Phillips Carbon Black Ltd

June 22, 2021

Ratings

Facilities	Amount (Rs. crore)	Rating[1]	Rating Action
Long Term Bank Facilities	550	CARE AA; Stable (Double A; Outlook: Stable)	Revised from CARE AA-; Stable (Double A Minus; Outlook: Stable)
Long Term/ Short Term Bank Facilities	1850	CARE AA; Stable / CARE A1+ (Double A ; Outlook: Stable/ A One Plus)	Revised from CARE AA-; Stable / CARE A1+ (Double A Minus ; Outlook: Stable / A One Plus)
Total	**2400 (Rs. Two thousand four hundred 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 Phillips Carbon Black Ltd (PCBL) takes cognizance of the improved operating performance of the company in FY21 (refers to period April 1 to March 31) driven by the steep recovery in demand from Q2FY21 from tyre companies, favourable product mix and increase in operating efficiencies. The sequential quarter on quarter recovery in the tyre segment led to better than anticipated performance, as PCBL derives significant share of revenue from tyre companies. Healthy operating performance has also led to improved capital structure and liquidity position of the company.

While capacity addition by domestic tyre companies is expected to keep demand for domestic carbon black buoyant, gradual change in product mix to higher proportion of value added and speciality grade is also expected to aid in improvement of margins and lead to continued healthy cash accruals going forward. The company commissioned the enhanced speciality black capacity of 32,000 MT in February 2021 which is expected to result in increasing the proportion of speciality black in overall sales.

The ratings continue to draw strength from the leadership position of PCBL in the domestic carbon black industry with satisfactory track record of operations, financial flexibility from being a part of the established RP-Sanjiv Goenka Group, strategic location of the plants, strong presence in export market and steady source of revenue from the power segment.

The ratings also take note of the large-scale greenfield project planned by the company in Tamil Nadu at a cost of about Rs.600 crore. Given that the operating cash flows are expected to remain healthy, a large part of the project is proposed to be funded through internal generations over a period of next two years and accordingly, the capital structure and debt protection metrics are expected to be remain comfortable.

The company remains exposed to the risk of volatility in raw material and finished goods prices and exposure to foreign exchange fluctuation risk given the significant dependence on imported raw material. However, the raw material price fluctuation risk is mitigated to an extent due to the pricing formula linked to crude oil prices, though with a lag of about a quarter, for the tyre segment sales which form a significant proportion of overall sales. Further, the foreign exchange risk is mitigated by the natural hedge from exports and stringent hedging policy.

The ratings remain tempered by the stringent pollution norms for the industry, cyclicality due to dependence on the fortunes of the tyre industry and threat of imports of carbon black.

Key Rating Sensitivities

Positive Factors

- Sustained increase in scale of operations, return indicators and business cash flows along with continued comfortable debt protection metrics.

Negative Factors

- Deterioration in overall gearing (>0.60x) and/or debt coverage indicators- Total debt/GCA (>3x) and interest coverage (<10) on a sustained basis.
- Any sharp deviation in envisaged sales volumes or contribution having a significant bearing on the company's performance.
- Any regulatory change having the potential to materially impact the company's performance.
- Any sharp cost or time over run in the proposed greenfield project having a bearing in financial risk profile or liquidity profile of the company.

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

Detailed description of the key rating drivers

Key Rating Strengths

Part of strong promoter group

PCBL is a part of RP-Sanjiv Goenka Group of Kolkata which has interests across diverse business segments such as power and natural resources, infrastructure, retail and media and entertainment apart from carbon black. The other major companies of the group include CESC Limited (rated CARE AA; Stable/CARE A1+), Haldia Energy Limited (CARE AA-; Stable/CARE A1+) Saregama India Ltd (rated CARE A+; Stable/CARE A1+) and Noida Power Company Ltd. Being part of a large established group provides significant financial flexibility to PCBL.

Satisfactory track record of operations with leadership position in the domestic carbon black segment

PCBL commenced its operations from 1962 and has acquired a leadership position in the domestic carbon black industry with its installed capacity gradually increasing from 14,000 MTPA to 603,000 MTPA. Furthermore, it has established a strong relationship with its customer base.

