October 20, 2022

Mukand Sumi Special Steel Limited: Rating reaffirmed; [ICRA]A-(Stable) assigned for the enhanced limits

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long Term - Fund Based Cash Credit	50.00	90.00	[ICRA]A-(Stable); assigned/reaffirmed
Long Term - Fund Based Term loan	100.00	262.00	[ICRA]A-(Stable); assigned/reaffirmed
Total	**150.00**	**352.00**	

**Instrument details are provided in Annexure-1*

Rationale

The rating reaffirmation considers ICRA's expectation that Mukand Sumi Special Steel Limited's (MSSSL) credit profile would be supported by healthy profitability and favourable demand outlook from the auto sector, its key end-user industry, despite incurring a large capital expenditure (capex) in the next two-to-three years. The rating continues to derive comfort from the strong parentage of MSSSL, which is a 51:49 joint venture (JV) between Jamnalal Sons Private Limited (JSPL; holding entity of the Bajaj Group) and Sumitomo Corporation (SC; rated Baa1/Stable by Moody's). ICRA also expects JSPL to be willing to extend financial support to MSSSL, should there be a need. The rating favourably factors in the extensive track record of the promoter groups in the automotive industry, through which the company enjoys a healthy market share in products of critical application in the said industry[1] and has a reputed customer base with a proven track record of repeat business.

MSSSL reported revenue of Rs. 2,345.6 crore in FY2022, reflecting a healthy YoY growth of 48% owing to strong demand from the automobile industry and higher average sales realisations. Besides savings in conversion costs led by operationalisation of the new rolling mill at Hospet (Karnataka) in August 2021, the company's operating profit margin (OPM) increased to 10.7% in FY2022 from 9.9% in FY2021. In FY2022, MSSSL commissioned a 4,00,000-MTPA[2] rolling mill at Hospet (Karnataka), which is in proximity to raw material suppliers and end-user industries. MSSSL benefits from savings in the freight expense and lower conversion costs vis-a-vis its earlier cost structure, given the favourable location of the plant and deployment of technologically advanced and efficient machinery. At present, the company continues to operate its old plant in Kalwe (Thane, Maharashtra) for few products. Going forward, the company's ability to attain optimum capacity utilisation levels and achieve desired operating and financial parameters remains critical. Healthy demand momentum from the end-user industries continued in the current fiscal with the company reporting sales of Rs. 1,296 crore in 5M FY2023 (on a provisional basis). While the company witnessed a healthy YoY revenue growth of 48% in 5M FY2023, the profitability was impacted as it consumed high-cost inventory and was able to pass on the high raw material prices to its customers only with a lag. However, in H2 FY2023, with softening of raw material prices and higher average sales realisations, the overall profitability is expected to increase, which will adequately support the credit metrics of the company. ICRA notes that the alloy steel division of Mukand Sumi Metal Processing Limited (MSMPL) has been merged with MSSSL in August 2022. This has led to addition of 5,000 MT per month bright bar capacities in MSSSL. As highlighted by the management, there has not been any cash outflow from MSSSL as shares held by Mukand Limited (ML) in MSMPL were purchased by JSPL and SC such that the shareholding in the merged entity remained in 51:49 ratio.

The rating factors in MSSSL's exposure to the cyclicality inherent in the automotive industry and to volatility in raw material prices, which account for ~80% of its total operating expenses. ICRA also notes that a large capex plan of ~Rs. 280 crore over FY2023-FY2025 would augment its product mix and help improve the profitability. However, the same would keep the free cash flow and credit metrics of the company under check in the medium term. The company's revenues and profit margins were adversely impacted during the downcycle in the automotive industry in FY2020.

The Stable outlook on the [ICRA]A- rating reflects ICRA's opinion that the credit profile of MSSSL is expected to remain supported by healthy automotive demand, its established customer base as well as a likely improvement in its profitability in H2 FY2023, aided by lower input costs.

