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India Ratings Downgrades Chemplast Sanmar to 'IND A-'/Stable; Off RWE

20
MAR 2020

By Prateek Goyal

India Ratings and Research (Ind-Ra) has downgraded Chemplast Sanmar Ltd's (CSL) Long-Term Issuer Rating to 'IND A-' from 'IND A+' while resolving the Rating Watch Evolving (RWE). 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
Term loan	-	-	March 2021	INR1,140	WD	Withdrawn (Paid in full)
Fund-based working capital facilities	-	-	-	INR80	WD	Withdrawn^
Non-fund-based working capital facilities*	-	-	-	INR1,000 (reduced from INR16,045)	IND A1	Downgraded; Off RWE
Proposed non-fund-based working capital facilities	-	-	-	INR1,000	Provisional IND A1	Assigned

* Includes INR500 million of fund based limits as interchangeable limits/ sub-limits of non-fund-based facilities
^ The company does not have separate fund-based limits post the demerger, with the fund-based limits becoming a sublimit of the non-fund-based limits

The RWE resolution reflects the completion of the demerger of the company's suspension poly vinyl chloride (PVC) business into a separate group entity on 29 April 2019, and the subsequent changes in CSL's business and financial risk profile. Also, Sanmar Specialty Chemicals Limited (SSCL), another group company, has merged with CSL as part of the overall group restructuring.

The downgrade reflects a significant deterioration in CSL's net leverage (net debt/ operating EBITDA) and gross interest coverage (operating EBITDA/gross interest expense), on account of the debt raised in CSL to complete the transaction with Fairfax India at Sanmar Engineering Services Limited's (SESL) level, the holding company of CSL. This transaction involved partial repayment of Fairfax India's debt and equity infusion by Fairfax India into SESL.

KEY RATING DRIVERS

Stable Business Profile: CSL has an established position in the domestic paste PVC market (installed capacity of 66,000 tonnes per annum (TPA)), with a market share of approximately 50% and a strong customer base. The company also manufactures chloro-chemicals (installed capacity of 35,000TPA), caustic soda (installed capacity of 119,000TPA) and refrigerant gases. CSL has also commissioned a 17,000TPA hydrogen peroxide plant in 4QFY20, with a ramp-up likely in FY21. Additionally, SSCL's merger with CSL would enable the company to undertake complex contract manufacturing projects for specialty chemical manufacturers, further diversifying the 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 40% of India's paste PVC demand is met through imports. On the supply side, plant closures in China and Europe, due to environmental concerns, have affected global capacity addition, thereby benefiting domestic PVC manufacturers. In FY19, CSL derived about 44% of its revenues from paste PVC, about 13% from chloro-chemicals, 28% from caustic soda, 7% from SSCL, and the balance from refrigerant gases and others. The revenue mix will improve further post the ramp-up of the hydrogen peroxide plant, which is likely to be margin accretive.

Integrated Manufacturing Capabilities: The company's paste PVC and non-PVC products such as caustic soda and chloro-chemicals are produced by fully-integrated operations at its Mettur (Tamil Nadu) facility. CSL has captive salt mines and coal-based power plant with adequate capacities to meet complete operational demand. 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. The company has its own marine terminal facility to import key raw material, ethylene. Ethylene and chlorine are used to manufacture ethylene dichloride (EDC), which is ultimately used to produce paste PVC. Methanol and chlorine are used to manufacture chloro-chemicals. The hydrogen produced through the salt electrolysis would be used for production of hydrogen peroxide. The highly integrated manufacturing processes reduce the raw material cost for the company, leading to higher-than-average EBITDA margins across the product categories.

Experienced Management; Increase in Fairfax Stake: CSL is one of the three operating chemical companies of the Sanmar Group, a large and reputed conglomerate with revenues of over USD1 billion and interests in chemicals, engineering services and shipping. The group has a presence in the US, Mexico, Egypt and India. 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.

In December 2019, Fairfax India Holding Corporation (Fairfax India) increased its stake in SESL by 13%, taking the total share to 43%. Fairfax India had outstanding investment of around USD300 million in SESL (plus accrued interest), out of which it invested approximately half the consideration into acquiring 13% common shares of SESL; the remaining amount was repaid by SESL to Fairfax India. SESL leveraged the balance sheets of two of the operating entities - CSL and Chemplast Cuddalore Vinyls Limited - to raise the funds needed to repay Fairfax India.

