December 28, 2023

# Neo Metaliks Limited: Ratings reaffirmed; [ICRA]A-(Stable)/[ICRA]A2+ assigned for the enhanced amount

## Summary of rating action

| Instrument* | Previous Rated Amount (Rs. Crore) | Current Rated Amount (Rs. crore) | Rating Action |
|---|---|---|---|
| Fund-based limits | 78.50 | 78.50 | [ICRA]A-(Stable); reaffirmed |
| Non-fund based facilities | 114.20 | 151.00 | [ICRA]A2+; reaffirmed/assigned |
| Term Loans | 189.24 | 256.00 | [ICRA]A-(Stable); reaffirmed/assigned |
| **Total** | **381.94** | **485.50** | |

**Instrument details are provided in Annexure-1*

## Rationale

The ratings factor in the experience of Neo Metaliks Limited's (NML) promoters of over a decade in the pig iron (mainly steel grade) manufacturing business, which has helped the company establish a strong customer base over the years. The ratings also consider the financial flexibility enjoyed by NML for being a part of the Rupa Group. The Group has a strong market position in the knitwear segment with a pan-India presence through Rupa & Company Limited (flagship company of the Rupa Group). The ratings further factor in the healthy financial performance of the company in FY2023 despite the challenging operating environment. While the broader industry reported a sequential decline in earnings in FY2023 due to elevated raw material costs, NML's earnings, on the contrary, moved up. While domestically produced met coke (key raw material for the company) was elevated on account of high coking coal prices, NML opted for relatively cheaper imported met coke, helping it record its best ever pig iron spreads and consequently its best ever absolute operating profits in FY2023. ICRA expects the company's financial performance to be healthy in FY2024 as well, supported by healthy spreads. The ratings also consider the semi-integrated nature of operations, which strengthens the operating profile of the company. Over the years, NML has taken various cost improvement initiatives viz. setting up of a 4.5-MW power plant in FY2010, which operates on gas generated from the mini blast furnace, and commissioning of a sinter plant in FY2012. In April 2021, the company had commissioned a pulverised coal injection (PCI) facility to partially replace costlier coke with cheaper pulverised coal. The operationalisation and stabilisation of the PCI facility have led to significant cost savings for the company, given the cost differences between met coke and pulverised coal. Once the upcoming mini blast furnace is operational, the capacity of which is almost double the capacity of the existing mini blast furnace, the company plans to significantly increase the PCI rate to around 160 kg/MT of hot metal from the existing level of around 80 kg/MT, thereby further increasing the quantum of structural cost savings. The larger furnace size of the upcoming mini blast furnace along with technical improvements incorporated in the revised scope of the expansion project would support better efficiency parameters. These include reduction in coke rate, increase in PCI rate, increased production days emanating from improved hearth design, increase in power generation from captive facilities, lower power consumption etc. This initiative would increase the cost competitiveness of the company and cushion its profits during periods when pig iron prices remain less buoyant.

The ratings, however, remain constrained by the large debt-funded capex being undertaken, which is expected to weaken the leverage ratios over the near term. ICRA has noted the change in the scope of the project from the time of the earlier rating exercise. The earlier expansion plan envisaged dismantling of the existing mini blast furnace and replacing it with a larger sized furnace in the same place, which would have entailed complete closure of the existing operations with no cash flow for five to six months. However, the revised scope includes erection of the new larger sized blast furnace in an adjacent location within the factory premises. This will not disrupt the operations of the existing mini blast furnace and thus ensure cash flow continuity, barring the last one month before the new furnace becomes operational. While the revised scope almost entirely eliminates the risk of business continuity due to potential unforeseen challenges during the erection stage, the same has led to an increase in the overall project cost by almost 38%. That said, a part of this increase is also due to technical improvements incorporated in the revised scope of the expansion project. This cost escalation would lead to higher reliance on debt. The debt-funded nature of the capex would keep the overall debt levels elevated, leading to a weakening of the leverage indicators (Gross Debt/OPBDITA) over the near term. However, ICRA expects that the leverage metrics, after weakening temporarily in FY2024 (Gross Debt/OPBDITA of ~3.9 times) and FY2025 (Gross Debt/OPBDITA of ~3.8 times), would gradually improve from FY2026 (Gross Debt/OPBDITA of ~2.3 times) as the benefits of the expansion start to fully flow in the income statement following a production ramp-up. While funding risks remain mitigated as the initial project debt of Rs.185 crore has already been tied up and the incremental project debt of Rs.71 crore is in the advanced stages of tie-up, NML would remain exposed to the project execution risks, given the company's limited track record in commissioning greenfield/brownfield projects. The ratings also remain constrained by the company's exposure to the cyclicality inherent in the pig-iron business as margins fluctuate due to temporary mismatches in the prices of raw materials and pig iron, causing volatility in profitability and cash flows. The ratings also remain constrained by the commoditised nature of the product, which keeps the company's profitability under check.

The Stable outlook on the long-term rating reflects ICRA's expectations that NML will continue to benefit from the favourable operating environment, cost-efficient operations, and competitive capital cost for the expansion project, which is expected to support its credit profile over the near-to-medium term.

