Press Release

Electrosteel Castings Ltd

December 18, 2018

Rating

Instrument / Facility	Amount (Rs. Crore)	Ratings	Rating Action
Outstanding Non-Convertible Debentures (NCD) - Series VI	27.00 (present o/s)	IVR A/Stable Outlook (IVR Single A with Stable Outlook)	Affirmed
Outstanding Non-Convertible Debentures (NCD) - Series VII	75.00 (present o/s Nil)	IVR A/Stable Outlook (IVR Single A with Stable Outlook)	Withdrawn

Details of Facilities are in Annexure 1

Detailed Rationale

The IVR A/Stable Outlook (IVR Single A with Stable Outlook) rating assigned to the outstanding NCD – Series VI of Rs.27.00 crore derives comfort from its long track record of operation, dominance presence in the domestic D.I pipe segment, integrated production facilities leading to operational efficiencies, full capacity utilisation, healthy order book indicating modest revenue visibility, infusion of equity in FY19, comfortable & improving capital structure, resolution of Electrosteel Steel Ltd.'s debt and favourable outlook for domestic D.I pipe segment. However, the rating is constrained by volatile input prices leading to volatile profitability, elongated operating cycle, uncertainty associated with receipt of compensation against de-allocation of coal mine, low debt protection parameters & stress on liquidity, foreign exchange fluctuation risk. Profitability, gross cash accruals and receipt of compensation against de-allocated coal mine are the key rating sensitivities.

List of Key Rating Drivers with Detailed Description

Key Rating Strengths

Long track record of operation

ECL has been in the business for about six decades with the current promoters having controlling stake for the last 53 years, signifying its long & established track record. The company is first one to set up a D. I. Pipe plant in India.

Group dominance in the domestic D. I. pipe segment

D.I pipe is the major product of the company having contributed ~76% of Gross Sales in FY18. ECL is the largest player in the DI pipe segment of the country commanding sizeable market share (about 22%). The market share of the group including Sri Kalahasti Pipes, an associate company, is 40%.

Fully integrated production facilities leading to operational efficiencies

ECL has fully integrated production facilities comprising Sinter Plant, Coke Oven Plant (capacity: 2.25 lakh tonnes) for production of LAMC for meeting captive requirements, Blast Furnace, Pig Iron Plant (capacity: 2.5 lakh tonnes), Sponge Iron Plant, Fittings Plant and Captive Power Plant (12 MW). Integrated production facilities ensure assured supply of inputs and insulate the company from fluctuation in input prices, to an extent.

Full capacity utilisation

ECL is running at full capacity in FY18 and HY1FY19 on the back of robust demand for DI pipes.

Healthy order book indicating a modest revenue visibility

The company has a strong order book position aggregating about Rs.1000 crore as on November 30, 2018 comprising supply orders of about 1.8 lakh ton pipes. The orders are expected to be completed within next 7-8 months, indicating a satisfactory revenue visibility.

Favourable outlook for domestic D. I. pipe market

Rapid increase in population, urbanisation and industrialisation has led to a significant increase in water requirement, leading to demand overtaking the supply. Increased central government grants under JNNURM scheme, funding from developmental agencies and current Central Government additional impetus to this sector through the AMRUT (Atal Mission for Rejuvenation and Urban Transformation) scheme are matters for significant comfort for the D. I. pipe segment, as the investment in urban water supply and sanitation has increased manifold in the last couple of years.

Infusion of equity in FY19

In the current financial year (FY19), the company has got equity infusion of Rs.140 crore which has mostly been used for repayment/pre-payment of debt. This augurs well for the company as it facilitates deleveraging the capital structure and reduction of debt level.

Comfortable & improving capital structure

The capital structure of the company, as reflected by long term debt-equity ratio and overall gearing ratio were comfortable as on the last two account closing dates (being at 0.39x and 0.53x respectively as on March 31, 2018, on a standalone basis) and improved vis-à-vis the previous account closing date due to gradual repayment of debt. However, due to the adverse impact of loss on sale of investment in Electrosteel Steel Ltd. in the current year, the gearing will be deteriorated marginally as on March 31, 2019 despite of infusion of equity of Rs.140 crore (however, the expected loss on sale of investment in Electrosteel Steel Ltd. was factored at the time of last review of rating). Further, advances and trade receivable amounting to Rs.211.21 crore receivable from ESL has also been written off in HY1FY19.

