and India. The group, which earns annual revenues of over US$1 billion, has interests in chemicals, engineering services and shipping. SESL is the group's holding company for the chemicals business, including CSL. FIH Mauritius Investments Limited (owned by the Fairfax group, Canada) held 42.9% stake in SESL as of March 2021.

CSL's promoters have an experience of over five decades in the chemicals industry (first PVC plant set up in 1967) and the company has a professional senior management team that has been associated with the group for over two decades. CSL constituted a new board in April 2021 with four new independent members (total eight-member board).

Revenue to Grow despite COVID-19 Impact: Ind-Ra expects overall product volumes to increase in FY22 in spite of the impact of the second wave of COVID-19 on demand. However, the benefit of the same is likely to be offset by the gradual correction in PVC prices, resulting in some moderation in revenues on a yoy basis in FY22. The agency believes that the company would grow steadily in the medium term owing to strong demand for PVC, caustic soda, hydrogen peroxide and chloromethane in domestic market, though the extent of the growth would depend upon debottlenecking/capacity expansion.

CSL's consolidated revenue (based on pro-forma result) amounted to INR24,568 million in 9MFY21 (FY20: INR31,212 million). Ind-Ra expects the consolidated revenues for FY21 as a whole to have increased by 15%-20% yoy, boosted by strong pent-up demand and a sharp increase in realisations, resulting from the high PVC prices during 2HFY21.During April 2020, there was a significant volatility in prices of the petrochemical products, primarily driven by a steep drop in global crude oil prices as well as lack of demand in the market, mainly during 1HFY21 due to the impact of the COVID-19-led disruptions. Despite this, CCVL's standalone revenue grew by 10% yoy to INR15,822 million in 9MFY21 owing to high demand for SPVC. CSL's standalone revenue decreased by 5% yoy to INR8,752 million during 9MFY21, impacted by the lockdown during 1QFY21.

On an annualised basis, CSL's PVC segment operated at a capacity of 87% (FY20: 100%), caustic soda at 45% (71%), chloro-chemicals at 89% (99%), refrigerant gas at 18% (75%), and custom manufacturing at 62% (64%) during 9MFY21. The company started producing hydrogen peroxide during FY20, with capacity utilisation of 21%. The utilisation improved to 41% on an annualised basis during 9MFY21, though this was lower than Ind-Ra's expectations.

Improved EBITDA Margins: Ind-Ra believes that the robust demand across the product categories coupled with tightening supply and limited capacity expansion would continue to benefit CSL over the rating horizon and help the company maintain strong margins of over 25% in the medium term on a standalone basis, and 15%-17% on a consolidated basis. The agency believes, the consolidated margins are likely to have increased on a yoy basis in FY21. The company's consolidated EBITDA margin rose to 25.1% in 9MFY21 (FY20: 12.8%), backed by a significant improvement in both CSL (9MFY21: 28.3%; FY20: 24.9%) and CCVL's margins (9MFY21: 23%; FY20: 5%; FY19: 10%), resulting from improved PVC prices and inventory gains. However, CCVL's margins remained volatile owing to the susceptibility to movement of raw material prices, which are partly linked to crude oil prices.

Deleveraging Likely Post Receipt of Capital via IPO Placement, Leading to Improved Credit Metrics: CSL has planned an initial public offering (IPO) during FY22. A part of the proceedings from the IPO is likely to be utilised for the full repayments of the NCDs; this would help improve credit metrics significantly. This would be a key monitorable for the ratings.

In FY20, the proforma consolidated net leverage (net adjusted debt to operating EBITDA) was high at 5.4x and the gross coverage (EBITDA/gross interest expenses) was low at 1.9x owing to high debt levels. However, the agency believes that the leverage as well as coverage are likely to have improved in FY21 because of higher EBITDA (9MFY21: INR6,170 million; FY20: INR3,987 million) and almost flat debt levels.

