Kanoria Chemicals & Industries Ltd

March 11, 2021

Ratings

Facilities	Amount (Rs. crore)	Ratings[1]	Rating Action
Long Term Bank Facilities	83.00	CARE A-; Negative (Single A Minus; Outlook: Negative)	Revised from CARE A; Negative (Single A; Outlook: Negative)
Long Term / Short Term Bank Facilities	14.00	CARE A-; Negative / CARE A2+ (Single A Minus; Outlook: Negative/ A Two Plus)	Revised from CARE A; Negative / CARE A1 (Single A; Outlook: Negative / A One)
Short Term Bank Facilities	50.00 (Enhanced from 40.00)	CARE A2+ (A Two Plus)	Revised from CARE A1 (A One)
Total Bank Facilities	**147.00 (Rs. One Hundred Forty-Seven Crore Only)**		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The revision in the ratings assigned to the bank facilities of Kanoria Chemicals & Industries Ltd (KCIL) factors in deterioration in the return metrices on the back of continued exposure in overseas subsidiaries having weak credit profile coupled with moderation in performance of KCIL in FY20 (refers to period April 1 to March 31) and H1FY21, albeit improvement witnessed in Q3FY21. KCIL had been supporting its subsidiary Kanoria Africa Textile (KAT) to meet repayment obligations of the guaranteed debt until KAT's availment of moratorium (during March 2020 to Aug 2020) and its subsequent application for restructuring under Reserve Bank of India's (RBI) guidelines issued on August 6, 2020. The invocation for restructuring of the guaranteed debt happened on November 27, 2020 and the resolution plan has been submitted to the lender. Successful implementation of the resolution plan of KAT and sustainability of recent recovery in performance of KCIL shall be a key rating monitorable. The rating action also factors in depletion of reserves of free cash and liquid investments of the company and delays in monetization of exposure in overseas subsidiary as against earlier estimates.

The ratings continue to derive comfort from the experience of the promoters, presence of the group in diversified businesses, long track record of operations of the company in the chemicals business, improvement in profitability in Q3FY21 and satisfactory capital structure. The ratings factor in the moderation in debt coverage indicators, vulnerability of profitability to volatility in input prices and project risk.

<u>Outlook: Negative</u>

The negative outlook factors in the uncertainty associated with the timely implementation and terms of the resolution plan of the KAT's debt guaranteed by KCIL. Failure to implement the resolution plan in a timely manner or inability of KCIL to maintain the recent recovery in performance on a sustainable basis thereby further impacting the return indicators and liquidity may result in a rating downgrade. The outlook may be revised to stable if KCIL is able to sustain the pace of recovery in its standalone performance and the resolution plan is timely implemented in a manner which alleviates KAT's, and thereby, KCIL's liquidity position.

<u>Rating Sensitivities</u>

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

- Divestment of exposure in group companies leading to improvement in return metrics.
- Increase in scale of operations (>Rs.500 crore) on a sustained basis.
- Return on Capital Employed moving beyond 10% on a sustained basis.

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

- Decline in PBILDT margin (<7%) on a sustained basis.
- Inability to achieve adequate improvement in its ROCE on a sustained basis.
- Deterioration in overall gearing (>0.60x) and TD/GCA (>7x) on a sustained basis.
- Non-implementation of KAT's resolution plan within 180 days of invocation or change in proposed terms significantly impacting the cash flows or coverage ratios in future.

[1]*Complete definition of the ratings assigned are available at www.careratings.com and in other CARE publications*

Detailed description of the key rating drivers

Key Rating Strengths

Experienced promoters and long track record of operations of the company in the chemical segment

KCIL is a part of the SS Kanoria Group with long presence in the fields of chemicals, petrochemicals, textiles and jute. KCIL has an operational track record of more than five decades in the chemical business. Mr. R.V. Kanoria (son of Late S. S. Kanoria), CMD, takes care of day-to-day affairs of the company and has more than three decades of experience in the business.

