June 02, 2017

# The Sandur Manganese & Iron Ores Limited

**Summary of Rated Instruments**

| Instrument* | Rated Amount (in crore) | Rating Action |
|---|---|---|
| Long term – Proposed Term Loans | 600.0 (enhanced from 100.0) | [ICRA]BBB+ (stable); assigned/outstanding |
| **Total** | **600.0** | |

*Instrument Details are provided in Annexure-1

**Rating action**

ICRA has assigned a long-term rating of [ICRA]BBB+[1] to the Rs. 600.0-crore[2] (enhanced from Rs. 100-0 crore) 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 largest 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 tonne and manganese ore of 7.83 million tonne, providing long-term visibility to its mining operations. SMIORE's open-cast mining operations have moderate cost of extraction. The gross margins for the mining operation are high, although susceptible to volatility due to variation in 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 and cash equivalents estimated to be ~Rs. 125 crore as on March 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 related to time and cost overrun. 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 and 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

[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

are yet to be finalised. For the mining division, obtaining approvals for the enhancement of production limits would be critical in achieving adequate utilisation of the enhanced mining infrastructure created under the capital expenditure programme. As 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 ferro-alloy 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 are expected to remain volatile. Further, the ferro-alloy 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 of 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 characterised by growth in revenues and profitability

**Credit weaknesses**

- Sizable capital expenditure compared to the current scale of operations; exposed to the risk of cost and time overrun
- 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 the 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 fifth 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 and 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 the earlier years, the company was into export markets also, it now caters to the domestic market only and primarily supplies to steel manufacturers in the region.

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

SMIORE intends to take up capital expansion as per the following plan:

- 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 ferro-alloy plant to be upgraded with modern equipment to enhance productivity and efficiency. Electrode assembly of the ferro-alloy furnace would 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 increase production capacity
- 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 though internal accruals. The proposed debt is expected to have a 2-year construction period, 2-year moratorium following commercial operation date and a 5-year repayment period with a total door-to-door tenure of nine 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 flagship company of the Karnataka-based Sandur Group, was promoted in 1954 by the former ruler of the Princely state of Sandur, Mr. Yashwanthrao Hindurao Ghorpade (YHG). Mr. M Y Ghorpade (MYG), the eldest son of Mr. YHG, was associated with the management of the company since its inception. Mr. SY Ghorpade (SYG), the younger son of Mr. YHG, is the present Chairman and Managing Director. He is a metallurgical engineer from Colorado School of Mines, US.

SMIORE is involved in mining of low phosphorous manganese and iron ore in the Hospet-Bellari region of Karnataka. The company is one of the largest miners of manganese ore in India and is estimated to hold reserves of 7.83 million tonne. Its iron ore reserves are estimated to be 75.71 million tonne at present. 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 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** |
| | | | | **June 2017** | **-** | **-** | **-** |
| 1 | Proposed Term Loans | Long Term | 600.0 | [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 | - | - | - | 600.0 | [ICRA]BBB+ (Stable) |

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