Resolution of Electrosteel Steels Ltd.'s Debt

In view of the resolution plan approved by the NCLT, Kolkata and pursuant to issuance of additional equity shares by Electrosteel Steels Ltd. (ESL) for giving impact of resolution plan of the successful bidder, ESL had ceased to be an associate of ECL. In view of the above, the company has made a fair valuation of its investment in ESL and a sum of Rs. 578.68 crore representing the difference between the carrying value of the said investment and fair value as on the date of transfer has been written off in HY1FY19. Further, advances and trade receivable amounting to Rs.211.21 crore receivable from ESL has also been written off in HY1FY19.

Key Rating Weaknesses

Volatile input prices

The cost of raw materials (i.e., coal, iron ore) is the largest component of total cost of sales (accounted for ~45% in FY18). Due to de-allocation of coal mines and delay in clearance in iron-ore mine, ECL has to procure raw materials from the open market. It procures coaking coal mainly from Australia and iron ore from the domestic market. The prices of these raw materials are volatile in nature and hence, ECL's profitability is susceptible to fluctuation in raw material prices.

Volatile profitability

ECL posted a lower EBIDTA margin (excluding other income) of 11.59% (standalone) in FY18, as against 16.10% (standalone) in FY17, owing to higher input cost. Generally, EBIDTA margin of ECL has been volatile majorly due to fluctuation in input cost and time lag in passing on input price variation to customers. This volatility generally gets even out over a one year time horizon and hence, the EBIDTA margin of ECL has been in the range of 12-16% during the last three to four years.

Elongated operating cycle though improved over previous year

ECL has working capital intensive operations, which gets reflected in the average receivable collection which has been on the higher side mainly due to supply to government parties (average realisation period is about three months) and export debtors (average realisation period is about five months). However, the credit profile of debtors is generally good and there has not been any issue in collection in the last three years. Further, the average collection period improved partially from 116 days in FY17 to 97 days in FY18.

Uncertainty associated with receipt of compensation against de-allocation of coal mine

The Hon'ble Supreme Court had de-allocated many coal blocks in September 2014, including the Parbatpur coal mine which was hitherto allocated to ECL, challenging the reasonableness of the allocation. As all the beneficiaries of such allocation (including ECL) had spent individually a considerable amount of money for development of these mines, the Government of India had passed relevant legislation to provide compensation to the parties whose blocks were de-allocated. However all the beneficiaries (including ECL) filed a writ petition in Hon'ble Delhi High Court. The Hon'ble Delhi High Court has pronounced its judgement on March 09, 2017 in favour of the petitioners (including ECL). Accordingly based on the said judgement, the Company has claimed Rs.1531.76 crore towards compensation against the said coal block. ECL has already received Rs.83.12 crore till date out of its total claim. The company strongly believes that at least 15-20% per year shall be recovered in the next two years.

Low debt protection parameters & stretched liquidity

The debt protection parameters of the company remained stretched with interest coverage ratio of 1.11x. However, the company has managed to maintain a satisfactory debt servicing track record over the years with the support of refinancing of loan, optimisation of net working capital level, receipt of part compensation against de-allocation of coal mine, in addition to the cash accruals. On an overall basis, the aggregate debt of the company got reduced from the level of Rs.2087.55 crore as on March 31, 2016 to Rs.1544.12 crore as on March 31, 2018.

Foreign exchange fluctuation risk

ECL is importing one of its major inputs, coking coal from overseas. Further, it has foreign currency borrowings (in the form of External Commercial borrowings). However, the company enjoys a natural hedging due to its large amount of export of DI Pipes and Fittings. Moreover, ECL hedges its foreign currency loan installments at least for next two installments through forward cover. However, the timing difference of the exports and imports exposes the company towards volatile foreign currency movement.

