

May 24, 2017

The Sandur Manganese & Iron Ores Limited

Summary of Rated Instruments

| Instrument* | Rated Amount (in crore) | Rating Action |
|---------------------------------|----------------------------|-------------------------------|
| Long term – Proposed Term Loans | 100.0 | [ICRA]BBB+ (Stable); assigned |
| Total | 100.0 | |

*Instrument Details are provided in Annexure-1

Rating action

ICRA has assigned a long term rating of [ICRA]BBB+¹ to the Rs. 100.0-crore² proposed term loans of The Sandur Manganese & Iron Ores Limited (SMIORE). The outlook on the long term rating is Stable.

Rationale

The assigned rating takes into consideration the established track record of the company of over six decades in the mining industry, being one of the large merchant miners of manganese ore in India and iron ore in Karnataka. The company is estimated to have iron ore reserves of 75.71 million tons and manganese ore of 7.83 million tons, providing long term visibility to its mining operations. SMIORE's open-cast mining operations have moderate cost of extraction; as such, the gross margins for the mining operation are high, although susceptible to volatility due to the variations in the iron and manganese ore market prices. During the recent months, SMIORE has been able to record improved profitability backed by buoyant ore prices, driven by favourable conditions in the local and international markets. The rating also takes comfort from the currently debt-free status of the company, with healthy cash & cash equivalents estimated to be ~Rs. 125 crore as on Mar 31, 2017. However, these liquid funds are committed to be utilised to meet a portion of SMIORE's equity contribution requirements for the upcoming capital expansion project of Rs. 848 crore towards enhancement of mining infrastructure and establishment of a new coke oven facility.

The rating is constrained by the sizeable debt funded capital expenditure plans of the company vis-à-vis the current scale of operations exposing the company to significant risks w.r.t. time and cost overruns. Given that SMIORE does not have any experience in coke manufacturing operations, the management's ability to streamline the operations in a timely manner and successfully achieve project design parameters would be critical. As such, the proposed debt funding is expected to have a two year moratorium on repayments following the commercial operations date (COD), providing support to the liquidity and financial flexibility until the operations are streamlined. As such, any adverse deviation in the repayment schedule of the term loan could correspondingly impact the cash flows and debt service indicators and would be a key rating sensitivity. These apart, the volatility in the international coking coal & coke prices coupled with the long operational cycle time exposes the company to significant price and foreign exchange risk. The company's ability to effectively limit these risks and develop stable customer relationships would be a key challenge once the coke oven facility is operationalised. Given the nascent stage of the project, the company is still in discussions with potential customers and off take agreements are yet to be finalised. For the mining division, obtaining approvals for the enhancement of production limits would be critical in achieving adequate utilization of the enhanced mining infrastructure created

¹ For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications

² 100 lakh = 1 crore = 10 million

under the capital expenditure programme. Given that the approvals are dependent on regulatory issues, it remains to be seen whether SMIORE is able to obtain these permits in a timely manner.

For SMIORE's existing operations, ICRA factors in the risks arising from operating in a highly regulated iron ore and manganese ore mining industry, and the exposure of margins to volatility in its prices given the inherent cyclicality in end user segments, further exacerbated by the significant inventory holdings of the company in the ferroalloy division. Going forward, due to the continued uncertainty in outlook for domestic iron ore and manganese ore prices, given the weak pick-up in domestic steel consumption and additional market supply backed by auction of new mines, the company's profits and cash flows is expected to remain volatile. Further, the ferroalloy division is exposed to high cost of power from the existing captive thermal power plant resulting in uncompetitive cost structure for this division. Nevertheless, the cost structure is expected to improve following the operationalisation of waste heat recovery based (WHRB) power plant once coke manufacturing is commissioned.

Key rating drivers

Credit strengths

- Established track record of the company of over eight decades in the mining industry; considerable experience of the promoters in the sector
- Operation of one the largest private sector iron ore and manganese ore mines in Karnataka with adequate reserves of moderate/low quality
- Debt free position of the company with healthy cash and liquid investments providing support to the liquidity position
- Significant improvement in financial profile in the first nine months of FY2017 characterized by growth in revenues and profitability

Credit weaknesses

- Sizable capital expenditure compared to the current scale of operations; exposed to risk of cost and time overruns
- Exposure to significant price and foreign exchange risk for the proposed coke manufacturing operations
- Risks arising from operating in a highly regulated iron ore and manganese ore mining industry, and the exposure of margins to volatility in prices
- Production of silico manganese unviable in the current manufacturing setup due to high power cost; though it is expected to be mitigated upon commencement of WHRB based power plant once coke manufacturing is commissioned

Description of key rating drivers:

SMIORE produces iron ore with Fe content of around 58-63% with typical lump to fine production ratio of 1:2. With production of 1.2 MTPA, SMIORE is the 5th largest producer in the state. SMIORE also produces low quality Manganese ore with Mn content of around 22-30%. The manganese ore is available in disconnected deposits, and as such the amount of waste produced has been high (average stripping ratio of around 50:1). During FY2017, there was improvement in the average gross realisation of iron ore on account of healthy demand & tight supply situation in Karnataka and also for manganese iron and silico-manganese backed by buoyant international prices aided by renewed demand from China. While in earlier years, the company was into export markets also, it currently caters to the domestic market only and largely supplies to steel manufacturers in the region.

