May 11, 2020

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

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- (Stable) reaffirmed; outlook revised from Positive to Stable
Fund-based Working Capital Facilities	10.0	10.0	[ICRA]A- (Stable) reaffirmed; outlook revised from Positive to Stable
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 (SMIOL) 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 National Company Law Tribunal has approved the Scheme of Amalgamation of SMPPL with SMIOL in March 2020.

The revision in the outlook on the long-term rating takes into consideration the expected moderation in the operating performance of SMIOL in the near term, given the weak demand conditions witnessed in the iron and steel industry following the Covid-19 outbreak. The company's operating performance remained steady in FY2020, characterised by strong margins, comfortable credit metrics and healthy liquidity position. SMIOL had free cash and liquid investment balances of Rs. 87 crore as on March 31, 2020, despite some reduction from the previous year's levels, to meet a portion of its equity contribution requirements for the ongoing capital expansion project. However, business volumes have been adversely impacted from the last week of March 2020 owing to the nationwide lockdown imposed after the pandemic outbreak. ICRA expects a sharp decline in domestic steel consumption and production in FY2021 due to continued demand weakness from key end-user industries namely construction, capital goods and automobile sectors. As a result, SMIOL's operating performance in FY2021 would be relatively weaker than ICRA's expectations. ICRA also notes that the project cost has increased on account of a change in scope whereby the company has set up a new furnace along with the existing plan of establishment of a new coke-oven facility, upgradation of the existing ferro-alloy plant and upgradation of the mining infrastructure. However, there has been some delays in the completion of the capex programme on account of a delay in approvals and the pandemic outbreak. The capex is part funded by debt of Rs. 400 crore, which has a two-year moratorium period, from the date of first disbursement (April 2019), which provides some support to the liquidity. SMIOL has availed moratorium on scheduled payment obligations from its lenders for the period March-May 2020 as a part of the Covid-19 regulatory package announced by the Reserve Bank of India (RBI).

The ratings, nevertheless, 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 revenue visibility to its mining operations. The ratings are, however, constrained by the sizeable debt-funded capital expenditure plans of the company vis-à-vis the current scale of operations. Although SMIOL 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 an 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 with the stabilisation of coke manufacturing operations. These apart, volatility in international coking coal and coke prices, coupled with the long lead time in imports of coking coal expose the company to significant price and foreign exchange risks.

Key rating drivers

Credit strengths

Established track record of over six decades in mining industry; considerable sector experience of promoters – SMIOL was promoted in 1954 by the former ruler of the Princely state of Sandur, Mr. Yashwanthrao Hindurao Ghorpade. SMIOL produces iron ore with Fe content of around 58-63%, with lump to fine production ratio of 1:2. The company is also among the large miners of manganese ore in India. In addition, SMIOL manufactures ferro-alloys (silico-manganese) from its 36,000-mtpa plant in Vyasankare, near Hospet.

One of the largest private sector iron ore and manganese ore miners in Karnataka with adequate reserves – Currently, the company has two mining leases, valid up to 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, long validity of the mining licence and the established presence of the company in the mining industry.

Strong net worth and healthy cash and liquid investments – The company's financial profile remained comfortable with a strong net worth on a consolidated level given the healthy accretion to reserves. Additionally, strong cash accruals in the last two years have kept its capital structure and coverage indicators at comfortable levels. The liquidity position was supported by healthy cash and liquid investment balances. Going forward, despite the planned debt-funded capex, the capital structure and liquidity position are expected to remain comfortable.

Credit challenges

Slowdown in demand following the Covid-19 outbreak and consequent pressure on iron ore prices, both of which are likely to affect the company's operating performance in FY2021 – SMIOL's revenues and earnings are expected to be adversely impacted in Q1 FY2021 on the back of prevalent tepid demand conditions in the domestic steel industry owing to the Covid-19 pandemic. Domestic steel consumption and production are likely to witness a sharp decline in FY2021 due to weak demand from the end-user industries, which in turn is likely to pressurise iron ore prices in the near term.

