

## The Sandur Manganese & Iron Ores Limited

June 22, 2018

### Summary of rated instruments

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund based-Term Loan	600.0	400.0	[ICRA]A- (Stable); Upgraded from [ICRA]BBB+ (Stable)
Fund based- Working Capital Facilities	0.0	10.0	[ICRA]A- (Stable); Upgraded from [ICRA]BBB+ (Stable)
Non-fund based-Working Capital Facilities	0.0	60.0	[ICRA]A2+; Assigned
Unallocated Facilities	0.0	130.0	[ICRA]A2+; Assigned
<b>Total</b>	<b>600.0</b>	<b>600.0</b>	

\*Instrument details are provided in Annexure-1

### Rating action

ICRA has upgraded the long-term rating to [ICRA]A- (pronounced ICRA A minus) for the Rs. 400.0-crore<sup>1</sup> (reduced from Rs. 600 crore) term loan facilities and the Rs.10.0-crore (enhanced from nil) fund-based facilities of The Sandur Manganese & Iron Ores Limited (SMIORE)<sup>2</sup>. The outlook on the long-term rating is Stable. ICRA has also assigned a short-term rating of [ICRA]A2+ (pronounced ICRA A two plus) to the Rs.60.0-crore non-fund based facilities and the Rs.130.0-crore unallocated facilities of the company.

### Rationale

For arriving at the ratings, ICRA has taken a consolidated view of SMIORE along with its subsidiary, Star Metallics and Power Private Limited (SMPPL), from which it has taken the ferro-alloy plant and the thermal power plant on lease.

The rating upgrade takes into consideration the improvement in SMIORE's financial performance in FY2018, which is expected to continue in the near to medium term, supported by the enhancement in the permissible annual production limits and a favourable price scenario for all its product segments – iron ore, manganese ore and ferro-alloys. During the past two years, SMIORE has recorded improved profitability and cash flows backed by buoyant ore prices, driven by favourable conditions in the local and international markets. The ratings continue to factor in 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 71.7 million tonnes and manganese ore of 15.1 million tonnes, providing long-term visibility to its mining operations. The rating also takes comfort from the currently debt-free status of the company, with healthy cash and liquid equivalents of ~Rs. 212 crore as on March 31, 2018. 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. 600 crore towards establishment of a new coke-oven facility and upgradation of the existing ferro-alloy plant, apart from upgradation of the mining infrastructure to enable production capacity enhancement and improved efficiency in operations.

<sup>1</sup>100 lakh = 1 crore = 10 million

<sup>2</sup>For complete rating scale and definitions, please refer to ICRA's website [www.icra.in](http://www.icra.in) or other ICRA Rating Publications

The rating is, however, constrained by the sizeable debt-funded capital expenditure plans of the company vis-à-vis the current scale of operations, exposing it to significant risks related to time and cost overruns. However, ICRA takes note of the revision in capital expenditure plan, entailing a postponement of a significant portion of the expenditure envisaged towards the upgradation of the iron ore mining capacity to 3.5 million tonnes per annum (mtpa) from the current 1.6 MTPA. The proposed debt requirement for the capital expenditure has been scaled down from the earlier estimate of Rs. 600 crore to Rs. 400 crore currently. The debt funding is expected to have a two-year moratorium period from the date of first disbursement, providing some support to the liquidity and financial flexibility until the operations are streamlined. As 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.

ICRA has factored 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 prices given the inherent cyclicity in the end-user segments. Further, the ferro-alloy division entails high cost of power from the existing captive thermal power plant, resulting in high cost structure for this division. However, it is expected to improve following operationalisation of waste heat recovery boiler (WHRB) based power plant once the coke manufacturing is commissioned. These apart, volatility in 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 a stable relationship with customers would be a key challenge once the coke oven facility starts its operations.

