July 14, 2023

M Hanumantha Rao: Ratings reaffirmed; rated amount enhanced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund based – Term Loans	54.27	84.70	[ICRA]BBB- (Stable); reaffirmed/ assigned
Fund based – Cash Credit	4.80	4.80	[ICRA]BBB- (Stable); reaffirmed
Non-fund based – Bank Guarantee	3.00	6.00	[ICRA]A3; reaffirmed/assigned
Fund based – Export Packing Credit	0.00	15.00	[ICRA]BBB- (Stable); assigned
Total	**62.07**	**110.50**	

**Instrument details are provided in Annexure-I*

Rationale

The rating action for M Hanumantha Rao (MHR) factors in its diversified revenue streams from mining and wind power generation businesses. ICRA notes that MHR's mining lease is valid till May 2055, which not only provides long revenue visibility, but also enhances the cost competitiveness due to the significantly lower taxes/duties compared to newly auctioned mines. The ratings, however, remain constrained by MHR's exposure to the cyclicality in iron ore prices and to the risks arising from operating in a highly regulated iron ore mining industry. However, the firm's overall earnings volatility is mitigated by the stable revenue stream generated from the high-margin wind power generation segment. The firm's profits witnessed sequential moderation in FY2023, weighed down by the regulatory action following the steep increase in export duties on iron ore to 50% in May 2022. This led to domestic oversupply and consequent sharp price corrections as well as limited offtake from end users last fiscal. However, earnings are expected to recover in the current fiscal, supported by the rollback of export duties in November 2022. This, along with the removal of export ban on iron ore in Karnataka in May 2022, has opened the international market for the firm, where prices remain more remunerative, especially for lower grade ores. The ratings also consider the working capital-intensive nature of the firm's operations due to its large inventory levels. Additionally, absence of any long-term agreement for sale of wind power restricts long-term revenue visibility, exposing the firm to offtake risk as well as the risk of a downward revision in the tariff, following any adverse policy changes by the state electricity regulatory commission for open-access sales to commercial & industrial (C&I) customers in Karnataka.

The firm's debt-funded expansion of its wind generation capacity by 4.2 MW, along with the moderation in earnings from the mining business, led to a weakening of the credit metrics in FY2023. However, the firm's leverage metrics (as measured by the total debt to operating profits), after temporarily deteriorating to 4.3 times in FY2023, are expected to recover to below 2.5 times in FY2024, as the earnings from the newly commissioned windmills and scaling up of the iron ore business from export sales starts to trickle down to the P&L. In FY2024, MHR is further planning its next windmill expansion by another 4.2 MW, which is targeted to be commissioned by March 2025. Timely completion of the project within the budgeted costs, while maintaining healthy capital structure and credit indicators, would be a key monitorable from the credit perspective. The rating is also tempered by MHR's status as a partnership firm, which exposes it to the risk of capital withdrawals.

The Stable outlook on the long-term rating reflects ICRA's opinion that MHR will continue to benefit from the healthy demand of iron ore in the near-to-medium term, which, along with stable earnings from wind energy sales, is expected keep its credit indicators at modest levels, going forward.

Key rating drivers and their description

Credit strengths

Diversified business profile with presence in mining along with continuously expanding wind power generation segment – MHR is primarily a mining firm and derives the major portion of its revenues from the mining segment. The mining business witnessed a dip in performance in FY2023, weighed down by the regulatory action following the steep increase in export duties on iron ore to 50% in May 2022. This disruption resulted in a delay in execution of a Rs. 31-crore export order by around a month from March 2023 to April 2023, in turn leading to a decline in the revenues from the mining operations to Rs. 16.7 crore in FY2023 from Rs. 62.5 crore in FY2022. However, mining business revenues are expected to recover in the current fiscal supported by the rollback of export duties in November 2022, which along with the removal of iron ore export ban on Karnataka earlier in May 2022, has opened the international market for the firm, where prices remain more remunerative, especially for lower grade ores. Wind business, on the other hand, contributes a smaller share of revenues to the firm. However, this business has received a continued thrust in fresh investments, leading to the installed capacity continuously showing a growing trend over the past five years (6.3 MW in FY2018 and 14.7 MW in FY2023). The 4.2 MW capacity which was expected to be commissioned in March 2023 although delayed is expected to commission in the upcoming months further increasing MHR wind generation capacity in addition to the firm's plan to continuously grow the capacity over the medium term.

Long lease validity provides healthy revenue visibility – MHR signed its mining lease in 2005 for a tenure of 50 years, providing a long lease validity till 2055. The current proven reserves in the mine stand at around 5 million MT, which, factoring in the current approved annual mining capacity, lead to a residual mine life of more than 20 years. This will ensure revenue visibility for the firm over a long period.