## Key rating drivers and their description

### Credit strengths

**Extensive experience of promoters; financial flexibility for being a part of Rupa Group** – NML benefits from the experience of its promoters in the pig-iron manufacturing industry, spanning over a decade. Long experience of the promoters has helped the company establish a strong customer base over the years. ICRA also notes the company's established trade relationships with clients, which enabled it to get repeat business over the years. NML's status of being a part of the Rupa Group imparts considerable financial flexibility. The Group has a strong market position in the economy, medium and premium segments of the innerwear market with a pan-India presence through Rupa & Company Limited (flagship company of the Rupa Group). In the past, the Group has supported NML through infusion of funds. ICRA expects the Group to support NML, if required.

**Healthy financial performance in FY2023 despite challenging operating environment** – While the broader industry reported a sequential decline in earnings in FY2023 due to elevated raw material costs, NML's earnings, on the contrary, moved up. While domestically produced met coke (key raw material for the company) price was elevated on account of high coking coal price, NML opted for relatively cheaper imported met coke, which helped it record its best ever pig iron spreads and consequently its best ever absolute operating profits in FY2023. ICRA expects the company's financial performance to be healthy in FY2024 as well, supported by healthy spreads.

**Semi-integrated nature of operations strengthens operating profile** – Over the years, NML has taken various cost-improvement initiatives viz. setting up of a 4.5-MW power plant in FY2010, which operates on gas generated from the mini blast furnace, and commissioning of a sinter plant in FY2012. In April 2021, the company had commissioned a pulverised coal injection (PCI) facility to partially replace costlier coke with cheaper pulverised coal, which led to significant cost savings for the company.

**Stabilisation of operations at PCI facility led to structural cost savings** – The operationalisation and stabilisation of the PCI facility in April 2021 have led to significant cost savings for the company, given the cost differential between met coke and pulverised coal. The company has been able to increase the PCI injection rate from around 40 kg/MT of hot metal to around 80 kg/MT at present, steadily, thus increasing the quantum of cost savings. Once the upcoming mini blast furnace is operational, the capacity of which is almost double the capacity of the existing mini blast furnace, the company would be able to significantly increase the PCI rate to around 160 kg/MT of hot metal, thereby increasing the quantum of structural cost savings further.

**Larger furnace size of the new mini blast furnace to support better efficiency parameters and increase cost competitiveness** – As a part of the company's growth strategy, it is setting up a new mini blast furnace, the capacity of which is almost double the capacity of the existing mini blast furnace. The larger furnace size of the upcoming mini blast furnace along with technical improvements incorporated in the revised scope of the expansion project would support better efficiency parameters. These include reduction in coke rate, increase in PCI rate, increased production days emanating from improved hearth design, increase in power generation from captive facilities, lower power consumption etc. These would increase the cost competitiveness of the company and cushion its profits during periods when pig iron prices remain less buoyant.

## Credit challenges

**Large debt-funded capex may weaken leverage ratios and expose the company to project execution risks** – The company is undertaking a large debt-funded capex for setting up a new mini blast furnace (hot metal capacity of around 0.4 MTPA), along with other ancillary expansion such as more than doubling the sinter capacity and installation of a new 10-MW captive power plant. ICRA has noted the change in the scope of the project from the time of the earlier rating exercise. While the earlier expansion plan envisaged dismantling of the existing mini blast furnace and replacing it with a larger sized furnace in the same place, which would have entailed complete closure of the existing operations with no cash flow for five to six months, the revised scope includes erection of the new larger sized blast furnace in an adjacent location within the factory premises. This will not disrupt the operations of the existing mini blast furnace and ensure cash flow continuity, barring the last one month, before the new furnace becomes operational. While the revised scope almost eliminates the risk of business continuity due to potential unforeseen challenges during the erection stage, the same led to an increase in the overall project cost by almost 38%. That said, a part of this increase is also due to technical improvements incorporated in the revised scope of the expansion project. This cost escalation would lead to higher reliance on debt.

The debt-funded nature of the capex would keep the overall debt levels elevated, weakening the leverage indicators (Gross Debt/OPBDITA) over the near term. However, ICRA expects the leverage metrics, after weakening temporarily in FY2024 (Gross Debt/OPBDITA of ~3.9 times) and FY2025 (Gross Debt/OPBDITA of ~3.8 times), to gradually improve from FY2026 (Gross Debt/OPBDITA of ~2.3 times) as the benefits of the expansion start to fully flow in the income statement following a production ramp-up. While funding risks remain mitigated as the initial project debt of Rs.185 crore has already been tied up and the incremental project debt of Rs.71 crore is in the advanced stages of tie-up, NML would remain exposed to project execution risks, given the company's limited track record in commissioning greenfield/brownfield projects.

**Profit and cash flows exposed to cyclical nature of pig-iron business –** Raw materials account for the major portion of the operational cost for pig-iron players, including NML, and are thus important determinants of profitability. As the pig-iron business is cyclical in nature (for being exposed to the cyclicality of the steel industry), NML's cash flows and profitability would remain volatile because of vulnerability to mismatches in prices of raw materials and pig iron. However, NML's semi-integrated nature of business, with the presence of sinter plant, captive power plant and PCI facility, enhances its cost competitiveness and reduces the vulnerability to an extent.

