September 30, 2022

Minera Steel and Power Private Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long Term – Fund Based (Term Loan)	130.32	150.00	[ICRA]A (Stable); reaffirmed
Long Term – Fund Based (Cash Credit)	85.00	100.00	[ICRA]A (Stable); reaffirmed
Short Term – Non-Fund Based	66.00	80.00	[ICRA]A1; reaffirmed
Long Term/Short Term – Unallocated	48.68	-	-
Total	**330.00**	**330.00**	

**Instrument details are provided in Annexure-1*

Rationale

The reaffirmation in the ratings of Minera Steel and Power Private Limited (Minera) factors in the company's improved financial performance in the FY2022, backed by the rising global steel prices, and the promoter's demonstrated experience of over 15 years in the steel industry. ICRA notes that the overall operating income of the company improved by 40% in FY2022 vis-a-vis FY2021, whereas the OPBIDTA[1] improved by 28% in FY2022 vis-a-vis FY2021. The operating margins however declined to ~18.0% in FY2022 from 19.7% in FY2021 due to rising raw material costs. The integrated nature of operations enhances the cost-competitiveness and partly mitigates from the cyclicity inherent in the steel industry. The captive power generation (which operates on waste-heat generated from the sponge iron kiln as well as on coal/dolochar as fuel), pellet, sponge iron, and billet manufacturing capacities of the company in Bellary, Karnataka strengthens the overall operating profile of the company due to backward integration.

The reaffirmation of ratings also factors in the expected operationalization of the two iron ore mines (out of which one mine is already in operation from September 2022), located at close proximity to the end use plant. While these mines have been won at premiums of 59.5% and 107.5%, it is still expected to generate sizeable savings in the future, largely emanating from the savings in logistics costs. The aggregate extraction of iron ore from the mines would sum up to 3,98,000 metric tonne per annum (MTPA) and facilitate the company to source more than 50% of its total iron ore requirement. The ratings also consider in the proposed acquisition of 1,15,000 MTPA sponge iron plant located adjacent to the company's existing operations in Bellary. The plant also has an 8 MW waste heat recovery based (WHRB) power plant which would help the company to become largely self-sufficient in its power requirement, besides its existing 12 MW of captive power plant (CPP) already in operation. Moreover, the plant's adjacent land area of around 60 acres gives scope for future growth options, given that it has the supportive infrastructure in place. ICRA understands that while the company operates the pellet plant with an approval of 6 lakhs MTPA at present, it has approached the Ministry of Environment and Forests (MoEF) to increase it to 8 lakhs MTPA. If this capacity enhancement is allowed, it would support a higher level of earnings from the merchant pellet business.

The ratings are, however, constrained by the expected moderation in the leverage indicators due to the sizeable debt-funded capex plan being lined up. The total investment accumulates to an estimated Rs. 230 crores towards the captive iron ore mines and sponge iron plant acquisition in the current and previous fiscal year, financed through a mix of external debt and internal accruals. The company's lumpy capex in the current fiscal is expected to push its free cash flows in the negative territory for

[1] *OPBIDTA: Operating profit before depreciation, interest, taxes and amortisation*

the first time in four years, in turn impacting the liquidity position temporarily. However, the healthy cash balance and undrawn working capital limits of Rs. 150 crore (which had a negative balance in end-August 2022) provides a cushion to the overall liquidity of the company during the current growth phase. ICRA understands that given the company's calibrated approach towards investment decisions in the past, the company's capex programme is expected to taper down in FY2024, with the focus shifting to operationalising/stabilising the acquired assets. This is expected to pull-back the free cash flows in the positive territory in FY2024, in turn strengthening the liquidity position. Moreover, with almost two-third of the overall outlay (for iron ore mines + 8 MW WHRB captive power plant) supporting cost-savings initiatives, the payback period is expected to remain attractive.

The ratings also remain constrained by the company's exposure to the cyclicality inherent in the steel industry and the susceptibility of its profitability to the volatility in raw material prices and end-product realisations The ratings also factor in the risk associated with geographical concentration of the company in the southern region of India along with the company's exposure to regulatory risks as any unfavourable change in the Government policy may impact its raw material availability and price of finished products. In this regard, the 45% duty on export of iron ore pellets imposed in May 2022 have resulted in pellet prices coming under pressure in the domestic market. Although iron ore prices have also declined significantly due to the imposition of a 50% export duty, partly mitigating the decline in pellet prices, overall spreads are expected to be weaker than levels seen in FY2022. In addition, the elevated coal costs would nibble at the margins of secondary steel products, and therefore ICRA expects the current year gross contribution levels to moderate from the highs of FY2022, leading to a sequential moderation in earning expectations, which will be partly alleviated by the expected cost savings and higher sponge-iron output from the planned capex as highlighted above. Also, the favourable demand outlook of the steel industry being supported by the Government's infrastructure capex plans is expected to auger well for the company.

