July 08, 2019

The Sandur Manganese & Iron Ores Limited: Ratings reaffirmed; outlook on long-term rating revised to Positive

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based Term Loan	400.0	400.0	[ICRA]A- reaffirmed; outlook revised from Stable to Positive
Fund-based Working Capital Facilities	10.0	10.0	[ICRA]A- reaffirmed; outlook revised from Stable to Positive
Non-fund based Working Capital Facilities	60.0	60.0	[ICRA]A2+ reaffirmed
Unallocated Facilities	130.0	130.0	[ICRA]A2+ reaffirmed
Total	**600.0**	**600.0**	

*Instrument details are provided in Annexure-1

Rationale

For arriving at the ratings, ICRA has taken a consolidated view of The Sandur Manganese & Iron Ores Limited (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 change in outlook takes into consideration the improvement in SMIORE's financial performance in FY2019, which is expected to continue in the near to medium term, supported by favourable domestic demand for the steel sector, to which all its product segments cater. The ratings also favourably factor in the good project progress of its large capex programme—a significant portion of the estimated costs (~57%) has been incurred till May 2019, with limited debt funding. The ratings continue to factor in the company's established track record of over six decades in the mining industry and its status as one of the leading merchant miners of manganese and iron ore. The company is estimated to have iron ore reserves of 118.5 million tonnes and manganese ore of 14.7 million tonnes, which provide long-term visibility to its mining operations. The rating also takes comfort from the cash and liquid equivalent of Rs. 133.3 crore as on March 31, 2019, which remains healthy at an absolute level, despite witnessing a reduction from Rs. 213.5 crore as on March 31, 2018. The decline was because cash was used to meet a portion of SMIORE's equity contribution requirements for the ongoing capital expansion project of Rs. 608 crore, which includes establishment of a new coke-oven facility, upgradation of the existing ferro-alloy plant and upgradation of the mining infrastructure. The debt funding for the capex has a two-year moratorium period, from the date of first disbursement (April 2019), which provides additional support to the liquidity.

The rating is, however, constrained by the sizeable debt-funded capital expenditure plans of the company vis-à-vis the current scale of operations. Although SMIORE does not have any track record in coke manufacturing, ICRA takes comfort from the induction of experienced personnel specialising in setting up of coke oven plants, which will aid the company to streamline the operations and successfully achieve project design parameters. 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 cyclicality in the end-user segments. Further, the ferro-alloy division entails high cost of power from the existing captive thermal power plant, resulting in elevated cost structure for this division. However, the ferro alloy division's operating profile is expected to improve, following commissioning of waste heat recovery boiler (WHRB) based power plant once the coke manufacturing operations commence. These apart, volatility in international coking coal and coke prices, coupled with the long lead time in imports of coking coal exposes the company to significant price and foreign exchange risks.

Outlook: Positive

The Positive outlook reflects the reduction in project risk, with significant progress in the capital expenditure programme and improvement in the company's financial performance, which is expected to continue in the near to medium term. 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 ratings may be upgraded if the company is able to derive the expected power cost benefits for its ferro alloy division 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 Stable if cash accruals are lower than expected because of unfavourable movement in prices of iron ore or manganese ore or if any cost or time overrun in the debt-funded capital expenditure, or elongation in the working capital cycle, affects the liquidity.

Key rating drivers

Credit strengths

Improvement in financial performance in FY2019 - During the past two years, SMIORE has recorded higher profitability and cash flows backed by buoyant ore prices and driven by favourable conditions in the local and international markets. The sales volume of silico manganese, iron ore and manganese ore improved by 5%, 11% and 29%, respectively, y-o-y in FY2019. Moreover, the average realisation of manganese ore and silico-manganese improved by 13% and 8%, respectively, y-o-y, supporting the revenue growth and profitability metrics. ICRA expects SMIORE's product realisation to remain favourable in the near term on the back of a healthy domestic demand from the steel sector.

Strong net worth, and healthy cash and liquid investments- The company had a debt of Rs. 150 crore as on May 31, 2019 with healthy cash and liquid equivalents of ~Rs. 133.3 crore as on March 31, 2019. Besides, the net worth on a consolidated level stood at Rs. 671.2 crore as on March 31, 2019. Additionally, strong cash accruals in the last two years have kept its capital structure and coverage indicators at comfortable levels. Going forward, despite the planned debt-funded capex, the capital structure and liquidity position are expected to remain comfortable.

Company's established track record of over six decades in mining industry; considerable sector experience of promoters - 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. 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.

Company possess one of 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 118.5 million tonnes of iron ore and around 14.7 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, the long validity of the mining license and the established presence of the company in the industry.