During FY20, CSL raised non-convertible debentures (NCDs) of INR12,700 million, the proceeds of which were primarily used to reduce debt at the holding company, SESL. The increase in debt levels (9MFY21: INR12,770 million; FY20: INR12,887 million; FY19: INR2,529 million) caused CSL's credit profile to deteriorate significantly. In FY20, CSL's standalone net adjusted leverage (including corporate guarantee extended to CCVL) deteriorated to 4.2x (FY19: 1.1x) and EBITDA interest coverage weakened to 3.3x (6.7x). Despite improved EBITDA levels (9MFY21: INR2,478 million; FY20: INR3,140 million; FY19: INR3,172 million), the company's gross interest coverage is likely to have remained at 1.5x-1.6x during FY21 owing to the high finance cost on the NCDs. CCVL's standalone debt stood at INR10,512 million at 9MFYE21; a portion of this had been availed to reduce debt at the holding company.

Liquidity Indicator - Adequate: At end-December 2021, the consolidated cash and equivalents amounted to INR4,386 million (FYE20: INR1,799 million), of which INR2,940 million (INR877 million) had been placed as margin deposits. CSL and CCVL have combined minimal repayment obligations of around INR930 million for FY22 and INR1,000 million for FY23. Ind-Ra expects the company to meet its obligations via internal accruals. Ind-Ra draws comfort from the ring-fenced cash flows for both CSL and CCVL, which have been earmarked for NCD/term-loan repayments for the respective entities till maturity. The company is likely to have generated modest consolidated cash flow from operations in FY21 (FY20: INR2,387 million) owing to the high interest outgo during the year. The debt service coverage ratio is likely to remain about 1.2x for FY22-FY23. The company has bulky repayments lined up for FY24-FY27, which could lead to refinancing risk in the medium term. Ind-Ra believes that the likely fund inflow post the IPO scheduled in FY22 might improve the capital structure and liquidity profile of CSL (consolidated) and SESL, as the high-cost debt is likely to get prepaid in a timely fashion using the IPO proceeds; this will mitigate the refinancing risk.

CSL divested its stake from Mowbrays Corporate Finance for INR10,744 million during FY21. Moreover, it redeemed CCPS of INR4,822 million invested into one of its associate company, Sanmar Group International Limited, during FY21. During the same year, CSL acquired 100% stake in CCVL for cash consideration of INR3,003 million from SESL (holding company), and further invested INR12,553 million in CCVL in the form of zero coupon compulsorily convertible debentures.

The management has various plans to expand its production capacities over the next three-to-four years for capex of around INR6,000 million; the company plans to fund the capex through internal accruals.

The company uses its non-fund-based facilities to import raw material such as ethylene, EDC and methanol. CSL maintains a low net working capital cycle below 10 days, with average trade payables of less than 70 days. Also, CSL hedges its raw material imports to mitigate foreign exchange risk. For standalone CSL, the average working capital utilisation of the fund-based limits was 23% and that of the non-fund-based limits was 56% for the 12 months ended April 2021.

Volatile Raw Material Prices; Forex Volatility: In Ind-Ra's view, the volatility in CSL's feed-stock prices (ethylene and EDC, which are crude derivatives) will continue to impact the company's operating EBITDA margins. However, the risk is mitigated to some extent by the fact that the company derives a sizeable proportion of the revenue and EBITDA from non-PVC products. Furthermore, the structural changes in PVC industry viz. closure of plants around the world and supply-demand gap in India are likely to keep the margins at high levels. Also, CSL has been leveraging the management's extensive experience in the chemical industry to manage the inherent price volatility in the PVC business.

CSL is exposed to foreign exchange fluctuations as key feedstock supplies are imported by the company. However, the company has a sound hedging policy that covers large-value forex exposure to effectively manage this risk.

RATING SENSITIVITIES

Positive: Continued strong and stable operating EBITDA margins, leading to deleveraging, with the consolidated interest coverage exceeding 3.0x, on a sustained basis, will lead to an upgrade.

Negative: Deterioration in the operating performance and/or weakening of the liquidity profile, leading to the debt service coverage ratio being below 1.5x, will lead to a downgrade.