The Stable outlook on the company's long-term rating reflects ICRA's expectation that notwithstanding the large debt-funded capex plans, the company's credit metrics would continue to remain at comfortable levels going forward, supported by its ability to efficiently run its plants.

Key rating drivers and their description

Credit strengths

Comfortable financial risk profile, characterized by healthy credit metrics – The OPBIDTA[2] of the company was a bit depressed in Q1 FY2023 (~Rs. 29 crore), but a sequential improvement has been witnessed in Q2 FY2023, when the company has reported operating profits of ~Rs. 40-45 crores. In the first half of FY2023, the revenue clocked was around Rs. 600 crores. The overall OPBIDTA of the company increased by 28% in FY2022 vis-à-vis FY2021, supported by the rally in steel prices, tempered to an extent by the rising inputs costs. However, the company's ability to procure raw material at competitive prices and partial pass-through of the increased raw material cost to the customers, helped the company to protect their operating margins to some extent, which declined marginally to ~18.0% in FY2022 from 19.7% in FY2021

Sizeable cost savings expected going forward following operationalization of captive iron ore mines (one mine is already operationalised)- The company has successfully been able to bid for two iron ore mines- Auro Minerals Iron Ore Mines in Vijayanagara district on February 21, 2022, and for Nidhi Mines in Bellary district on September 3, 2018. These mines are located at close proximity (15-45 km) to the end use plant, and once fully operational, will enable the company to source more than 50% of its total iron ore requirement and help the company in significant savings, which as per ICRA's estimates is expected to remain in the range of Rs. 20-25 crores annually.

Integrated nature of operations and experienced management – Minera has manufacturing facilities for pellet, sponge iron and billets along with captive power generation plant. Backward integration into iron ore mining operations would further

[2] *OPBIDTA: Operating profit before depreciation, interest, taxes and amortisation*

strengthen the company's operating profile. The company has already operationalised the 84,000 MTPA Auro mines in September 2022 and is looking forward to starting production from the 3,14,000 MTPA Nidhi mines shortly following the receipt of necessary regulatory clearances. Captive iron ore sourcing gives the company a cost advantage over other secondary steel producers who are dependent on sourcing costlier iron ore from the market. The experience of the management and the promoter's demonstrated track record of over 15 years supports the operational and financial profile of the company.

Favourable demand outlook for the steel industry - The steel sector witnessed a revision in outlook from positive to stable due to the elevated input cost pressures along with steel price corrections following the imposition of export duty. Consequently, ICRA has revised the industry's operating profit estimate downwards by 30% over the earlier forecasts made before the Russia-Ukraine conflict. However, supported by the Government's infrastructure capex plans, domestic steel demand is expected to grow at a healthy 7-8% in FY2023, which should support adequate capacity levels of domestic steel mills.

Credit challenges

Debt funded proposed acquisition of a secondary steel plant is expected to lead to weakening of the liquidity profile and a moderation in the credit metrics in the near term - The company has acquired the two mines and sponge iron plant (including the 8 MW WHRB plant) for ~Rs. 230 crores, to be funded through a mix of bank loans and internal cash accruals. Consequently, the external debt levels are expected to rise significantly in the current fiscal from the level of FY2022, leading to a weakening of the leverage indicators (Total Debt/OPBDITA expected to be around 1.9 times in FY2023 against 0.9 times in FY2022 and 0.9 times in FY2021) over the near term. However, ICRA also expects the company's external debt levels to gradually come down from FY2024, supported by a reduction in capex spends and healthy free cash flow generation. This in turn is likely to help its leverage indicators improve meaningfully from FY2024 onwards (Total Debt/OPBDITA expected to decline to 1.5 times in FY2024 and 1.0 times in FY2025).

Exposure to volatile profits given the cyclicality inherent in the steel industry– The steel industry is cyclical in nature, which is likely to result in volatile cash flows for steel players, including Minera. Nevertheless, the company's efficient cost structure emanating from its modest level of integration partly reduces the susceptibility of its profitability to downturns in the steel industry. The cash flows and profitability of the company would remain volatile largely because of fluctuation in spreads emerging from the mismatch in price movement of raw materials and end products.

Exposure to regulatory risks as any unfavourable change in the Government policy may impact its raw material availability and price of finished products - On May 21, 2022, the Government of India (GoI) imposed a steep 45% duty (from nil earlier) on export of iron ore pellet, post which pellet prices have come under pressure. Although iron ore prices have also declined significantly, partly cushioning the decline in pellet prices, ICRA expects the gross contribution level to reduce from the high of FY2022, leading to a moderation in FY2023 earnings, partly alleviated by the expected savings from lower captive power and iron ore costs. The timely receipt of regulatory clearance for operationalising the second mine (Nidhi mine) is also a regulatory risk associated to the mine acquisition.