Around 60% of the revenues of the company are derived from the mining segment while the power & ferroalloy segment contribute to the remaining portion of the revenues. The company captively consumes a portion of the manganese ore mined for the ferroalloy segment. Further, power being an important input required for manufacture of ferroalloys, it is captively consumed to the extent required. The surplus power generated is exported to the grid. As such, depending on the quantity of ferroalloy manufactured, the revenues from sale of power also varies year on year. Given the high coal based production cost and the high power consumption associated with the manufacture of ferroalloy, the capacity has been lying underutilized, which has also depressed the company's returns on capital employed (RoCE).

SMIORE currently intends to take up capital expansion as follows:

- Install a 400,000 tpa coke oven plant and a 24 MW combined waste heat recovery boiler (capable of using CO flue gas and BF gas) to supply steam to turbo generator of existing power plant.
- The existing ferroalloy plant to be upgraded with modern equipment to enhance productivity and efficiency. Electrode assembly of the ferroalloy furnace shall be replaced and the electrical network upgraded.
- Upgrade of mining infrastructure, laying of pipe conveyor from mine head to railway siding, asphalt laying of internal roads, etc. to enable production capacity enhancement.
- Other general and administrative expenses

For the current capital expenditure plans, the total project cost has been estimated to be ~Rs. 848 crore which is proposed to be funded by a term loan of Rs. 600 crore with the balance being funded through internal accruals. The proposed debt is expected to have a 2-years construction period, 2-years moratorium following commercial operation date and a 5 years repayment period with a total door-to-door tenor of 9 years.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below.

Links to applicable Criteria

[Rating Methodology for Mining Entities](#)

[Rating Methodology for Entities in the Ferrous Metals Industry](#)

[Corporate Credit Rating –A Note on Methodology](#)

About the company:

Sandur Manganese and Iron Ore Limited (“SMIORE”/ “the company”), the flagship company of the Karnataka-based Sandur group, was promoted in 1954 by the former ruler of the Princely state of Sandur, Mr. Yashwantrao Hindurao Ghorpade (YHG). Mr. M Y Ghorpade (MYG), the eldest son of Mr. YHG, was associated with the management of the company since inception. Mr. S Y Ghorpade (SYG), the younger son of Mr. YHG, is currently the Chairman and Managing Director. He is a metallurgical engineer from Colorado School of Mines, USA.

SMIORE is engaged in mining of low phosphorous manganese and iron ore in the Hospet-Bellari region of Karnataka. It has large mines with two leases – M L-2678 and ML-2679 each with an area of 1863.02 ha and 142.58 ha, respectively. ML-1678 contained 3 iron ore pits, 36 manganese pits and 2 pits with both iron and manganese ore, whereas ML2679 had only 8 manganese ore pits. The entire lease area is in forest land, falling under Swamy Mallai (SM) and Rammana Mallai (RM) forest blocks of Sandur Range.

The company is one among the large miners of manganese ore in India and is estimated to hold reserves of 7.83 million tons. Its Iron Ore reserves are estimated to be 75.71 million tons currently. However, the permissible production capacity is 1.16 MTPA for iron ore and 0.18 for manganese ore. In addition,



SMIORE manufactures ferro-alloys (Silico-Manganese) from its 36,000 tpa plant in Vysankare, near Hospet and has a captive coal based power plant of capacity accumulating to 32 MW.

In the FY2016, the company reported a net profit of Rs 6.98 crore on an operating income of Rs 268.84 crore on a consolidated level and a net profit of Rs 3.90 crore on an operating income of Rs 222.41 crore on a standalone level. For the nine months period ending December 2016, the company reported a net profit of Rs 19.75 crore on an operating income of Rs 266.51 crore on a standalone level.

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating History for last three years:

Table: Rating History

| S.No | Name of Instrument | Current Rating | | | Chronology of Rating History for the past 3 years | | |
|------|---------------------|----------------|---------------------------|----------------------------|---|--------------------------------|--------------------------------|
| | | Type | Rated amount (Rs. Crores) | Month-year & Rating FY2018 | Month- year & Rating in FY2017 | Month- year & Rating in FY2016 | Month- year & Rating in FY2015 |
| | | | | May 2017 | - | - | - |
| 1 | Proposed Term Loans | Long Term | 100.0 | [ICRA]BBB+ (Stable) | - | - | - |

Complexity level of the rated instrument:

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1
Details of Instrument

| Name of the instrument | Date of issuance | Coupon rate | Maturity Date | Size of the issue (Rs. Cr) | Current Rating and Outlook |
|-------------------------------|-------------------------|--------------------|----------------------|-----------------------------------|-----------------------------------|
| Proposed Term Loans | - | - | - | 100.0 | [ICRA]BBB+ (Stable) |



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