COMPANY PROFILE

CSL manufactures PVC, chloro-chemicals, caustic soda, hydrogen peroxide, custom chemicals and refrigerant gases. The company is a part of the Sanmar group, which has interests in chemicals, shipping and engineering.

PROFORMA CONSOLIDATED FINANCIAL SUMMARY:

Particulars	9MFY21	FY20	FY19*

Revenue (INR million)	24,568	31,212	33,050
EBITDA (INR million)	6,170	3,987	5,187
EBITDA margin (%)	25.1	12.8	15.7
Interest coverage (x)	1.8	1.9	4.7
Net leverage (x)	-	5.4	0.5
Source: Ind-Ra; CSL *FY19 financials consolidated by Ind-Ra			

STANDALONE FINANCIAL SUMMARY:

Particulars	9MFY21	FY20	FY19
Revenue (INR million)	8,752	12,593	12,527
EBITDA (INR million)	2,478	3,140	3,172
EBITDA margin (%)	28.3	24.9	25.3
Interest coverage (x)	1.3	3.3	6.7
Net leverage (x)	-	3.9	0.6
Net leverage adjusted for corporate guarantee (x)	-	4.2	1.1
Source: CSL; Ind-Ra			

RATING HISTORY

Instrument Type	Current Rating/Outlook			Historical Rating/Rating Watch/Outlook			
	Rating Type	Rated Limits (million)	Rating	20 March 2020	3 June 2019	1 March 2019	6 April 2018
Issuer rating	Long-term	-	IND A-/Stable	IND A-/Stable	IND A+/RWE	IND A+/Positive	IND A/Stable
Non-fund-based working capital facilities	Short-term	INR2,000	IND A1	IND A1	IND A1+/RWE	IND A1+	IND A1

COMPLEXITY LEVEL OF INSTRUMENTS

Instrument Type	Complexity Indicator
Non-fund-based working capital facilities	Low

For details on the complexity levels of the instruments, please visit https://www.indiaratings.co.in/complexity-indicators.

SOLICITATION DISCLOSURES

Additional information is available at www.indiaratings.co.in. The ratings above were solicited by, or on behalf of, the issuer, and therefore, India Ratings has been compensated for the provision of the ratings.

Ratings are not a recommendation or suggestion, directly or indirectly, to you or any other person, to buy, sell, make or hold any investment, loan or security or to undertake any investment strategy with respect to any investment, loan or security or any issuer.

ABOUT INDIA RATINGS AND RESEARCH

About India Ratings and Research: India Ratings and Research (Ind-Ra) is India's most respected credit rating agency committed to providing India's credit markets accurate, timely and prospective credit opinions. Built on a foundation of independent thinking, rigorous analytics, and an open and balanced approach towards credit research, Ind-Ra has grown rapidly during the past decade, gaining significant market presence in India's fixed income market.

Ind-Ra currently maintains coverage of corporate issuers, financial institutions (including banks and insurance companies), finance and leasing companies, managed funds, urban local bodies and project finance companies.

Headquartered in Mumbai, Ind-Ra has seven branch offices located in Ahmedabad, Bengaluru, Chennai, Delhi, Hyderabad, Kolkata and Pune. Ind-Ra is recognised by the Securities and Exchange Board of India, the Reserve Bank of India and National Housing Bank.

India Ratings is a 100% owned subsidiary of the Fitch Group.

For more information, visit www.indiaratings.co.in.

DISCLAIMER

Applicable Criteria

Corporate Rating Methodology
Parent and Subsidiary Rating Linkage
Short-Term Ratings Criteria for Non-Financial Corporates

Analyst Names

Primary Analyst

Bhavana Mhavarkar

Senior Analyst
India Ratings and Research Pvt Ltd Wockhardt Towers, 4th floor, West Wing Plot C-2, G Block. Bandra Kurla Complex Bandra (East), Mumbai 400051
022 40356167

Secondary Analyst

Prateek Goyal

Associate Director
0124 6687294

Committee Chairperson

Prashant Tarwadi

Director
+91 22 40001772

Media Relation

Ankur Dahiya

Manager – Corporate Communication
+91 22 40356121