Strong presence in the export market

PCBL is the largest exporter of carbon black from India having presence in more than 40 countries, though majority of exports are to south-east Asian countries. Presence in the export market reduces the offtake risk in an event of a slowdown in domestic market. In terms of volume, share of exports was 27% in FY21 as against 29% in FY20.

Improvement in operating performance in FY21, despite COVID related disruptions impacting Q1FY21

At the onset of FY21, in Q1FY21, the sales volume got impacted due to Covid-19 related lockdown in an already febrile auto industry. However, from Q2FY21, the volumes picked up pace with improved demand from replacement market and recovery in the auto industry and thus higher tyre demand also leading to higher demand for carbon black. The PBILDT level of PCBL also started to improve q-o-q due to improving spreads and increasing volumes. On a y-o-y basis, the total operating income (TOI) of PCBL declined by 18% mainly due to decrease in realizations of carbon black which mirrored lower crude prices and lower sales volume. However, the impact of lower sales volume was offset by increase in spreads in H2FY21. The PBILDT levels increased by 7% y-o-y in FY21, resulting in PBILDT margin improving from 15.59% in FY20 to 20.60% in FY21. Spreads were higher on account of lower cost raw material purchased in the beginning of FY21, higher proportion of sales of speciality black and value-added grades, greater operational efficiencies and demand supply gap in the spot non-tyre rubber market.
Going forward as well, with increase in capacity of speciality black, stable demand outlook and benefits derived from operational efficiencies, the operating profitability is expected to remain healthy.

Comfortable capital structure and debt protection metrics of the company

The capital structure of the company continued to remain comfortable with the overall gearing improving from 0.51x as on March 31, 2020 to 0.43x as on March 31, 2021. The company had availed term debt at competitive rates for reimbursement of past capex and financing of ongoing capex and it also pre-paid higher cost term debts. On a y-o-y basis, although year end borrowings were at similar levels, lower average working capital utilization and decreasing rates had led to lower interest costs. Thus, the interest coverage improved from 11x in FY20 to 16x in FY21. The Total debt/GCA also improved from 2.25x as on March 31, 2020 to 1.95x as on March 31, 2021 with higher cash accruals. Going forward as well, the capital structure is expected to remain comfortable given that a large part of proposed capex will be funded out of internal generations and operating profitability is expected to remain healthy with increasing share of speciality black and operating efficiencies.

Steady source of revenue from the power segment

PCBL has captive power plants aggregating to 76 MW at its manufacturing facilities. Power produced over and above the captive requirement is sold and adds to the overall contribution per ton of carbon black produced. In FY21, while the power segment contributed to only 2.52% of PCBL's operating income (as against 2.66% in FY20), its contribution to overall PBIT (before un-allocable expense) was significant at around 12.57% in FY21 (17.47% in FY20). PCBL does not have any Power Purchase Agreement for off-take of power; however, it enters into medium term agreements for the same. Also, a part of the power is sold to group company, CESC Limited. Power generated as well as power sold outside witnessed decline in FY21 over FY20 mainly on account of decline in production of carbon black which led to lower generation of off gas and thereby lower power. Further the power rates also declined in FY21 on account of overall decline in market tariff rates due to weak demand.

Strategic location of the plant

PCBL's units are situated in different parts of India, close to the ports {for imports of Carbon Black feedstock (CBFS) and exports of carbon black} and near major tyre manufacturing plants. Its location facilitates PCBL in optimizing transportation cost. Moreover, the greenfield project at Tamil Nadu would also add to the locational advantage as plants of major tyre companies are situated in Southern India.

Favourable industry prospects
Initially the carbon black market was impacted in terms of demand and revenue loss due to the COVID-19 pandemic. However, buoyed by demand from replacement market post removal of lockdown and strong recovery in the auto sector, the carbon black demand surged from Q2FY21 onwards. The second wave of COVID has restricted mobility however, factory operations of the end users are not completely shut. Although some moderation in OEM tyre demand is expected, the replacement market is expected to help tyre production. Notwithstanding the near-term demand hiccup due to second wave of COVID, the medium-term outlook with respect to tyre production appears stable with major capex expected in the current financial year. This is also expected to help in better capacity utilization of the carbon black capacities.