Key rating drivers and their description

Credit strengths

Healthy financial flexibility for being a part of Bajaj and Sumitomo Groups – MSSSL was incorporated in FY2018 as a 51:49 JV between ML and SC. In FY2021, ML sold its 51% stake to JSPL, which is the principal holding company of the Bajaj Group. MSSSL enjoys healthy financial flexibility, along with operational and financial support for being a part of the Bajaj and Sumitomo Groups. ICRA also expects JSPL to be willing to extend financial support to MSSSL, should there be a need. JSPL has extended intercorporate deposits (ICDs) of ~Rs. 52 crore (as on date) to MSSSL. SC has also guaranteed 49% of MSSSL's external borrowings.

Reputed clientele and extensive track record of promoter groups in the auto industry – MSSSL's product portfolio comprises round cornered square (RCS), round (RND), wire rod (WRD) and straightened wire rod (STW). These products find application in the automotive industry. MSSSL's top customers are reputed auto ancillary manufacturers. MSSSL is the sole supplier of products in critical applications like engine parts, transmission, suspension spring, bearings etc. for ~30-40% of its customers and enjoys a healthy market share in this segment. The rating also derives comfort from the extensive track record of its promoter groups in the auto industry. While the Bajaj Group, through Bajaj Auto Limited, enjoys a healthy market share in the domestic two-wheeler and three-wheeler segments, the Sumitomo Group has presence in the automotive design and development segment.

Location-specific advantages – MSSSL's new rolling mill at Hospet (Karnataka) is well connected to the auto OEM cluster in Chennai by NH48. Besides, its proximity to ML's billet manufacturing facility at Hospet, which is its sole supplier, would also reduce its transportation costs.

Healthy operating performance in FY2022; continued healthy demand momentum in FY2023 – MSSSL's revenues increased to Rs. 2,345.6 crore in FY2022, reflecting a YoY growth of 48%, led by higher sales realisations and healthy demand from the auto sector. Consequently, the OPM increased to 10.7% in FY2022 from 9.9% in FY2021. The improvement in OPM was also partly attributable to operationalisation of new rolling mill in Hospet (Karnataka), which led to savings in freight expense and lower conversion costs. The healthy demand momentum continued in the current fiscal with the company reporting sales of ~Rs. 1,296 crore in 5M FY2023. While the company witnessed a healthy YoY revenue growth of 48% in 5M FY2023, the profitability was impacted as it consumed high-cost inventory and was able to pass on the high raw material prices to its customers, only with a lag. However, in H2 FY2023, with softening of input prices and higher average sales realisations, the overall profitability is expected to increase, which will adequately support the credit metrics of the company.

Credit challenges

Exposure to risks associated with stabilisation of the new plant as per expected operating parameters; debt-funded capex plans – While MSSSL successfully commissioned its new rolling mill in Hospet (Karnataka) in August 2021, its ability to attain optimum capacity utilisation levels and achieve desired operating and financial parameters remains critical. The company plans to incur capex of ~Rs. 55-60 crore in FY2023 towards setting up of value-added capacity for bearing steel (capex of Rs. 47 crore and partly funded by debt of Rs. 40 crore) and sourcing renewable energy under the Group captive model (capex of Rs. 10 crore to be funded by internal accruals). In FY2024 and FY2025, the company plans to incur debt-funded capex of ~Rs. 220 crore towards setting up of value-added capacities for pickling and bright bar. While these value-added capacities would result in higher margins, going forward, timely commissioning without any cost overrun and ramp-up of such capacities as per the desired operating parameters would be crucial from the credit perspective.

Exposure to cyclicality associated with auto industry – The automotive sector accounts for ~80-85% of MSSSL's total sales every year. Dependence on the automotive sector exposes the company to the cyclical nature of the industry. Muted demand from the auto sector led to a 31% revenue fall and a sharp decline in OPM in FY2020. While the expected cost savings from the new plant would shield the profit margins to some extent, a prolonged lull in the industry could impact MSSSL's operational and financial risk profiles.

Exposure to volatility in raw material prices – The key raw material for MSSSL is alloy steel billet. The prices of billet depend on iron ore and coke prices, which in turn have exhibited sharp volatility in the past. While any major fluctuation in prices can be passed on to the customers with a lag of one month, the company would remain exposed to volatility in raw material prices in case of weak demand.