Exposure to geographical concentration risks – The company's operations are mainly concentrated in the southern region, exposing it to geographical concentration risk. A slowdown in steel demand in its key addressable markets in the southern region could lead to an overall decline in its revenues and profits in the future. However, apart from the core market of Karnataka, the company has diversified into new markets like Tamil Nadu, Kerala, Maharashtra, Madhya Pradesh and Gujarat, which can reduce geographical concentration risks in the future.

Liquidity position: Adequate

The Company's liquidity position is **adequate** supported by healthy retained cash flows and sufficient undrawn limits. The average monthly utilisation of fund-based working capital limits stood at negative 8% during June 2021 to Sep 2022. While the company reported positive free cash flows in three years back-to-back (FY2020 – FY2022), the ~Rs. 230-crore acquisition of iron ore mines and sponge iron plant (including 8 MW WHRB plant) will pull the free cash flows in the negative territory in

FY2023. However, the undrawn working capital bank lines, tied-up/ proposed acquisition debt aggregating to ~Rs. 140 crores, along with healthy free cash (including liquid investments) supports the adequate liquidity position of the company. The established relationship with domestic banks also supports the company's financial flexibility. ICRA understands that given the company's calibrated approach towards investment decisions in the past, the company's capex programme is expected to taper down in FY2024, with the focus shifting to operationalising/stabilising the acquired assets. This is expected to pull-back the free cash flows in the positive territory in FY2024, in turn strengthening the liquidity position.

Rating sensitivities

Positive factors – Stabilisation and ramping up of operations of the captive iron ore mines and new steel unit, leading to improvement in the cost structure and increase in scale of operations, will be positive for the ratings. Specific metrics that could lead to an upgrade of the long-term rating is Total Debt/OPBITDA being less than 1.5 times on a sustained basis.

Negative factors – Any significant debt-funded capex or drop in earnings leading to deterioration in debt protection metrics can exert downward rating pressure; Specific credit metric that would put pressure on the ratings would be a Total Debt/OPBITDA of more than 2.3 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Ferrous Metals Industry
Parent/Group Support	Not Applicable
Consolidation/Standalone	Standalone

About the company

Established in 2006 as a private limited company in the name of KMMI Steel Private Limited and later renamed as Minera Steel & Power Private Limited in February 2011, Minera Steel & Power Private Limited is an integrated steel plant, manufacturing MS Billets, sponge iron and pellets along with a captive power plant of 12 MW capacity. Currently the company has its works location in Bellary district of Karnataka and registered office in Bangalore. The company is promoted by Mr. H. Noor Ahmed and is managed by his son Mr. Tanveer Ahmed and a professional team. The current capacity of the company is 6 lakhs MTPA for pellets, 1,50,000 MTPA for sponge iron and 1,38,600 MT pa for billets. The company is at an advanced stage to acquire a sponge iron plant of capacity 1,15,000 MTPA and an 8 MW captive power plant in the current fiscal. In addition, the company is in the process of operationalising two iron ore mines having a cumulative rated capacity of 3,98,000 MTPA.

Key financial indicators

Standalone	FY2021	FY2022**
Operating income	736.7	1032.2
PAT	62.9	117.0
OPBDIT/OI	19.7%	18.0%
PAT/OI	8.5%	11.3%
Total outside liabilities/Tangible net worth (times)	0.8	0.7
Total debt/OPBDIT (times)	0.9	0.9
Interest coverage (times)	8.5	14.8

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation

***Provisional*

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 March 31, 2022 (Rs. crore)	Date & rating in FY2023	Date & rating in FY2022	
				September 30, 2022	June 16, 2021	June 03, 2021
Term loan	Long Term	150.0	111.3	**[ICRA]A (Stable)**	**[ICRA]A (Stable)**	[ICRA]A (Stable)
Non-Fund based	Short Term	80.0	-	**[ICRA]A1**	**[ICRA]A1**	-
Cash Credit	Long Term	100.0	50.0	**[ICRA]A (Stable)**	**[ICRA]A (Stable)**	-
Unallocated	Long Term/ Short Term	-	-	-	**[ICRA]A (Stable)/ [ICRA]A1**	-

Complexity level of the rated instrument

Instrument	Complexity Indicator
Long Term – Fund Based (Term Loan)	Simple
Long Term – Fund Based (Cash Credit)	Simple
Short Term – Non-Fund Based	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, is available on ICRA's website: www.icra.in

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loan	Jul-2016	8.20%	Mar-2026	150.00	[ICRA]A (Stable)
NA	Cash Credit	-	-	-	100.00	[ICRA]A (Stable)
NA	Non-fund based	-	-	-	80.00	[ICRA]A1

Source: *Company*

Annexure-2: List of entities considered for consolidated analysis

Company Name	Consolidation Approach
Not Applicable	

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About ICRA Limited:

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For more information, visit www.icra.in

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