Chemfab Alkalis Limited

November 07, 2022

Ratings

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Long Term Bank Facilities	20.00	CARE A-; Stable (Single A Minus; Outlook: Stable)	Reaffirmed
Short Term Bank Facilities	20.00	CARE A2+ (A Two Plus)	Reaffirmed
Total Bank Facilities	**40.00 (₹ Forty Crore Only)**		

Details of instruments/facilities in Annexure-1.

Detailed rationale and key rating drivers

The ratings assigned to the bank facilities of Chemfab Alkalis Limited (CAL) continue to derive comfort from the experienced promoters and management, long track record of operations in the caustic soda business, diversified client base across industries and comfortable capital structure. The ratings take into account the improvement in the total operating income (TOI) in the chemical segment of the company over the past year on the back of buoyant chlor-alkali industry scenario; however, the oriented-polyvinyl chloride (PVC-O) pipes segment has remained stagnant with low utilisations over the past three years coupled with declining margins due to steep price increase of PVC resin prices and lower pass through.

The ratings are constrained by the inherent volatility present in realisations of electro chemical units (ECU), and pressure on caustic soda production due to lower downstream uses of chlorine. The ratings also take note of the envisaged expansion of caustic soda and PVC-O pipes capacity in CAL, the proposed large debt-funded green-field project under its wholly-owned subsidiary, and its expected funding support from CAL.

Rating sensitivities

Positive factors – Factors that could lead to positive rating action/upgrade:

- Commencement of operations on the enhanced capacity and achieving envisaged TOI on the new capacity with TOI reaching over ₹500 crore.
- Sustained increase in profitability with return on capital employed (ROCE) over 15% on a sustained basis

Negative factors – Factors that could lead to negative rating action/downgrade:

- Drop in ECU realisation leading to significant reduction in the cash accruals.
- Any other large debt-funded expansion or exposure to the group companies resulting in leverage levels exceeding 0.75x on a consolidated basis.
- Any inordinate delay in the execution of the projects

Detailed description of the key rating drivers

Key rating strengths

Experienced promoters and management: CAL was promoted by late Dr C H Krishnamurthi Rao, who was a technocrat and an industrial entrepreneur. His son, Suresh Krishnamurthi Rao, a management graduate with three decades of experience, is the current Chairman of CAL. CAL's day-to-day operations are managed by V M Srinivasan, CEO of the company, who has almost three decades of experience in plastics and chemical business.

Long track record of operations in chlor-alkali business: The company's Pondicherry plant has a track record of more than three decades in the production of caustic soda. The caustic soda unit at Pondicherry is one of the early adopters of membrane cell technology for electrolysis of salt, which is relatively more eco friendly and energy efficient. The plant was initially started with 25 tonnes per day (TPD) capacity in 1985 and subsequently expanded in various phases over the years to 155TPD as on March 31, 2022. The capacity utilisation levels had been comfortable at more than 80% during the last few years. The chlor-alkali is the major revenue generator for the company contributing to around 75%-80% of the TOI of the company. On the back of buoyant industry scenario for caustic soda, the realisations of ECU have significantly improved which has aided CAL's revenue and profitability in FY22 (refers to the period April 1 to March 31) and Q1FY23. In this segment, the company

[1]Complete definition of the ratings assigned are available at www.careedge.in and other CARE Ratings Ltd.'s publications

reported a TOI of ₹225 crore with a PBILDT margin of 23% in FY22 as against TOI of ₹134 crore with a PBILDT margin of 12% in FY21. The PBILDT margins has further improved to 38% in Q1FY23.

Product diversification with PVCO pipes: CAL has diversified its product profile beyond chemicals and had forayed into the PVC-O pipes segment with a production line in Sricity, Andhra Pradesh, from December 2018. The company initially started with a capacity of 3000 MT and further expanded the same to 6000 MT in April 2021. This segment contributes to around 20%-25% of the TOI of the company.

Moderate diversification in clientele across various industries: CAL's chlor-alkali products find application across various industries like textiles, fast-moving consumer goods (FMCG), petrochemicals, acids and chemicals, pharmaceutical and paper industries, which keeps its client profile moderately diversified. This provides protection to CAL's revenue to an extent during times of slowdown in any one industry. The demand from textile and paper industry was subdued as a result of COVID-19; however, this was offset by the demand from the aluminium sector. While the prices have remained volatile, the company's sales volume has been stable due to such diversification in industries.
The company's major customers in PVC-O pipes segment currently are from the private sector, mainly farmers' associations for irrigation projects. The company plans to supply its pipes to engineering, procurement and construction (EPC) contractors who are under-taking water supply-related government projects as well.

