July 12, 2022

Kothari Petrochemicals Limited: Ratings reaffirmed; rated amount enhanced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Fund-based – Term loan	15.00	28.28	[ICRA]A (Stable) reaffirmed
Long-term – Fund based CC	25.00	22.50	[ICRA]A (Stable) reaffirmed
Short-term Non-Fund Based	15.00	20.00	[ICRA]A1 reaffirmed
Total	**55.00**	**70.78**	

**Instrument details are provided in Annexure-I*

Rationale

The reaffirmation of the ratings of Kothari Petrochemicals Limited (KPL) factors in its established position in the domestic poly iso-butylene (PIB) market and its established relationships with feedstock suppliers, which mitigate the raw material availability risks. Feedstock availability is a key risk for PIB manufacturers in India as feedstock is increasingly used for alternative higher value-added applications. KPL sources its raw material from Chennai Petroleum Corporation Limited (CPCL) and Reliance Industries (RIL). KPL procures feedstock from CPCL through pipelines and the unreacted feedstock is supplied back to CPCL through pipelines. However, it directly procures isobutylene (IB) from RIL, which is the main raw material for PIB. Also, KPL has stopped sourcing from a couple of suppliers from FY2021, as its margins were adversely affected due to the under recoveries from LPG sales to the parallel marketers. The ratings factor its healthy capacity utilisation despite the increase in capacity and revenue growth in FY2022. KPL secured PCB approval in March 2021 to increase the capacity from the existing level of 24,000 MTPA to 36,000 MTPA.

The ratings also consider KPL's well-established customer base, which includes major lubricant manufacturers in the domestic and export markets. ICRA also notes KPL's efforts to develop new products and growing demand for such products. While the revenue contribution of the new products is modest at present, they are expected to drive growth and provide diversification benefits, going forward. The ratings continue to draw comfort from KPL's favourable financial risk profile, characterised by healthy capital due to low gearing and comfortable coverage indicators.

The ratings are, however, constrained by KPL's vulnerability to commodity price cycles, forex fluctuations and import duty levels, as demonstrated by its volatile profitability metrics in the past. ICRA also notes the moderate cost competitiveness arising from the limited integration across the petrochemical value chain with moderate capacities. The ratings further consider the subdued market outlook for two-stroke (2T) oils in the medium to long term, where PIB finds major applications as an additive. It would, hence, be imperative for KPL to currently diversify its clientele based on end applications. Although, the projects to be undertaken by KPL to diversify into new customer segments are at a very nascent stage, the company has been continuously involved in R&D to mitigate the risk of demand deficit. ICRA also notes the sizeable proposed capex plans for production of value-added product in near future. The capex would be funded with the existing cash balances, internal accruals and the balance through debt. Any larger-than-expected debt-funded capex would remain a key sensitivity.

The Stable outlook on the [ICRA]A rating reflects ICRA's opinion that KPL will continue to benefit from its extensive experience and dominant market share in the PIB segment in the country.

Key rating drivers and their description

Credit strengths

Established position as largest PIB manufacturer in India - KPL has an established position in the PIB segment with an annual production capacity of around 36,000 MT as on date. The company also benefits from decreased competition from domestic competitors due to constrained availability of raw materials, which had adversely impacted their operations. However, KPL faces competition from well-established international manufacturers, such as Daelim Corporation in Korea and MNC in Singapore. At present, KPL meets over 80% of the total domestic demand. It used to sell LPG (by-product) to parallel marketers which terminated from FY2021. The company has diversified/trying to diversify its revenue stream into different product categories (such as HR PIB, high molecular weight PIB and different grade variants from main grade PIB products), which will provide both customer and business diversification benefits in the medium to long term. However, revenue contribution from the same remains modest at present.