Robust Operating Performance: The demerged suspension PVC business was a commodity segment, with large volumes but relatively low and volatile profitability. Pro-forma for the demerger, CSL's standalone revenue grew 13.2% yoy to INR12,527 million in FY19, mainly driven by strong demand and improved realisation for caustic soda and chloromethane. The restructured entity operates in niche segments with high operating margins. The EBITDA margins remained strong at 25.3% in FY19 (FY18: 25.9%). The merger of SSCL and the ramp-up of the company's hydrogen peroxide operations would help sustain the healthy operating margins and provide diversification. Ind-Ra believes that the robust demand across the product categories, the tightening supply situation, and limited capacity expansion would continue to benefit CSL and enable it to maintain strong margins of over 22% in the medium term.

Deterioration in Credit Metrics: During FY20, CSL raised NCDs of INR12,700 million, the proceeds of which were primarily used to reduce debt at SESL. The resultant rise in debt levels (FY19: INR2,529 million; FY18: INR2,103 million) led to significant weakening of CSL's credit metrics. Ind-Ra expects a net leverage of around 4.2x in FY20 (FY19: 0.6x) and interest coverage of 2.9x (6.7x). The agency expects the interest coverage ratio to decline to around 1.5x in FY21 owing to the full-year interest expense of the NCDs. CSL maintains a debt service reserve account to meet three months of interest payments on the NCDs. Also, the company has significant short-term investments in another group entity; the agency has not considered the same to calculate the credit metrics.

Liquidity Indicator - Adequate: At end-December 2019, CSL had cash and equivalents of INR1,066 million (FYE19: INR488 million). The company's term debt repayment requirement is minimal for the remainder of FY20 and INR318 million for FY21. The cash flow from operations remained strong at INR1,853 million in FY19 (FY18: INR1,835 million) owing to strong profitability. The cash flow from operations is likely to moderate in FY21 because of large interest payments, but would be sufficient to fund CSL's modest debt servicing and normal capex requirements, given that the company does not have material expansion plans for the medium term.

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 of 10-20 days, with average trade payables of over 70 days.

Volatile Raw Material Prices; Forex Risk: CSL's EBITDA margins will continue to be impacted by fluctuations in feed-stock prices (ethylene and EDC, which are crude derivatives). However, the impact would be mitigated to some extent by the sizeable share of non-PVC products in the company's revenue and EBITDA. Also, the company has been leveraging the management's extensive experience in the chemical industry to manage the inherent price volatility in the PVC business.

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

RATING SENSITIVITIES

Positive: The ratings could be upgraded if CSL continues to display strong operating EBITDA margins, leading to deleveraging, with the interest coverage remaining over 2.5x, on a sustained basis.

Negative: A downgrade would occur if the financial performance of the company deteriorates significantly, with net debt/EBITDA exceeding 4.25x and/or the interest coverage falling below 1.75x on a sustained basis.

COMPANY PROFILE

CSL manufactures paste PVC market, chloro-chemicals, Caustic Soda, Hydrogen Peroxide, refrigerant gases and has a contract manufacturing segment. The company is a part of the Sanmar Group, which has interests in chemicals, shipping and engineering.

FINANCIAL SUMMARY

Particulars	FY19	FY18
Revenue (INR million)	12,527	11,063
EBITDA (INR million)	3,172	2,864
EBITDA margin (%)	25.3	25.9
Interest coverage (x)	6.7	7.7
Net leverage (x)	0.7	0.3
Source: CSL, Ind-Ra		

RATING HISTORY

Instrument Type	Current Rating/Outlook			Historical Rating/Rating Watch/Outlook			
	Rating Type	Rated Limits (million)	Rating	3 June 2019	1 March 2019	6 April 2018	28 December 2016
Issuer rating	Long-term		IND A-/Stable	IND A+/RWE	IND A+/Positive	IND A/Stable	IND A-/Stable
Fund-based working capital facilities	Long-term	INR80	WD	IND A+/RWE	IND A+/Positive	IND A/Stable	IND A-/Stable
Non-fund-based working capital facilities	Short-term	INR2,000	IND A1	IND A1+/RWE	IND A1+	IND A1	IND A2+
Term loan	Long-term	INR1,140	WD	IND A+/RWE	IND A+/Positive	IND A/Stable	IND A-/Stable

COMPLEXITY LEVEL OF INSTRUMENTS

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Applicable Criteria

Corporate Rating Methodology

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