Key Rating Weaknesses
Profitability susceptible to volatility in raw material prices and foreign exchange fluctuations
Carbon Black Feed Stock (CBFS) is the key raw material for carbon black, accounting for around 77% of cost of sales in FY21. CBFS is a derivative product of crude oil refining having strong correlation with crude oil prices and exhibits volatility. However, a significant portion of the sales of PCBL is to the tyre segment which operates as per pricing formulae, thereby reducing volatility in profits, if sales volumes are maintained.
PCBL sourced 75% of its raw material requirement (CBFS) through imports whereas it exported around 26% of its gross sales. PCBL being a net importer is exposed to the risk of having foreign currency payables. However, exposure to volatility in profits on account of foreign currency fluctuation is reduced to a certain extent as PCBL hedges most of its net forex exposure at all points of time. This includes its foreign currency term loans which are also completely hedged.

Dependence on the fortunes of tyre industry
A major portion of PCBL's revenue is from sale of carbon black to tyre manufacturers, in line with the overall application of carbon black produced across the globe. More than 70% of the product is used for tyre manufacturing. This leads to PCBL's dependence on the fortunes of the tyre industry which in turn is dependent on the cyclical auto industry. Tyre industry caters to the OEM's as well as replacement market. Around 60% of the total tyre industry sales is to the replacement market which provides support during cyclical auto sector downturns. Although degrowth in auto sales has the potential to impact the future replacement market, the replacement market sales have supported the overall tyre sales in FY21. Further, PCBL has also been increasing its presence in the specialty black range catering to diversified industries- paints, inks, plastics, etc. It also operates a R&D centre in Palej and Belgium where one of the objectives is to grow its portfolio in the speciality black segment.

Project risk in the form of ongoing projects
PCBL has commissioned the 32,000 MT specialty black project of Rs.230 crore in Palej in February 2021. Going forward, the company plans to increase share of specialty black in its portfolio along with other value-added grades. The company is also setting up captive power plants in Mundra, Palej and Kochi at a cumulative cost of around Rs.50 crore and same is expected to commission in a phased manner till Q2FY22.
PCBL has also resumed progress for the previously slowed greenfield capacity expansion of 150,000 MTPA of carbon black in Tamil Nadu and expects to commission the same by March 2023. The Rs.600 crore project would largely be funded through internal accruals. The company has not incurred substantial cost for the project except for land and has applied for environmental clearance. Given the amount of expected investment there exists project execution, stabilization and marketing risks.
However, as the project is largely proposed to be funded from internal accruals, the solvency ratios are expected to remain comfortable going forward. Furthermore, with announcement of capex by tyre companies, off take risk gets subdued due to some extent. The Tamil Nadu project also has a locational advantage with existing and upcoming capacities of major tyre companies being located in southern India.

Stringent pollution norms for the major industry segments
The Central Pollution Control Board (CPCB) regulates the general standards for emission or discharge of environmental pollutants of carbon chemical industry. Presently, PCBL is adhering to the pollution norms of CPCB and all its plants are zero-discharge facility.

Threat of imports of carbon black
Anti-dumping duty (ADD) which had been imposed on import of carbon black (USD 397/MT from China and USD 36/MT from Russia) from November 2009 was removed in January 2021.
As China accounts for a significant portion of the world's carbon black capacity and production, any Chinese demand supply imbalance has the potential to impact market share and performance of domestic players. However, China majorly produces carbon black through the Carbon Black Oil (CBO)/ Coal Tar route, the prices of which are higher than that of CBFS prices. Further, carbon black prices in China have surged due to plant shutdowns caused by the Chinese government's intensifying environmental protection campaign. The average prices of total imports of carbon black into India (including that from China)

have been higher than average prices of imports from China, indicating that Chinese imports have been cheaper than imports from other countries till FY20, however the said difference has decreased considerably in recent past indicating reducing cost competitiveness of China. Further, the basic customs duty on import was increased from 5% to 7.5%. The same is expected to mitigate overall import of carbon black into India.

Liquidity: Strong
Liquidity is marked by strong accruals as against relatively low debt repayment obligations. The company had free cash, bank and liquid investments of Rs.259 crore (primarily parked in bank balances and fixed deposits) as on March 31, 2021. Liquidity is also supported by unutilized lines of working capital limit where average utilization stood at 53% for sanctioned limits of Rs.550 crore in the last 12 months ended March 31, 2021. The company also enjoys financial flexibility by virtue of it being part of RP-SG group.
Its capex requirements are largely expected to be met out of internal generations though there is sufficient headroom with overall gearing at 0.43x as on March 31, 2021 to raise debt.

