Seshasayee Paper and Boards Limited

April 07, 2020

Ratings

Facilities	Amount (Rs. Crore)	Rating[1]	Rating Action
Long Term Bank Facilities – Term Loan	82.50 (reduced from 120.34)	**CARE A+; Positive [Single A Plus; Outlook: Positive]**	**Reaffirmed**
Long Term Bank Facilities - Fund Based	205.00	**CARE A+; Positive [Single A Plus; Outlook: Positive]**	**Reaffirmed**
Short Term Bank Facilities - Non Fund Based	205.00	**CARE A1+ [A One Plus]**	**Reaffirmed**
Total Facilities	**492.50 [Four hundred ninety two crore and fifty lakh only]**		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The reaffirmation of the ratings assigned to the bank facilities of Seshasayee Paper and Boards Limited (SPBL) continue to factor in the established track record of the company along with extensive experience of the promoters in the paper industry as well as a strong and well-qualified technical team, well-established distribution network, its continued healthy operating performance backed by operating efficiencies as well as synergies derived from integrated manufacturing operations. The ratings also derive strength from the healthy financial risk profile marked by robust capital structure along with comfortable debt coverage indicators in FY19 and 9MFY20.

The aforementioned strengths are however tempered by susceptibility of profit margins to volatile input prices, inherent industry cyclicality and the potential impact of any latent capacity coming on stream in the industry or threat of imports in the paper industry.

Rating Sensitivities:

Positive

- *Significant improvement in scale of operations while sustaining the current level of PBILDT margins and capital structure*

Negative

- *Sustained decline in PBILDT margin below 10% on account of reduced sales realization*
- *Deterioration in overall gearing beyond 0.5x on account of debt funded organic or inorganic growth*

Outlook: Positive

The outlook continues to remain positive owing to expected sustenance in operational and financial performance resulting in healthy cash accruals, comfortable capital structure as well as strong liquidity position. The outlook may be revised to stable in case of any significant deviation in the operating performance because of import threat or slowdown in demand, thereby impacting the overall financial risk profile.

Detailed description of the key rating drivers

Key Rating Strengths

Long track record coupled with vast promoter experience in the paper industry: Incorporated in 1960, SPBL has a well established track record of around six decadesin the Indian paper industry. The company is the flagship company of the Esvin

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

group which is engaged in other industries like sugar, chemicals, project consultancy, etc. Currently, the day-to-day operations of the Erode and Tirunelveli units are handled by professional management and are ably supported by team of qualified and experienced personnel instrumental in providing technical and managerial inputs. The company is supported by its in-house project consultancy company named SPB Projects and Consultants Limited (SPB-PC), which is the project consultant for almost all major paper companies in India.

Well established distribution network: The company has a strong marketing set-up and a well-established distribution network to support the manufacturing activities. SPBL commands a strong goodwill in South India which is evident from the revenue contribution of around 65-70% of its total sales. The company has a well-built network of more than 50 dealers appointed on commission basis and one depot in Bengaluru. The company also exports its products to countries like United States of America, Sri Lanka, Nepal and Middle East countries. The company's production is largely order based procured by its dealer network.

Synergies between manufacturing facilities led to enhanced operating efficiency: The two manufacturing units of the company situated at Erode and Tirunelveli share significant synergies, wherein the company has an excess capacity of pulp manufacturing at its Erode facility which is deployed at Tirunelveli unit, thereby reducing the latter's dependency on imported pulp. The excess pulp production at the Erode unit caters to around 60% of the pulp requirement of the Tirunelvelii plant.Moreover, the captive power plant of 21 MW at Erode unit is able to supply power to the extent of 3MW to the Tirunelveli unit and reduces its dependence on external sources. The aforementioned synergies have led to savings in the raw materials as well as power cost thereby positively impacting the profit margins.

Improved operating and financial performance: The total revenue during FY19 has improved by around 20% led by increase in both volume as well as sales realization. During FY19, the company expanded the capacity of its Erode plant from 1,15,000 TPA to 1,30,000 TPA. The PBILDT margin increased significantly from 19.25% during FY18 to 23.40% during FY19 primarily led by higher sales realization during the year as well as operating efficiencies.

During 9MFY20, the revenue has decreased by around 10% on a Y-O-Y basis mainly on account of sluggish demand as well as cheaper imports from China, ASEAN countries and South Korea. However, the PBILDT margin improved from 23.07% during 9MFY19 to 25.07% during 9MFY20 primarily due to higher sales realization as well as lower input costs and operating efficiency of the company.

Improved capital structure and debt protection metrics: The overall capital structure of the company continues to remain robust marked by an improved overall gearing of 0.23x at the end of FY19 led by healthy accretion to the networth as well as reduction in borrowings. The total debt to GCA also stood healthy at 0.81x as compared 1.37x in FY18, while total debt to PBILDT ratio was at 0.64x at the end of FY19 as compared to 1.10x in FY18. An overall decrease in the term loans and working capital borrowings has led to improvement in the debt coverage indicators. The company plans to undertake capex of Rs. 315 crore, funded by term loan of Rs. 82.50 crore and the balance through internal accruals or cash reserves. Overall gearing is expected to remain comfortable despite this additional term loan.