Sizeable capital expenditure programme compared to current scale of operations – SMIOL's ongoing debt-funded capex programme is sizeable vis-à-vis its current scale of operations, exposing it to the risks related to project stabilisation, time and cost overrun. Moreover, going forward, the company has further large capex plans, the nature, timing, scale and the funding pattern of which are yet to be finalised.

Exposure to significant price, demand and foreign exchange risks 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 cash flows 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 the movement in currency exchange rates, given the expected dependence on imported coking coal.

Risks arising from operating in a highly regulated iron ore and manganese ore mining industry – SMIOL'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 imposed 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.

Sizeable contingent liabilities – SMIOL 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: Adequate

SMIOL's liquidity position is adequate, supported by steady cash accruals, adequate free cash and liquid investments and undrawn term loans, despite the sizeable capex undertaken. The company has availed debt of Rs. 330 crore out of the sanctioned amount of Rs. 400 crore in FY2020 for funding the capex. Around Rs. 590 crore has been spent towards the capex till March 2020. The company's liquidity profile continued to remain adequate, aided by unencumbered cash and liquid investments of Rs. 87 crore as on March 31, 2020, availability of sanctioned undrawn term loans from banks and healthy cash accruals from the existing operations.

Rating sensitivities

Positive triggers – 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 risks for its coke oven operations.

Negative triggers – Pressure on the ratings could emerge 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 its liquidity.

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, including the financials of its subsidiary, Star Metallics & Power Private Limited (please refer annexure 2)

About the company

The Sandur Manganese & Iron Ores Limited (SMIOL), 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.

SMIOL 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, with an area of 1860.10 hectares (ha) and 139.20 ha, respectively. The entire lease area is in the 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, SMIOL 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.

SMIOL 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. Two out of the four coke oven batteries have been stabilised and are under trial production.
- Upgradation of the existing ferro-alloy plant with modern equipment to enhance productivity and efficiency, along with addition of a new furnace. The new 24 MVA furnace has been under trial production since February 2020.
- Upgradation of mining infrastructure to increase the ores evacuation facility, through conveyor and strengthening of existing roads, and some quarters for staff

Key financial indicators (consolidated - audited)

	FY2018	FY2019	9M FY2019	9M FY2020
Operating Income (Rs. crore)	609.1	702.5	566.7	472.1
PAT (Rs. crore)	111.3	147.4	126.4	101.7
OPBDIT/OI (%)	28.7%	31.9%	35.8%	35.6%
RoCE (%)	35.1%	46.8%		
Total Outside Liabilities/Tangible Net Worth (times)	0.2	0.2		
Total Debt/OPBDIT (times)	0.0	0.0		
Interest Coverage (times)	35.3	35.1	47.3	34.5
DSCR (times)	26.7	25.4		

Source: SMIOL

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

		Current Rating (FY2021)				Chronology of Rating History for the Past 3 Years			
	Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding as on 31-Mar-20 (Rs. crore)	Date & Rating 11-May, 2020	Date & Rating in FY2020 8-Jul-2019	Date & Rating in FY2019 22-Jun-2018	Date & Rating in FY2018 2-Jun-2017	24-May-2017
1	Fund based-Term Loan	Long Term	400.0	330.0	**[ICRA]A- (Stable)**	[ICRA]A- (Positive)	[ICRA]A- (Stable)	[ICRA]BBB + (Stable)	[ICRA]BBB+ (Stable)
2	Fund based-Working Capital	Long Term	10.0	-	**[ICRA]A- (Stable)**	[ICRA]A- (Positive)	[ICRA]A- (Stable)		
3	Non-fund based-Working Capital	Short Term	60.0	-	**[ICRA]A2+**	[ICRA]A2+	[ICRA]A2+		
4	Unallocated	Short Term	130.0	-	**[ICRA]A2+**	[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- (Stable)
NA	Term Loan 2	FY2018	-	FY2028	100.0	[ICRA]A- (Stable)
NA	Term Loan 3	FY2018	-	FY2028	100.0	[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: SMIOL

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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About ICRA Limited:

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