Diversified customer base with major oil marketing companies and lubricant manufacturers from domestic and exports markets - The company caters to reputed customers. Its clientele comprises major lubricant manufacturers and 2T lube-oil producers, including Lubrizol India Limited, Hindustan Petroleum Corporation Limited (HPCL), Bharat Petroleum Corporation Limited (BPCL) and Indian Oil Corporation Limited (IOCL), etc, in the domestic market, and Infineum Singapore PTE Limited in the overseas market. The orders are a mix of long-term contracts and tender-based orders (mainly for public sector units). KPL receives repeat orders from several of its customers and faces moderately high customer concentration risk, with its top-five customers accounting for 50-70% of sales during the last few years. In FY2022, KPL witnessed strong growth in sales volume backed by acquisition of new customers and increased domestic sales.

Diversified supplier base mitigates risks related to raw material procurement - Raw material availability is a major risk for the industry and some of the company's competitors witnessed production shutdown due to constrained raw material supply. KPL has, however, demonstrated its ability to sustain operations by procuring raw materials from diversified suppliers in the last few years. While ~35% of its requirements are met from CPCL, it meets its pending requirements from Reliance Industries Limited (RIL). The company also benefits from the raw material procured from CPCL as the refinery of CPCL and KPL's plant are located near each other, which reduces the freight cost of the company and the residual feedstock from CPCL can be pumped back through pipelines.

Capital structure characterised by healthy gearing and comfortable coverage indicators - KPL's capital structure is characterised by low gearing and comfortable coverage indicators. The gearing remained healthy despite a slight moderation to 0.08 times as on March 31, 2022, from 0.02 times as on March 31, 2021, with the improvement in accretion to reserves supported by better profitability. Going forward, the company's capital structure is expected to remain healthy on the back of healthy profitability despite 20-30% of debt-funded capex expected in FY2023. The coverage indicators also remained healthy with TD/OPBDIT and interest coverage of 0.24 times and 80.6 times, respectively, in FY2022 compared with 0.07 times and 35.9 times, respectively, in FY2021.

Credit challenges

Margins vulnerable to commodity price cycles, especially spread between PIB and LPG/C4 rich feedstock - PIB being a commodity chemical, its prices move mainly in line with the international demand-supply scenario and are subject to considerable volatility, depending on crude oil price movements. KPL has generally two types of sales arrangements - relatively long-term contract/tender-based supply and spot market sales. Due to the volatilities witnessed in the prices of the major raw material, KPL primarily has a formula-based pricing mechanism for its long-term agreements to better insulate its profit margins. Most of KPL's sales are on contract/tender basis with product delivery spread over relatively long periods. In such cases, the PIB prices are linked to the underlying prices of either LPG or naphtha. For spot market sales, KPL notifies its selling prices on a monthly basis, once its suppliers fix their prices.

Although margins on PIB sales are protected to some extent by formula-linked pricing, the company had to dispose of the balance unreacted feedstock from non-CPCL suppliers in the market, as returning the balance feedstock would not be economical due to high freight cost involved. The company incurred loss on such disposal in the past, which adversely impacted margins. However, with the changes in feedstock procurement implemented in FY2020, with increased procurement of high IB content feedstock, the impact has been mitigated to a large extent as negligible unreacted feedstock is being generated. However, any change in the feedstock procurement mix to earlier levels may have an adverse impact on margins. The margins also remain vulnerable to commodity price cycles (especially the spread between PIB and LPG/C4 rich feedstock), forex fluctuations and import duty levels.

Declining demand prospects for 2T oils over medium to long term – At present, PIB finds major application in the lubricant manufacturing sector and as an additive in 2T oils, which are facing declining demand prospects in the medium to long term. KPL is trying to mitigate the risk by trying to diversify its end-customer segments and has started catering to rubber, PVC, adhesives and masterbatch manufacturers. It is also trying to develop new products, like HR PIB. However, the translation of these efforts into improved performance remains to be seen.

Liquidity position: Strong

The liquidity is expected to be strong, backed by healthy cash flow from operations on the back of increased profitability, unencumbered cash and liquid investment of ~Rs. 42 crore undrawn limits of Rs. 22.5 crore as on March 31, 2022, and modest debt repayment obligation of ~Rs. 2.7 crore in FY2023. However, the planned capex will reduce the available liquidity to an extent.