**Commoditised nature of the product keeps margins under check –** The company operates in a commoditised market and is a price taker. Low value-added nature of its business, combined with the fragmented market structure keeps the company's profit margins under check.

## Liquidity position: Adequate

NML's liquidity profile remains adequate, reflected in the large cash/bank/liquid investment portfolio of around Rs.90 crore as of mid-December 2023. Besides, the company does not have any debt repayment scheduled in the current fiscal. Notwithstanding the ongoing capex for which the long-term funding is already in place, NML's liquidity would continue to remain adequate.

## Rating sensitivities

**Positive factors** – ICRA may upgrade NML's ratings if it commissions its ongoing expansion project within the budgeted time and costs, leading to an increase in scale, healthy growth in earnings, and improvement in profitability. Specific metric that may lead to a rating upgrade includes Total debt/OPBDITA of less than 2.0 times on a sustained basis.

**Negative factors** – Pressure on NML's ratings could arise if the company encounters unexpected challenges during the execution phase of the capex, leading to time and cost overrun as well as a deterioration in its liquidity position. Also, any significant contraction in the pig-iron spreads from the prevailing level could exert pressure on the ratings. The ratings could also witness pressure if the interest coverage ratio falls below 4.0 times on a sustained basis.

## Analytical approach

| Analytical Approach | Comments |
|---|---|
| **Applicable rating methodologies** | Corporate Credit Rating Methodology<br>Rating Methodology for Entities in Iron & Steel Industry |
| **Parent/Group support** | Not Applicable |
| **Consolidation/Standalone** | The rating is based on the standalone financial profile of the company. |

## About the company

Neo Metaliks Limited (NML) was set up in FY2003 and was jointly promoted by the Madhogaria and Agarwal families of Kolkata. In FY2005, the Madhogaria family exited the business and the Agarwal family took complete control of the company. NML manufactures pig iron at its plant in Durgapur, West Bengal (since FY2007) with the present installed capacity of 1,88,000 TPA. As a part of its backward integration initiative, the company has set up a waste heat recovery-based captive power plant of 4.5 MW and a sinter plant with a capacity of 3,00,000 TPA.

### Key financial indicators (Audited)

| NML Standalone | FY2022 | FY2023 |
|---|---|---|
| **Operating income** | 835.0 | 1068.0 |
| **PAT** | 31.0 | 35.6 |
| **OPBDIT/OI** | 6.4% | 6.7% |
| **PAT/OI** | 3.7% | 3.3% |
| **Total outside liabilities/Tangible net worth (times)** | 0.8 | 1.0 |
| **Total debt/OPBDIT (times)** | 1.7 | 1.1 |
| **Interest coverage (times)** | 11.0 | 12.4 |

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

### Status of non-cooperation with previous CRA:

| CRA | Status | Date of Release |
|---|---|---|
| CRISIL | CRISIL BB+/Stable/A4+; ISSUER NOT COOPERATING | March 31, 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 March 31, 2023 (Rs. crore) | Date & rating in FY2024 | Date & rating in FY2023 | | Date & rating in FY2022 | Date & rating in FY2021 |
| | | | | | Dec 28, 2023 | Sep 29, 2022 | Jul 14, 2022 | Jul 8, 2021 | Mar 15, 2021 |
| 1 | Fund-based limits | Long Term | 78.50 | -- | [ICRA]A- (Stable) | [ICRA]A- (Stable) | [ICRA]A- (Stable) | [ICRA]A- (Stable) | [ICRA]A- (Stable) |
| 2 | Term Loans | Long Term | 256.00 | 29.25 | [ICRA]A- (Stable) | [ICRA]A- (Stable) | [ICRA]A- (Stable) | [ICRA]A- (Stable) | [ICRA]A- (Stable) |
| 3 | Non-fund based facilities | Short Term | 151.00 | -- | [ICRA]A2+ | [ICRA]A2+ | [ICRA]A2+ | [ICRA]A2+ | [ICRA]A2+ |

## Complexity level of the rated instruments

| Instrument | Complexity Indicator |
|---|---|
| Fund-based limits | Simple |
| Non-fund based facilities | Very Simple |
| Term Loans | 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-1: Instrument details

| ISIN | Instrument Name | Date of Issuance / Sanction | Coupon Rate | Maturity Date | Amount Rated (Rs. Crore) | Current Rating and Outlook |
|---|---|---|---|---|---|---|
| **NA** | Fund-based limits | NA | NA | NA | 78.50 | [ICRA]A- (Stable) |
| **NA** | Non-fund based facilities | NA | NA | NA | 151.00 | [ICRA]A2+ |
| **NA** | Term Loans | FY2023 | NA | FY2031 | 256.00 | [ICRA]A- (Stable) |

*Source: Company*

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

## Annexure-2: 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.

For more information, visit www.icra.in

## ICRA Limited

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