Operational performance impacted in FY20 & H1FY21, however, improvement witnessed in Q3FY21

KCIL's income from operations declined by 19% y-o-y to Rs.369 crore in FY20 mainly due to decrease in sales across all three of its major chemicals namely formaldehyde, pentaerythritol and hexamine. The PBILDT margin deteriorated from 8.08% in FY19 to 4.59% in FY20, on account of decline in contribution from Pentaerythritol, due to lower end user industry demand and competition from cheaper imports. Profitability was also impacted due to lower spreads across major products. With low PBILDT and high capital charge, the company reported a loss of Rs.0.82 crore at the PAT level, however, it reported a cash profit of Rs.7 crore in the year.

The performance in H1FY21, was impacted due to lower sales volumes in Q1FY21 on account of lockdown to contain spread of COVID 19. In Q2FY21, the sales volumes had increased, however, realizations and spreads of Pentaerythritol and Hexamine continued to remain under pressure. However, during Q3FY21 a significant improvement was witnessed as the company was able to command better margins and sell higher volumes of formaldehyde, following shut down of some unorganized formaldehyde plants coupled with demand recovery from end user industry. In Q3FY21, KCIL's TOI increased y-o-y by 46% and PBILDT margin improved y-o-y from 5.84% to 17.64%.

Satisfactory capital structure

KCIL's overall gearing has been comfortable due to high net worth at 0.24x as on March 31, 2020 though deteriorated from 0.20x as on March 31, 2019. Considering exposure in group companies and corporate guaranteed loan as debt, adjusted gearing stood at 0.78x as on March 31, 2020 as against 0.68x as on March 31, 2019. As on December 31, 2020, the overall gearing stood at 0.23x.

Key Rating Weaknesses

Moderation in debt coverage indicators

Weak operational performance coupled with increase in interest expenses owing to increase in term loans led to deterioration in interest coverage from 5.76x in FY19 to 1.40x in FY20. Further, total debt/GCA moderated significantly to 20x as on March 31, 2020 as against 4x as on March 31, 2019 due to cash profits being impacted in the year on account of weak operational performance. As on December 31, 2020, TDGCA improved to 11.70x from Mar'20 levels.

High exposure in group companies

The company has fund based exposure in subsidiary companies in the form of investment and loans & advances amounting to Rs.258.32 crore as on March 31, 2020 (Rs.230.36 crore as on March 31, 2019) accounting for 42% of its net-worth (39% in FY19). Further, KCIL has also extended corporate guarantee (outstanding guarantee of Rs.199 crore as on March 31, 2020; loan outstanding against such guarantee stood at Rs.136 crore) for loans availed by subsidiary companies.

Around Rs.297 crore (including loan outstanding s against corporate guarantee) exposure was in subsidiary KAT, whose performance though improved recently, has been weak. KCIL had been supporting its loan repayments where it has extended corporate guarantee until KAT's availment of moratorium and its application and subsequent invocation for restructuring. Further the exposure in APAG Holdings AG, Switzerland stood at Rs. 97.65cr (including loan outstanding against corporate guarantee). Performance of APAG has deteriorated in FY20 owing to auto slowdown.

Volatile raw material prices

Raw material prices, especially for methanol have been volatile over the past few years. This is mainly due to volatility in the crude oil prices coupled with volatility in the global demand and supply matrix for methanol. This makes KCIL's profitability susceptible to the volatile prices of methanol.

Project Risk

Project risk for the company has reduced with the company commissioning two out of three phases of expansion of its formaldehyde plant at Nalidupeta in Andhra Pradesh for a total cost of Rs.48 crore funded out of mix of Rs.38 crore of debt (Rs.38 drawn) and balance internal accruals/liquid investments. As substantial capex (more than 95%) for the project has already been incurred, commissioning of the third phase and successful running of the project are critical for better return indicators.

Liquidity: Adequate
Liquidity is marked by average of month end utilization of 68% for the last twelve months ended Nov. 2020. However, the company relies on other short-term financing to fund its working capital needs. KCIL had applied for moratorium for interest on term loan and has also subsequently repaid them. Further, it has already met its debt repayment obligations for the year FY21. KAT, subsidiary of KCIL, had also applied for both the tranches of moratorium for the debt guaranteed by KCIL and subsequently applied for restructuring of the same. Restructuring was invoked on November 27, 2020; however, timely implementation along with terms of the resolution plan are critical to assess KAT and KCIL's liquidity position going forward. Liquidity is also supported by cash and cash equivalent of Rs.5.29 crore as on December 31, 2020 of which Rs.4.15 crore is in free alternative investments funds and balance in cash and fixed deposits. The same had reduced from Rs.31.25 crore as on March 31, 2019 following the company earmarking some AIFs against loan availed by KCIL.