Liquidity position: Adequate

MSSSL's liquidity position is **adequate**, supported by its healthy cash flow from operations. Given the healthy demand momentum and expectation of improvement in its profitability, the cash generation in the business is likely to improve to ~Rs. 200 crore in FY2023, which will be sufficient to meet the debt repayment obligations and capex requirements for that year. The company has term loan repayment obligations of Rs. 153 crore in FY2023 and plans to incur debt-funded capex of Rs. 55-60 crore during the same year. The company's term loan repayment obligations in FY2024 and FY2025 are Rs. 156 crore and Rs. 132 crore, respectively while capex for both years combined is estimated at Rs. 220 crore. The company's average utilisation of fund-based working capital limits of Rs. 421 crore stood at 94% during September 2021-August 2022. Besides, the company maintains average unencumbered liquid balances of Rs. 15-20 crore. ICRA also expects JSPL to be willing to extend financial support to MSSSL, should there be a need.

Rating sensitivities

Positive factors – ICRA could upgrade MSSSL's rating if there is a substantial growth in its scale of operations and profits, leading to an improvement in credit metrics and liquidity position. Specifically, MSSSL's debt-to-operating profit ratio remaining below 2.0 times on a sustained basis, would be a positive trigger.

Negative factors – Pressure on MSSSL's rating could arise if there is any weakening in linkages with the Bajaj and Sumitomo Groups. Any sharp decline in revenues and/or profits or any large unanticipated debt-funded capex, which results in weakening of its credit metrics and/or the liquidity position would also be a negative factor. Specifically, MSSSL's debt-to-operating profit ratio remaining above 3.0 times on a sustained basis, would be a negative trigger.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Entities in the Ferrous Metals Industry Rating Approach – Implicit Parent or Group Support
Parent/Group Support	JV partners – JSPL (51%) and SC (49%) MSSSL's rating factors in the high likelihood of its JV partners, JSPL and SC, extending financial support to it, as and when required. While SC has guaranteed 49% of MSSSL's external borrowings, ICRA expects JSPL to be willing to extend financial support to MSSSL, should there be a need.
Consolidation/Standalone	Standalone

About the company

MSSSL manufactures alloy steel bars and wire rods, which find applications in automotive and engineering industries. MSSSL was incorporated by amalgamation of alloy steel rolling and finishing business of ML into Mukand Alloy Steels Private Limited (MASPL) in FY2018. Post the amalgamation, SC in FY2019, acquired a 49% stake in MSSSL for Rs. 1,181 crore. In December 2020, the Competition Commission of India (CCI) approved the acquisition of ML's share by JSPL. The acquisition was completed in April 2021. MSSSL was earlier operating from its 500,000-MTPA Kalwe unit in Thane (Maharashtra). However, in August 2021, the company shifted its manufacturing activities entirely to Hospet (Karnataka) by commissioning a new 4,00,000-MTPA facility. From August 2022, the alloy steel business of Mukand Sumi Metal Processing Limited (MSMPL) was merged into MSSSL.

Key financial indicators – Audited

Standalone financials	FY2021	FY2022
Operating Income (Rs. crore)	1,581.4	2,345.6
PAT (Rs. crore)	-171.0	207.8
OPBDIT/OI (%)	9.9%	10.7%
PAT/OI (%)	-10.8%	8.9%
Total Outside Liabilities/Tangible Net Worth (times)	0.7	0.5
Total Debt/OPBDIT (times)	5.4	3.6
Interest Coverage (times)	4.2	3.3

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

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. Cr.)	Amount Outstanding (Rs. Cr.)	Date & Rating in	Date & Rating in FY2022	Date & Rating in FY2021	Date & Rating in FY2020
					Oct 20, 2022	Jul 06, 2021	-	-
1	Cash Credit	Long-term	90.00	-	[ICRA]A- (Stable)	[ICRA]A- (Stable);	-	-
2	Term Loan	Long-term	262.00	202.39*	[ICRA]A- (Stable);	[ICRA]A- (Stable);	-	-

*Amount in Rs. crore; *As on March 31, 2022*

Complexity level of the rated instrument

Instrument	Complexity Indicator
Long Term - Fund Based Cash Credit	Simple
Long Term - Fund Based Term loan	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 analyzing 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. Cr.)	Current Rating and Outlook
NA	Cash Credit	-	-	-	90.00	[ICRA]A-(Stable)
NA	Term Loans	FY2021	8.0-8.5%	FY2027	262.00	[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

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