Rating sensitivities

Positive factors – ICRA could upgrade the company's ratings if KPL exhibits sustained improvement in scale and profitability, while maintaining healthy capital structure, coverage indicators and working capital intensity.

Negative factors – Pressure on the ratings could arise if there is sustained decline in scale and profitability, or a stretch in the working capital cycle or larger-than-expected debt-funded capex weakening liquidity.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology
Parent/Group support	Not Applicable
Consolidation/Standalone	The ratings were based on standalone financial statements of the issuer.

About the company

Kothari Petrochemicals Limited is the largest manufacturer of PIB in the country, with a nameplate manufacturing capacity of 36,000 TPA. KPL is a part of the Chennai-based HC Kothari Group. The promoter Group's shareholding in KPL was 70.99% as of March 31, 2022. The company also used to sell liquefied petroleum gas (LPG), which is a by-product of the manufacturing process of PIB, to the parallel marketers of LPG till FY2020.

KPL was established in 1989, with a manufacturing unit for caustic soda. This unit was set up as a backward integration initiative for the nitro chloro benzene (NCB) business of Kothari Sugars and Chemicals Limited (KSCL). The promoters eventually sold off its chlor-alkali unit in Karaikal, Puducherry, to Chemplast Sanmar Limited. Post this, KPL remained a shell company without any significant business interests, except marginal trading operations. With effect from April 1, 2006, KPL absorbed Primetra Technologies Private Limited (PTPL), a Group company involved in PIB manufacturing by way of Merger. With the merger, PIB became KPL's major business line. KPL has a plant in Manali (Tamil Nadu), located adjacent to CPCL's refinery. Using raw material input from CPCL and other sources like Reliance Industries Ltd (RIL), it manufactures PIB of varying grades with specific applications in lube oil, paint, PVC, adhesives and rubber industries.

Key financial indicators (audited)

KPL Standalone	FY2021	FY2022
Operating income	226.8	381.5
PAT	22.6	32.8
OPBDIT/OI	14.85%	13.02%
PAT/OI	9.85%	8.59%
Total outside liabilities/Tangible net worth (times)	0.39	0.43
Total debt/OPBDIT (times)	0.07	0.24
Interest coverage (times)	38.2	80.6

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amounts in Rs crore

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2023)				Chronology of rating history for the past 3 years		
		Type	Amount rated (Rs. crore)	Amount outstanding as of Mar 31, 2022 (Rs. crore)	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021	Date & rating in FY2020
					Jul 12, 2022	Apr 21, 2021	Apr 15, 2020	May 20, 2019
1	Term loans	Long term	28.28	10.99	**[ICRA]A (Stable)**	**[ICRA]A (Stable)**	**[ICRA]A- (Stable)**	**[ICRA]A- (Stable)**
2	Fund-based facilities	Long term	22.50	NA	**[ICRA]A (Stable)**	**[ICRA]A (Stable)**	**[ICRA]A- (Stable)**	**[ICRA]A- (Stable)**
3	Non-fund based facilities	Short Term	20.00	NA	**[ICRA]A1**	**[ICRA]A1**	**[ICRA]A2+**	**[ICRA]A2+**

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term fund-based – Term Loan	Simple
Long-term– Fund-based CC	Simple
Short-Term- Non-fund based facilities	Very Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: www.icra.in

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loan-I	Feb, 2022	7.90%	FY2027	27.07	[ICRA]A (Stable)
NA	Term Loan-II	Jul, 2020	7.55%	FY2024	1.21	[ICRA]A (Stable)
NA	Cash Credit	NA	NA	NA	22.50	[ICRA]A (Stable)
NA	Bank Guarantee	NA	NA	NA	20.00	[ICRA]A1

Source: *Company*

Please click here to view details of lender-wise facilities rated by ICRA

Annexure II: List of entities considered for consolidated analysis- Not Applicable

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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.

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