## Outlook: Stable

ICRA believes that SMIORE will continue to benefit from the extensive experience of its promoters and its strong market position in the mining industry. The outlook may be revised to Positive if the company is able to conclude the capex within the budgeted cost and time and develop a stable relationship with customers to mitigate the offtake risk once the coke oven facility starts its operations. The outlook may be revised to Negative if cash accruals are lower than expected with unfavourable movement in prices of iron ore or manganese ore or if any cost or time overrun in the debt-funded capital expenditure, or stretch in the working capital cycle, weakens the liquidity.

## Key rating drivers

### Credit strengths

**Enhancement in the permissible production limit and buoyant ore prices** - The company's production cap for iron ore was enhanced to 1.6 mtpa and for manganese ore to 0.28 mtpa during December FY2017 resulting in higher-than-expected sales volume in FY2018 and providing for greater revenue visibility going forward. Moreover, the average realisation of iron ore and manganese ore improved by 20% and 19% y-o-y respectively in FY2018, supporting the revenue growth and profitability metrics. ICRA expects the price realisations to remain buoyant in the near term.

**Debt-free position with healthy cash and liquid investments support liquidity position** - The company currently has a debt-free status with healthy cash and liquid equivalents estimated to be ~Rs. 212 crore as on March 31, 2018. Besides, the networth on a consolidated level stood at ~ Rs 530 crore as on March 31, 2018. The healthy financial flexibility, comfortable liquidity position, moderate working capital intensity and healthy cash accruals year-on-year has resulted in a comfortable capital structure and robust coverage indicators. Going forward, despite the planned debt-funded capex, the capital structure and liquidity position are expected to remain comfortable.

**Established track record of the company of over six decades in the mining industry; considerable experience of the promoters in the sector** - SMIORE was promoted in 1954 by the former ruler of the Princely state of Sandur, Mr. Yashwanthrao Hindurao Ghorpade. SMIORE produces iron ore with Fe content of around 58-63% with typical lump-to-fine production ratio of 1:2. With production capacity of 1.6 mtpa, SMIORE is the fifth largest producer in the state. The

company is also one among the large miners of manganese ore in India. In addition, SMIORE manufactures ferro-alloys (silico-manganese) from its 36,000 mtpa plant in Vyasankare, near Hospet.

**Operation of one the largest private sector iron ore and manganese ore mines in Karnataka with adequate reserves -** Currently, the company has two mining leases, valid upto 2033, with proven reserves of almost 71.7 million tonnes of iron ore and around 15.7 million tonnes of manganese with an annual production capacity of 1.6 million tonnes per annum (mtpa) for iron ore and 0.28 mtpa for manganese ore. ICRA takes comfort from the vast reserves, long validity of the mining license and established presence of the company in the industry.

## Credit challenges

**Sizeable capital expenditure compared to the current scale of operations; exposed to risk of cost and time overruns -** The debt-funded capex programme being undertaken by the company is sizeable vis-à-vis the current scale of operations, exposing the company to significant risks related to 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.

**Exposure to significant price, demand and foreign exchange risk for the proposed coke manufacturing operations -** Exposure to fluctuation in coking coal and coke prices, given the large lead time for the entire process of ordering coking coal and selling coke is expected to keep the company's profitability and cashflows volatile. Moreover, lack of backward integration is likely to expose the company to temporary mismatches between the price of coking coal and met coke. The company also remains exposed to movement in currency exchange rates, given the expected dependence on imported coking coal. Moreover, any off-take agreements for its produce are yet to be finalised, which accentuate the demand risk, resulting in uncertainty on the company's revenue and profitability.

**Risks arising from operating in a highly regulated iron ore and manganese ore mining industry -** SMIORE's earnings from the mining business remain volatile, as it is exposed to fluctuations in the prices of iron ore and manganese ore and to any changes to the regulatory framework (as witnessed by the mining restriction in Karnataka in the past). Metal ores and ferro-alloy prices exhibit considerable cyclicity, and are highly sensitive to global demand patterns and general macro-economic factors.