Key Rating Weaknesses

Profit margins susceptible to volatile input prices: Wood Pulp forms a key raw material for all paper manufacturers, the prices of which have been volatile and witnessed a downward trend in the current year. Another major raw material required is wood for production of pulp. Domestically, the supply of wood to the paper industry from natural forest resources is restricted by government regulations leading to raw material availability issues. The company also remains exposed to sharp increase in hardwood prices due to higher minimum support prices of agricultural commodities. In order to mitigate the risk and ensure long term raw material availability, SPBL has taken steps to step up production of clonal seedlings and bare-rooted seedlings at its nursery and other company sponsored nurseries. With excess production of pulp at Erode plant, the company has also lowered the dependence on imported pulp to a certain extent as well. Nonetheless, SPBL's profit margins remain exposed to the fluctuations in key raw material prices (wood, wood pulp, waste paper and bagasse) depending on demand-supply dynamics.

Inherent cyclicality; competitive industry with paper players facing import threat: The paper industry is inherently cyclical owing to the long gestation period in capacity addition and lead time for raw material generation, among other factors. The demand is dependent on education and corporate sectors which are affected by the overall macroeconomic situation.

Indian Paper industry has a fragmented structure consisting of small, medium and large paper mills, having capacities ranging from 5 to 1,150 tonnes per day. The increased competition restricts companies' ability in the paper industry to pass on the rise in input cost to the end consumers and keep margins under check in the near-term. Further, there has been a rise in paper imports from ASEAN countries which has resulted in increasing share of imports in paper consumption in India thereby affecting the profitability margins of the domestic players.

Industry Outlook

Subdued and diverse trading conditions caused by geopolitical uncertainties including the current coronavirus outbreak across globe are expected to continue to impact the overall global demand. Demand in the packaging paper & board segment is slated to increase, while other segments are expected to either grow slowly or remain at similar levels.

For the domestic industry, growth is expected to be driven by factors such as income levels, growing per capita expenditure, rapid urbanization and a larger proportion of earning population which is expected to lead consumption. Despite increasing digitization, CARE Ratings expects that the overall paper demand to grow at 6 -7%. Writing and printing paper demand could grow 4%-5% while Packaging paper and board segment is expected to grow at 8%-9% per cent.

Liquidity: Strong
The company has prepaid all the outstanding term loans as on December 31, 2019 except the interest free sales tax loan, through internal accruals. Further, the company has negligible repayment obligations in FY21. The company has planned a capex of Rs. 315 crore which will be funded by debt only to the extent of 26% and balance through its cash reserves. As on December 31, 2019, the company had cash balances to the extent of Rs.258 crore. With a gearing of 0.23 times as on March 31, 2019, the issuer has sufficient gearing headroom, to raise additional debt for its capex. Moreover, the company has nil fund based utilization which provides more than adequate liquidity cushion.

Analytical approach: Standalone

Applicable Criteria
Criteria on assigning Outlook and Credit Watch to Credit Ratings
CARE's Policy on Default Recognition
Rating Methodology: Manufacturing Companies
Financial ratios – Non-Financial Sector
Criteria for Short Term Instruments

About the Company
Seshasayee Paper and Boards Limited (SPB) operates an integrated pulp, paper and paper board mill at Pallipayam (Erode, Tamil Nadu) and a paper manufacturing mill at Tirunelveli. SPB was incorporated in 1960 and commenced commercial production in December 1962 with a modest capacity of 20000 tonne per annum (TPA) integrated facility comprising of a pulp mill and two paper machines (PM 1 and PM 2). Over the years, through organic expansion, the company expanded its Erode facility to its current capacity of 1,32,000 TPA.
The company in February 2011 acquired a defunct paper mill (Subburaj Papers Limited, SPL; located in Tirunelveli) having a paper manufacturing capacity based on waste paper pulp of 60000 TPA; SPL was subsequently merged with the operations of SPB from April 2012. During FY19, the company undertook capacity expansion to increase the capacity to 90,000 TPA.
SPB manufactures a variety of papers such as printing and writing (P&W) grade papers (WPP), packing and wrapping grade papers, specialty grade papers, etc. The company markets its paper products in the domestic market under the brand name of Sprint, Sprint Plus, Swift and Success; which are amongst leading brands in Southern India.

Brief Financials (Rs. crore)	FY18 (A)	FY19 (A)
Total operating income	1111.42	1343.80
PBILDT	213.96	314.40
PAT	122.89	190.00
Overall gearing (times)	0.34	0.23
Interest coverage (times)	14.96	22.77

A: Audited; Classified as per CARE Standards

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating History for last three years: Please refer Annexure-2

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
Fund-based - LT-Term Loan	-	-	March 2026	82.50	CARE A+; Positive
Fund-based - LT-Cash Credit	-	-	-	205.00	CARE A+; Positive
Non-fund-based - ST-	-	-	-	205.00	CARE A1+

Name of the Instrument	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
BG/LC					

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 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017
1.	Fund-based - LT-Term Loan	LT	82.50	CARE A+; Positive	1)CARE A+; Positive (05-Apr-19)	1)CARE A+; Positive (07-Apr-18)	-	1)CARE A+; Stable (23-Jan-17)
2.	Fund-based - LT-Cash Credit	LT	205.00	CARE A+; Positive	1)CARE A+; Positive (05-Apr-19)	1)CARE A+; Positive (07-Apr-18)	-	1)CARE A+; Stable (23-Jan-17)
3.	Non-fund-based - ST-BG/LC	ST	205.00	CARE A1+	1)CARE A1+ (05-Apr-19)	1)CARE A1+ (07-Apr-18)	-	1)CARE A1+ (23-Jan-17)
4.	Fund-based - ST-SLC-WC	ST	-	-	-	1)Withdrawn (07-Apr-18)	-	1)CARE A1+ (23-Jan-17)

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

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