Analytical approach: Consolidated Approach.
Approach is being changed from standalone to consolidated as PCBL has undertaken a green field expansion project of at Tamil Nadu through newly incorporated subsidiary PCBL (TN) Ltd. The following subsidiaries are considered:

S. No.	Name of Company	% of ownership
1	Phillips Carbon Black Cyprus Holdings Ltd (PCBLCHL)	100%
2	Phillips Carbon Black Vietnam Joint Stock Company	80%
3	PCBL (TN) Ltd	100%

Applicable Criteria
Criteria on assigning Outlook & Credit watch to Credit Ratings
CARE's Policy of Default Recognition
Criteria for Short Term Instruments
Financial ratios – Non-Financial Sector
Rating Methodology: Consolidation
Rating Methodology-Manufacturing Companies
Liquidity indicators- Non-financial sector entities

About the Company
PCBL, incorporated in 1960, is engaged in the manufacturing and sale of carbon black, which is mainly used in tyre and other rubber products. The company also produces specialty carbon blacks which are used as pigmenting, UV stabilizing and conductive agents in a variety of common and specialty products, including plastics, printing & packaging and coatings. PCBL is the largest producer of carbon black in the country and one of the largest players in the world, with an installed capacity of 603,000 MTPA of carbon black. It also has captive power plants (CPP) at all its locations (aggregate capacity of 76 MW). The company sells excess power generated after meeting its own requirement. Its plants are located at Durgapur (West Bengal), Mundra (Gujarat), Palej (Gujarat) and Kochi (Kerala). PCBL is managed under the stewardship of Kolkata-based RP–Sanjiv Goenka group.

Brief Financials (Rs. crore)- Consolidated	FY20 (A)	FY21 (A)
Total operating income	3252	2670
PBILDT	507	550
PAT	288	314
Overall gearing (times)	0.51	0.43
Interest coverage (times)	11.05	16.24

A: Audited

Status of non-cooperation with other 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 Facilities

Name of the Instrument	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Fund-based - LT-Cash Credit	-	-	-	550.00	CARE AA; Stable
Non-fund-based - LT/ ST-BG/LC	-	-	-	1275.00	CARE AA; Stable / CARE A1+
Non-fund-based - LT/ ST-BG/LC	-	-	-	575.00	CARE AA; Stable / CARE A1+

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 2021-2022	Date(s) & Rating(s) assigned in 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019
1.	Commercial Paper-Commercial Paper (Standalone)	ST	-	-	1)Withdrawn (12-Apr-21)	1)CARE A1+ (23-Sep-20) 2)CARE A1+ (02-Jun-20)	1)CARE A1+ (18-Feb-20)	1)CARE A1+ (26-Dec-18)
2.	Fund-based - LT-Cash Credit	LT	550.00	CARE AA; Stable	-	1)CARE AA-; Stable (23-Sep-20)	1)CARE AA-; Stable (18-Feb-20)	1)CARE AA-; Positive (26-Dec-18)
3.	Non-fund-based - LT/ ST-BG/LC	LT/ST	1275.00	CARE AA; Stable / CARE A1+	-	1)CARE AA-; Stable / CARE A1+ (23-Sep-20)	1)CARE AA-; Stable / CARE A1+ (18-Feb-20)	1)CARE AA-; Positive / CARE A1+ (26-Dec-18)
4.	Term Loan-Long Term	LT	-	-	-	-	-	1)Withdrawn (26-Dec-18)
5.	Non-fund-based - LT/ ST-BG/LC	LT/ST	575.00	CARE AA; Stable / CARE A1+	-	1)CARE AA-; Stable / CARE A1+ (23-Sep-20)	1)CARE AA-; Stable / CARE A1+ (18-Feb-20)	1)CARE AA-; Positive / CARE A1+ (26-Dec-18)
6.	Commercial Paper-Commercial Paper (Standalone)	ST	-	-	1)Withdrawn (12-Apr-21)	1)CARE A1+ (23-Sep-20) 2)CARE A1+ (02-Jun-20)	1)CARE A1+ (18-Feb-20)	1)CARE A1+ (26-Dec-18)

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

Annexure 4- Complexity of various instruments rated for this Company

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