Multiple capital expenditure projects: In April 2021, the company concluded the projects for expansion of caustic soda from 125 TPD to 155 TPD and expansion of second line of PVC-O pipes plant from 3000 MT to 6000 MT. The proposed capex to expand its caustic soda further to 200TPD has been pushed from FY22 to FY24. The company proposes to gradually to 180 TPD in FY23 and 200 TPD in FY24 with an estimated cost of ₹20 crore. The company is putting up a liquefied natural gas (LNG) plant, to shift to green energy source, in place of furnace oil for its current and expanded capacities and also a pipeline for conveyance of treated sewage water from government authority water treatment plant to the factory to reuse treated water as water conservation measure. Both together is expected to cost around ₹13 crore.
The company also has further plans to expand the caustic soda plant to 300 TPD, which is contingent on the receipt of approvals. The cost for this is expected to be around ₹70-75 crore. On the PVC pipes segment, the company plans on putting up one more line of O-PVC pipes bringing its total capacity to 11,000 MTPA with an estimated cost of ₹30 crore. This is expected to commence by the end of FY24.
It is noteworthy that the above projects are likely to be funded out of internal accruals and the capital structure is expected to remain comfortable with minimal debt in the company.

Project under wholly-owned subsidiary: The company is planning to set-up an integrated green-field project in Karaikal under its wholly-owned subsidiary, Chemfab Alkalis Karaikal Limited (CAKL). The project envisages 250 TPD caustic soda capacity, desalination plant and production of chlorine derivative (aluminium chloride). The project is to be implemented in phases over the next three years with aluminium chloride unit to be set up in the first phase with a capacity of 10,000 TPA. The aluminium chloride plant is expected to cost about ₹50 crore and is expected to be commissioned by the end of Q2FY23.
The total project cost, which was expected to be around ₹350 crore has been revised upwards to ₹450 crore. This is on account of the revision in the capacity of caustic soda planned from 200 TPD to 250 TPD and other increase in the prices. CAL has already infused ₹11.1 crore in the subsidiary and subsequent investments is expected in concurrence with project progress. The total investment from CAL is expected to be around ₹90-100 crore towards the subsidiary as equity component. The subsidiary is expected to take a debt of around ₹360 crore. It is to be noted that the above projects are likely to be funded out of internal accruals and the capital structure is expected to remain comfortable with minimal debt in the company.

Key rating weaknesses

Profitability margins exposed to volatile ECU realisations: CAL's profitability margins are exposed to volatile ECU realisations. As the chlor-alkali and inorganic chemicals are commodity by nature, the prices are governed by international and domestic demand/supply conditions. Furthermore, the caustic soda industry is inherently cyclical. The industry witnessed a cyclical downturn after H1FY20, which was further exacerbated during FY21 owing to the COVID-19-led pandemic-related contraction in demand leading to ECU realisations dropping. However, from March 2021 onwards, the sector has seen revival with an improvement in demand from the end-user industries and better availability of raw materials, leading to a rebound in the ECU realisations, which has augured well for the companies in the segment including CAL. The PBILDT margins have improved from 13% in FY21 to 21% in FY22 and has further significantly improved to 36% in H1FY23 with peaking caustic soda prices.
A major parameter determining the profitability for chemical division apart from prices, is the power cost. CAL's power supply is fairly stable and the cost is lower owing reliance on the grid power from the Union Territory of Puducherry.

Lower-than-envisaged performance in the PVC-O pipes segment: In this segment, the capacity utilisation levels have remained very low over the last three years. COVID-19-related disruptions and delays in government approvals and registrations have affected the sales volume in this segment rendering the revenue stagnant. The TOI from this segment has also remained stagnant at ₹45-46 crore in FY21 and FY22.

Competition from established players: CAL is relatively a small player in the caustic soda market and faces competition from the other large domestic players apart from the competition from imports. However, it is noteworthy that the chlor-alkali industry is mostly a regional one as transporting to a long distance will not be feasible and adds to the logistics cost, and therefore, the competition is limited in South India with fewer players.

Liquidity: Strong

The liquidity position of CAL is strong with comfortable accruals of around ₹53 crore with no debt repayment obligations. The company also has cash and liquid investments of ₹32.76 crore as on March 31, 2022. The company's operating cycle also remains low at 10 days with less than 2% utilisation of its working capital facilities.