Credit challenges

Sizeable capital expenditure compared to current scale of operations - The ongoing debt-funded capex programme being undertaken by the company is sizeable vis-à-vis the current scale of operations, exposing it to risks related to project stabilisation, time and cost overruns. Moreover, going forward, the company has further large capex plans, the nature, timing, scale and the funding pattern of which remain to be seen.

Exposure to significant price, demand and foreign exchange risk for proposed coke manufacturing operations - Exposure to fluctuation in coking coal and coke prices, given the large lead time of the entire process, from ordering coking coal to 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 that of 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 agreement for its produce is yet to be finalised, which accentuate the demand risk, resulting in uncertainty on the company's revenue and profitability for the coke division.

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

Unfavourable cost structure for silico manganese production till proposed WHRB-based power plant commissions– The company has not been able to maintain healthy profits for ferro alloys manufacturing because of its dependence on expensive coal-based power. However, the cost structure of 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 invocation of the same could adversely impact its financial risk profile.

Liquidity position

Although the company reported an increase in its cash flow from operations, the free cash flows turned negative in FY2019 because of the Rs. 250-crore capital expenditure incurred during the year. The capex was funded through cash and liquid investments and internal accruals of the company. In FY2020, the company is expected to incur capital expenditure of over Rs. 300 crore for the ongoing project, besides, the regular capex. The company has availed debt of Rs. 150 crore, out of the sanctioned amount of Rs. 400 crore, in FY2020 (till May 2019) for funding the same. The company's liquidity profile continued to remain strong, aided by unencumbered cash and liquid investments of Rs 105 crore as on March 31, 2019, availability of sanctioned undrawn term loans from banks and healthy cash accruals from existing operations.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Rating Methodology for Mining Entities Rating Methodology for Entities in the Ferrous Metals Industry Corporate Credit Rating Methodology
Parent/Group Support	Not applicable
Consolidation / Standalone	The ratings are based on the consolidated financial profile of the entity

About the company:

The Sandur Manganese & Iron Ores 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, has been associated with the company's management 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 Hosapete-Ballari region of Karnataka. It has large mines with two leases – ML-2678 and ML-2679 each with an area of 1860.10 hectares (ha) and 139.20 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 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) at its 36,000-tpa plant in Vyasankare, near Hospet, and has a captive coal-based power plant of 32 MW capacity.

SMIORE is currently undertaking 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, along with addition of a new furnace.
- 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 at ~Rs. 608 crore, which is proposed to be funded by a term loan (Rs. 400 crore) and internal accruals. The trial production run of the coke oven operations is expected to commence by October 2019. The debt has a two-year moratorium from the date of first disbursement, which was in April 2019 and a seven-year repayment period with a total door-to-door tenure of nine years. As on May 31, 2019, the company had incurred around Rs. 345 crore, funded by Rs. 150 crore term loan and the balance through internal accruals.

Key financial indicators (audited)

	FY2018	FY2019
Operating Income (Rs. crore)	609.1	702.5
PAT (Rs. crore)	111.3	147.4
OPBDIT/OI (%)	28.7%	31.9%
RoCE (%)	35.1%	46.8%
Total Debt/TNW (times)	0.0	0.0
Total Debt/OPBDIT (times)	0.0	0.0
Interest Coverage (times)	35.3	35.1

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

	Instrument	Current Rating (FY2020) Type	Amount Rated (Rs. crore)	Amount Outstanding as on Mar 19 (Rs. crore)	Date & Rating July 2019	Chronology of Rating History for the Past 3 Years: Date & Rating in FY2019 June 2018	Date & Rating in FY2018 June 2017	May 2017
1	Fund based-Term Loan	Long Term	400.0	Nil	**[ICRA]A- (Positive)**	[ICRA]A- (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)
2	Fund based-Working Capital	Long Term	10.0		**[ICRA]A- (Positive)**	[ICRA]A- (Stable)		
3	Non-fund based-Working Capital	Short Term	60.0		**[ICRA]A2+**	[ICRA]A2+		
4	Unallocated	Short Term	130.0		**[ICRA]A2+**	[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

Annexure-1: Instrument details

ISIN No	Instrument Name	Date of Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loan 1	FY2018		FY2028	200.0	[ICRA]A- (Positive)
NA	Term Loan 2	FY2018		FY2028	100.0	[ICRA]A- (Positive)
NA	Term Loan 3	FY2018		FY2028	100.0	[ICRA]A- (Positive)
NA	Fund based- Working Capital				10.0	[ICRA]A- (Positive)
NA	Non-fund based - Working Capital				60.0	[ICRA]A2+
NA	Unallocated				130.0	[ICRA]A2+

Source: SMIORE

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Star Metallics & Power Private Limited	80.58%	Full Consolidation

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