Analytical Approach: Standalone. Exposure in the group companies has also been factored in the rating.

Applicable Criteria
Criteria on assigning Outlook and credit watch to Credit Ratings
CARE's Policy on Default Recognition
Criteria for Short Term Instruments
Financial ratios – Non-Financial Sector
Rating Methodology-Manufacturing Companies
Liquidity Analysis of Non-Financial Sector Entities
Factoring Linkages Parent Sub JV Group

About the Company
Kanoria Chemicals & Industries Ltd. (KCIL), promoted by Late S. S. Kanoria about five decades ago, is the flagship company of S. S. Kanoria faction of Kolkata based Kanoria family. The company has three manufacturing facilities at Ankleshwar in Gujarat and at Visakhapatnam and Naidupeta in Andhra Pradesh for the manufacture of alco Chemicals primarily Pentaerythritol, Formaldehyde and Hexamine. The company has a solar power plant of 5.0 MW capacity in Jodhpur, Rajasthan.
Its major two subsidiaries are Kanoria Africa Textiles Plc in Ethiopia engaged in denim manufacturing and APAG Holding AG, Switzerland engaged in the design, development and manufacturing of electronic control units (ECUs) and LED-based concept or design lighting modules primarily for the automotive industry.

Brief Financials (Rs. crore)	FY19 (A)	FY20 (A)
Total operating income	457.44	369.43
PBILDT	36.96	16.97
PAT	8.57	-0.82
Overall gearing (times)	0.20	0.24
Interest coverage (times)	5.76	1.40

A: Audited
Status of non-cooperation with previous CRA: Not Applicable
Any other information: Not Applicable
Rating History for last three years: Please refer Annexure-2
Covenants of rated instrument / facility: *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	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Non-fund-based - ST-BG/LC	-	-	-	50.00	CARE A2+
Fund-based - LT-Cash Credit	-	-	-	10.00	CARE A-; Negative
Fund-based/Non-fund-based-LT/ST	-	-	-	14.00	CARE A-; Negative / CARE A2+
Fund-based - LT-Term Loan	-	-	Nov. 2027	73.00	CARE A-; Negative

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018
1.	Term Loan-Long Term	LT	-	-	-	-	-	1)Withdrawn (28-Mar-18)
2.	Non-fund-based - ST-BG/LC	ST	50.00	CARE A2+	1)CARE A1 (06-Apr-20)	1)CARE A1+ (05-Apr-19)	-	1)CARE A1+ (28-Mar-18)
3.	Commercial Paper	ST	-	-	1)Withdrawn (06-Apr-20)	1)CARE A1+ (05-Apr-19)	-	1)CARE A1+ (28-Mar-18)
4.	Fund-based - LT-Cash Credit	LT	10.00	CARE A-; Negative	1)CARE A; Negative (06-Apr-20)	1)CARE A+; Stable (05-Apr-19)	-	1)CARE A+; Stable (28-Mar-18)
5.	Fund-based/Non-fund-based-LT/ST	LT/ST	14.00	CARE A-; Negative / CARE A2+	1)CARE A; Negative / CARE A1 (06-Apr-20)	1)CARE A+; Stable / CARE A1+ (05-Apr-19)	-	1)CARE A+; Stable / CARE A1+ (28-Mar-18)
6.	Fund-based - LT-Term Loan	LT	73.00	CARE A-; Negative	1)CARE A; Negative (06-Apr-20)	1)CARE A+; Stable (05-Apr-19)	-	-

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

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

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

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

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About CARE Ratings:
CARE Ratings commenced operations in April 1993 and over two decades, it has established itself as one of the leading credit rating agencies in India. CARE is registered with the Securities and Exchange Board of India (SEBI) and also recognized as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI). CARE Ratings is proud of its rightful place in the Indian capital market built around investor confidence. CARE Ratings provides the entire spectrum of credit rating that helps the corporates to raise capital for their various requirements and assists the investors to form an informed investment decision based on the credit risk and their own risk-return expectations. Our rating and grading service offerings leverage our domain and analytical expertise backed by the methodologies congruent with the international best practices.

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