Prospects

The outlook for the domestic caustic soda industry is likely to be stable in the near-term, mainly on account of continued demand from its key end-use industries like textiles, pulp and paper, aluminium, pharmaceuticals, agrochemicals, etc. After a dip during FY19-FY21, the prices saw a significant improvement in FY22, especially in H2FY22. The realisations are also expected to be around similar levels as Q1FY23 even after record high capex and capacities coming up in FY23 and FY24; however, there persists a continuous threat of industrial downturn in such a commoditised chemical industry like caustic soda, which poses a threat to the profitability of the companies in the industry.
The Indian plastic pipes and fittings industry derives demand from the construction and irrigation sectors, substitution of metal pipes with polymer pipes, and replacement demand. The irrigation sector is one of the key end-user segments for plastic pipes. Furthermore, the demand is expected to come from public-sector projects as well as private sector investments in water management.

Going forward, the company along with its subsidiary has large capital expenditure plans which would require an outflow for the CAL. CAL's accruals have improved over FY22 and Q1FY23 on the back of improved ECU realisations. While the ECU realisations are expected to remain in the same trend over FY23, owing to the volatile nature of the chlor-alkali industry, the continued ability of the company to maintain the internal accruals by levelling up its PVC-O pipes business as well is key to its ability to support the expansion and investments in the subsidiaries.

Analytical approach

Standalone

Applicable criteria

Policy on default recognition
Financial Ratios – Non financial Sector
Liquidity Analysis of Non-financial sector entities
Rating Outlook and Credit Watch
Short Term Instruments
Manufacturing Companies

About the company

Chemfab Alkalis Limited (CAL) has been operational from 1983. Prior to March 2017, the sodium chlorate plant was under 'Teamec Chlorates Limited' (TCL), which was operational from 2012. Teamec acquired Chemfab Alkalis Limited with effect from March 30, 2017, and subsequently changed its name to CAL in July 2017. CAL has currently suspended the operations of the sodium chlorate plant.
As on September 2022, CAL has an installed capacity of 155 TPD of caustic soda in Pondicherry and 6000 MTPA of PVC-O-Pipes Plant in Sricity (Andhra Pradesh). CAL also produces chlorine, hydrogen, sodium hypo chlorite, and hydro chloric acid as by-products from manufacture of caustic soda.

Brief Financials (₹ crore)	March 31, 2021 (A)	March 31, 2022 (A)	H1FY23 (Prov.)
Total operating income	186.91	276.13	175.93
PBILDT	23.72	58.06	63.02
PAT	-8.04	28.84	34.69
Overall gearing (times)	0.12	0.03	-
Interest coverage (times)	8.57	51.74	-

A: Audited; Prov.: Provisional

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating history for the last three years: Please refer Annexure-2

Covenants of the rated instruments/facilities: Detailed explanation of covenants of the rated instruments/facilities is given in Annexure-3

Complexity level of various instruments rated for this company: Annexure-4

Annexure-1: Details of instruments/facilities

Name of the Instrument	ISIN	Date of Issuance (DD-MM-YYYY)	Coupon Rate (%)	Maturity Date (DD-MM-YYYY)	Size of the Issue (₹ crore)	Rating Assigned along with Rating Outlook
Fund-based - LT-Cash Credit		-	-	-	20.00	CARE A-; Stable
Non-fund-based - ST-BG/LC		-	-	-	20.00	CARE A2+

Annexure-2: Rating history for the last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating History			
		Type	Amount Outstanding (₹ crore)	Rating	Date(s) and Rating(s) assigned in 2022-2023	Date(s) and Rating(s) assigned in 2021-2022	Date(s) and Rating(s) assigned in 2020-2021	Date(s) and Rating(s) assigned in 2019-2020
1	Non-fund-based - ST-BG/LC	ST**	20.00	CARE A2+	-	1)CARE A2+ (05-Oct-21)	1)CARE A2+ (16-Oct-20)	1)CARE A2+ (26-Sep-19)
2	Fund-based - LT-Term Loan	LT*	-	-	-	-	1)Withdrawn (16-Oct-20) 2)CARE A-; Stable (16-Oct-20)	1)CARE A-; Stable (26-Sep-19)
3	Fund-based - LT-Cash Credit	LT	20.00	CARE A-; Stable	-	1)CARE A-; Stable (05-Oct-21)	1)CARE A-; Stable (16-Oct-20)	1)CARE A-; Stable (26-Sep-19)

*Long term; **Short term.

Annexure-3: Detailed explanation of the covenants of the rated instruments/facilities – Not Applicable

Annexure-4: Complexity level of various instruments rated for this company

Sr. No.	Name of Instrument	Complexity Level
1	Fund-based - LT-Cash Credit	Simple
2	Non-fund-based - ST-BG/LC	Simple

Annexure-5: Bank lender details for this company

To view the lender wise details of bank facilities please [click here]

Note on complexity levels of the rated instruments: CARE Ratings has classified instruments rated by it on the basis of complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careedge.in for any clarifications.

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About us:
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