**Unfavourable cost structure for production of silico manganese until the commissioning of the proposed WHRB-based power plant -** Given the high power consumption associated with the manufacturing of ferro alloys for which it is dependent on costly coal-based power production, the company has not been able to maintain profitable operations on a continued basis. As such, the company has not been able to maintain capacity utilisations at high levels, especially during periods of declining ferro-alloy prices as witnessed during FY2016. However, the cost structure for the ferro-alloy division is expected to improve following commencement of the waste-heat-recovery-based (WHRB) power plant once coke manufacturing is commissioned.

**Sizeable contingent liabilities -** SMIORE has sizeable contingent liabilities, which primarily include disputed income tax claims and payments related to forest development tax. Any adverse development on the same would be a key rating sensitivity.

**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 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. 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 involved in mining of low phosphorous manganese and iron ore in the Hospet-Bellari region of Karnataka. It has large mines with two leases – ML-2678 and ML-2679 each with an area of 1863.02 ha and 142.58 ha, respectively. 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 among the large miners of manganese ore in India and is estimated to hold reserves of 15.1 million tonnes. Its iron ore reserves are estimated to be 71.7 million tonnes. The permissible production capacity is 1.6 mtpa for iron ore and 0.28 mtpa for manganese ore. In addition, SMIORE manufactures ferro-alloys (silico-manganese) from its 36,000-tpa plant in Vyasankare, near Hospet and has a captive coal-based power plant of capacity accumulating to 32 MW.

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

- Installation of a 400,000-mtpa coke oven plant and a 30-MW waste heat recovery boiler (capable of using CO flue gas and BF gas) to supply steam to turbo generator of the existing power plant
- Upgradation of the existing ferro-alloy plant with modern equipment to enhance productivity and efficiency. Electrode assembly of the ferro-alloy furnace is also to be replaced and the electrical network upgraded
- Upgradation of mining infrastructure to increase the ores evacuation facility, through conveyor and strengthening of existing roads, and some quarters for staff

For the current capital expenditure plans, the total project cost has been estimated to be ~Rs. 600 crore, which is proposed to be funded by a term loan of Rs. 400 crore and the balance through internal accruals. The coke production is expected to commence by September 2019. The proposed debt is expected to have 18-month construction period, 2-year moratorium from the date of first disbursement and a seven-year repayment period with a total door-to-door tenure of nine years.

## Key financial indicators (audited)

	FY2017	FY2018
Operating Income (Rs. crore)	422.2	608.1
PAT (Rs. crore)	55.4	111.3
OPBDIT/OI (%)	22.9%	28.7%
RoCE (%)	22.3%	35.6%
Total Debt/TNW (times)	0.0	0.0
Total Debt/OPBDIT (times)	0.0	0.0
Interest Coverage (times)	13.4	35.1

**Status of non-cooperation with previous CRA: Not applicable**

**Any other information: None**

**Rating history for last three years:**

		Current Rating (FY2019)		Chronology of Rating History for the Past 3 Years			
Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating June 2018	Date & Rating in FY2018		Date & Rating in FY2017
					June 2017	May 2017	
1 Fund based-Term Loan	Long Term	400.0	Nil	[ICRA]A-(Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	-
2 Fund based-Working Capital	Long Term	10.0		[ICRA]A-(Stable)			
3 Non-fund based-Working Capital	Short Term	60.0		[ICRA]A2+			
4 Unallocated	Short Term	130.0		[ICRA]A2+			

**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](http://www.icra.in)

## Annexure-1: Instrument Details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loan 1	FY2018		FY2027	200.0	[ICRA]A- (Stable)
NA	Term Loan 2	FY2018		FY2027	200.0	[ICRA]A- (Stable)
NA	Fund based- Working Capital				10.0	[ICRA]A- (Stable)
NA	Non-fund based-Working Capital				60.0	[ICRA]A2+
NA	Unallocated				130.0	[ICRA]A2+

Source: SMIORE

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