Low duties/ taxes compared to auctioned mines enhance cost competitiveness of the iron ore mining business – For MHR, unlike the recently auctioned mines, there is no revenue sharing with the state of Karnataka. The firm's duties and taxes accumulate to ~29.8% (special purpose vehicle contribution @10% of IBM prices, royalty @15% of IBM prices, along with DMF and NMET equivalent to 30% and 2% of royalty, respectively). A low base for duties/ taxes enhances MHR's cost-competitiveness and helps the firm generate profits across business cycles.

High-margin wind power segment to cushion margin volatility arising from the mining business – Wind power business has a stable operating margin of around 80% historically due to its low and fixed cost nature of operating and maintenance expenses. The margin in the mining business is volatile and depends on the average selling price of ore in the market, which in turn is driven by the demand-supply dynamics. However, the firm's overall earnings volatility is mitigated by the stable revenue generated from the high-margin wind power generation segment. Historically, operating profits from the wind power segment contributed around 40-50% to the firm's operating profits, except in FY2021 and FY2022, which was an upcycle for the mining segment. Going forward, share from the wind power segment is expected to remain between 40-60%, supported by higher generation capacity with commissioning of 4.2 MW capacity in the upcoming months in addition to planned additions by the firm over the medium term.

Credit challenges

Moderation in credit indicators in FY2023; however, improvement expected in FY2024 – Due to utilisation of the windmill debt and moderation in the firm's performance, the credit metrics in FY2023 have moderated for the firm with Total Debt to OPBDITA of 4.3 times (against 0.8 times in FY2022) and interest cover of 3.7 times (against 18 times in FY2022). However, with the expected improvement in earnings in FY2024 from a recovery in the performance of the mining operations in addition to the stable earnings of the wind power business, the credit indicators are expected to sequentially improve in FY2024 and remain at comfortable levels thereafter. Additionally, the long tenure of the debt taken ensures that earnings from MHR's wind assets should be able to meet the repayment requirements, keeping a comfortable buffer (DSCR expected to remain at ~2 times in FY2024E).

Exposure to cyclicality of iron ore prices and regulatory risks – MHR is vulnerable to the fluctuations in domestic iron ore prices, given its linkages with the inherently cyclical steel sector, which is its only end-user industry. Additionally, MHR operates in a highly regulated iron ore mining industry, which exposes it to regulatory risks. In FY2023 itself, there have been multiple policy changes, which impacted the iron ore miners in Karnataka including lifting of the export ban by the Supreme Court, imposition and reversal of export duties, and discontinuation of auctions conducted by the Monitoring Committee.

Working capital intensive nature of operations – MHR historically maintains high level of inventory primarily at the mine head. This leads to a sizeable working capital blockage, as reflected in the Net Working Capital/Operating Income (NWC/OI) historically remaining at an elevated level (29-35% between FY2019 and FY2021). While the working capital intensity gradually moderated in FY2022 (~16%), it is increased to 80% in FY2023 due to delay in delivery of the export order of ~50,000 metric tonne (MT) from March 2023 to April 2023, leading to elevated inventory levels for a temporary period. Over the medium term, the NWC/OI is expected to moderate to around 25-30%. To support the exports the firm has received sanction for a packing credit facility for Rs. 15.0 crore, to support the elevated working capital requirements from its export orders.

Exposure to offtake/ renewal risks in the wind power business, given the short tenure of the power sale agreement – MHR does not have a long-term power purchase agreement (PPA) with its commercial and industrial (C&I) customers. However, the firm has a wheeling and banking agreement with the Karnataka Power Transmission Corporation (KPTC) and enters short-term sales contracts with C&I customers. This increases the offtake/renewal risks for the firm and restricts revenue visibility for the segment. Additionally, as per the latest tariff order by the Karnataka Electricity Regulatory Commission, the additional surcharge has been proposed to be increased from Rs 0.35/unit to Rs 1.48/unit, which would make open access purchases less attractive for C&I customers and could adversely impact MHR's tariff competitiveness. However, ICRA understands that the matter is subjudice and the outcome of the same is awaited which would remain a key monitorable.

Exposure to the capital withdrawal risk given its status as a partnership firm – Being a partnership firm, the risk of capital withdrawal is inherent for MHR, which can arise from outflow for personal use, investments in any related entities or dissolution of the partnership. In FY2022, capital withdrawals from the firm were elevated, however the same have moderated in FY2023. Any major capital withdrawal, which adversely impacts the liquidity and capitalisation indicators, will remain a key monitorable for the firm.