Analytical Approach & **Applicable Criteria:**

Rating Methodology for Manufacturing Companies

Financial Ratios & Interpretation (Non-financial Sector)

Liquidity

The company has low debt protection parameters. However, the company has been able to manage its debt servicing well, over the years, through various financial means. In the current year, there has been infusion of Rs.140 crore equity in the company and the company has prepaid the corresponding portion of its debt. On an overall basis, the company has pared down its debt level gradually during the last three years. Further, the increasing level of gross cash accruals arising out of higher level of operating profit and significant amount of unavailed fund based working capital bank lines are matters of comfort for the company. The likelihood of receiving amount by way of compensation from Govt. of India on account of de-allocation of coal mine will help meeting commitments appears to be imminent, given the fact that the Hon'ble Delhi High Court has passed a favourable decision and the company has been able to receive Rs.82.30 crore, till date.

About the Company

ECL incorporated under the name "Dalmia Iron and Steel Limited" in November, 1955 currently belongs to Shri G. Kejriwal and his family based in Kolkata.ECL commenced its manufacturing activity in May, 1959 with the commissioning of Cast Iron (CI) pipes manufacturing unit. Although, the company started operations with manufacturing of C.I pipes, ECL over the years diversified into production of ductile iron (D.I) pipes and increased the capacity in both the segments through acquisitions and/or setting up greenfield units. Currently, ECL manufactures D.I pipes, C.I pipes and D.I fittings, besides producing pig iron and low ash metallurgical coke (LAMC) majorly for captive consumption with D.I pipes and fittings being the major products. The company has three manufacturing units - two in West Bengal and one in Tamil Nadu. ECL is one of the largest players in the DI Pipe industry with aggregate manufacturing capacity being 2.8 lakh tones, which is being operated at full capacity. The company also has its co-generation power plants at each location.

Financials (Standalone):

(Rs. crore)

For the year ended* / As On	31-03-2017	31-03-2018
	Audited	Audited
Total Operating Income	1808.58	1943.66
EBITDA	291.20	225.21
PAT	77.28	46.99
Total Debt	1903.83	1544.12
Tangible Net worth	2859.45	2889.74
EBITDA Margin (%)	16.10	11.59
PAT Margin (%)	4.09	2.32
Overall Gearing Ratio (x)	0.67	0.53

*Classification as per Infomerics' standards.

Status of non-cooperation with previous CRA: Nil

Any other information: Nil

Rating History for last three years:

Sr. No.	Name of Instrument/Facilities	Current Rating (Year 2018-19)			Rating History for the past 3 years			
		Type	Amount outstanding (Rs. Crore)	Rating	Date(s) & Rating(s) assigned in 2018-19	Date(s) & Rating(s) assigned in 2017-18	Date(s) & Rating(s) assigned in 2016-17	Date(s) & Rating(s) assigned in 2015-16
1.	Non-Convertible Debentures(Series VI)	Long Term	27.00	IVR A /Stable Outlook	April 20, 2018 IVR A/Stable	April 1, 2017 IVR A/Stable		-
2.	Non-Convertible Debentures(Series VII)	Long Term	0.00	IVR A /Stable Outlook	April 20, 2018 IVR A/Stable	April 1, 2017 IVR A/Stable		-

Note on complexity levels of the rated instrument: Infomerics has classified instruments rated by it on the basis of complexity and a note thereon is available at www.infomerics.com.

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About Infomerics:

Infomerics commenced rating & grading operations in April 2015 after having spent over 25 years in various segments of financial services. Infomerics is registered with the Securities and Exchange Board of India (SEBI) and accredited by Reserve Bank of India. It is gradually gaining prominence in domestic rating and/or grading space. Infomerics is striving for positioning itself as the most trusted & credible rating agency in the country and is gradually widening its product portfolio. Company's long experience in varied spectrum of financial services is helping it to fine tune its product offerings to best suit the market.

Annexure 1: Details of Facilities

Name of Facility	Date of Issuance	Coupon Rate/ IRR	Maturity Date	Size of Facility (Rs. Crore)	Rating Assigned/ Outlook
Non-Convertible Debentures(Series VI)	March 7, 2017	11.75%	March 06,2023	27.00	IVR A /Stable Outlook (IVR Single A with Stable Outlook)
Non-Convertible Debentures (Series VII)	March 7, 2017	12%	March 06,2023	0.00	Withdrawn