Liquidity position: Adequate

As of May 31, 2023, the firm's free cash and bank balances worth Rs. 0.91 crore at the standalone level, along with its cushion of unutilised working capital facilities of Rs. 4.80 crore (cash credit), support the liquidity position. Additionally, firm also availed an export packing credit limit of Rs 15 crore and has undrawn term loans of Rs 28.5 crore, which increases the liquidity headroom. ICRA estimates that the retained cash flows in FY2024 should comfortably meet its debt repayment obligation of Rs 9.4 crore for the fiscal, and equity contribution of the planned wind capex. Consequently, the firm's liquidity has been assessed as adequate.

Rating sensitivities

Positive factors – The rating could be upgraded in case of a significant scale up in the revenues and profitability of the firm, leading to sustainable improvement in its net worth.

Negative factors – The rating could witness a downward revision in case of any adverse impact on the revenue/ profitability of the firm leading to deterioration in debt protection metrics. Further, any sizeable capital withdrawal/major cash outflow to group companies or higher working capital requirement leading to an adverse impact on the liquidity position of the firm may trigger a downward rating action. Specific credit metric for a rating downgrade includes DSCR falling below 1.4 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating Methodology for Mining Entities Rating Methodology for Wind Power Producers
Parent/Group support	Not Applicable
Consolidation/Standalone	The ratings are based on the standalone financials of MHR

About the company

M Hanumantha Rao (MHR) is a partnership firm started in 2002 and is involved in iron ore mining in Sandur Taluk, Bellary district, Karnataka with a sanctioned mining area of 40.47 hectares with lease validity till 2055. MHR is involved in extraction and sale of iron ore and has permission for mining of 2,26,000 MT per annum of iron ore per annum. MHR also operates windmills for power generation with an existing capacity of 14.70 MW.

MHR was started by Shri Shyam Sunder Chirania and Shri M Hanumantha Rao as equal partners in the firm. MHR is promoted by Shri Shyam Sunder Chirania, his sons Mr. Anil Kumar Chirania and Mr. Arun Kumar Chirania and Mr. M Maruti Rao with effect from 2018.

Key financial indicators

M Hanumantha Rao	FY2022	FY2023*	2M FY2024*
Operating income	72.35	30.36	32.3
PAT	24.97	0.49	21.5
OPBDIT/OI	51.8%	44.5%	67.7%
PAT/OI	34.5%	1.6%	66.6%
Total outside liabilities/Tangible net worth (times)	1.29	2.32	-
Total debt/OPBDIT (times)	0.80	4.34	-
Interest coverage (times)	17.98	3.67	-

Source: Company, For MHR PAT is equivalent to PBT as taxation is charged in partner's capital account
*PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore; *Provisional*

Status of non-cooperation with previous CRA:

CRA	Status	Date of Release
Brickworks	BWR BB- (Stable)/BWR A4; ISSUER NOT COOPERATING/Downgraded	May 18, 2023

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2024)				Chronology of rating history for the past 3 years			
		Type	Amount rated (Rs. crore)	Amount outstanding as of Mar 31, 2023 (Rs. crore)	Date & rating in FY2024	Date & rating in FY2023		Date & rating in FY2022	Date & rating in FY2021
					Jul 14, 2023	Jan 23, 2023	Jan 06, 2023	-	-
1	**Term loans**	Long term	84.70	45.19	**[ICRA]BBB- (Stable)**	**[ICRA]BBB- (Stable)**	**[ICRA]BBB- (Stable)**	-	-
2	**Cash Credit**	Long term	4.80	-	**[ICRA]BBB- (Stable)**	**[ICRA]BBB- (Stable)**	-	-	-
3	**Bank Guarantee**	Short term	6.00	-	**[ICRA]A3**	**[ICRA]A3**	-	-	-
4	**Export Packing Credit**	Long term	15.00	-	**[ICRA]BBB- (Stable)**	-	-	-	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long Term – Term Loans	Simple
Long Term – Cash Credit	Simple
Short Term – Bank Guarantee	Very Simple
Long Term – Export Packing Credit	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 are available on ICRA's website: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	**Term Loans**	March 22	NA	March 37	84.70	[ICRA]BBB- (Stable)
NA	**Cash Credit**	NA	NA	NA	4.80	[ICRA]BBB- (Stable)
NA	**Bank Guarantee**	NA	NA	NA	6.00	[ICRA]A3
NA	**Export Packing Credit**	NA	NA	NA	15.00	[ICRA]BBB- (Stable)

Source: Company

Please click here to view details of lender-wise facilities rated by ICRA

Annexure II: List of entities considered for consolidated analysis: Not Applicable

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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