Sanghi Industries Limited

February 14, 2019

Summary of rating action

Instrument	Previous Rated Amount (Rs. Crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-Convertible Debenture Program (NCD)	258.00	258.00	[ICRA]A reaffirmed; outlook revised to Negative from Stable
Term Loan	200.00	200.00	[ICRA]A reaffirmed; outlook revised to Negative from Stable
Long-term Fund-based Limit	150.00	150.00	[ICRA]A reaffirmed; outlook revised to Negative from Stable
Short-term Fund-based Limit	60.00*	60.00*	[ICRA]A1 reaffirmed
Non-fund Based Limit	15.00	15.00	[ICRA]A1 reaffirmed
Total	**683.00**	**683.00**	

** Rating for short-term fund-based limit assigned for the first time; includes Rs. 25-crore interchangeability with non-fund based limit*

Material event

Sanghi Industries Limited (SIL) has announced its quarterly results for Q3 FY2019 on February 6, 2019. The company reported operating income (OI) of Rs. 266.1 crore with operating profit (OPBDITA) of Rs. 32.1 crore and net profit of Rs. 4.3 crore in Q3 FY2019 against OI of Rs. 279.6 crore with OPBDITA of Rs. 61.8 crore and net profit of Rs. 32.2 crore in Q3 FY2018.

Impact of the material event

The company's long-term and short-term ratings remain unchanged at [ICRA]A/[ICRA]A1; however, the outlook on the long-term rating is revised to Negative from Stable due to the continued weaker-than-expected performance in Q3 FY2019.

On a YoY basis, the OI registered a de-growth of 5% whereas the raw material cost increased by 25% and the power and fuel cost increased by 15% in Q3 FY2019. Consequently, the operating profitability moderated to 12.1% in Q3 FY2019 vis-à-vis 22.1% in Q3 FY2018 and the PAT margin dropped to 1.6% in Q3 FY2019 vis-à-vis 11.5% in Q3 FY2018. The drop in profitability results in a downward revision of the company's expected cash flow generation and debt coverage indicators for FY2019.

The previous detailed rating rationale is available on the following link: Click here

Rationale

The revision in rating outlook factors in the moderation in SIL's performance in Q3 FY2019 and over 9M FY2019, primarily due to a significant increase in raw material, power and fuel costs compared to the same period last year (Q3 FY2018 and 9M FY2018), accompanied by zero clinker exports in Q3 FY2019 and lower-than-expected average realisations over the nine-month period. Consequently, the company's profitability and cash accruals remained lower than ICRA's expectations, resulting in a downward revision of the projected cash flows for FY2019 and FY2020.

The ratings continue to factor in the benefits arising out of the integrated nature of SIL's cement operations by way of easy access/low cost of raw materials. This is due to SIL's captive mines and production scale economies, given its large-sized single-kiln operations and ease of cement/clinker offtake by way of a captive jetty. The ratings also take into account the company's access to a captive power plant with multiple fuel intake options. ICRA notes the healthy liquidity position of the company and the successful completion of its moderate capex plans, which should improve the cost structure. The ratings, moreover, favourably factor in the expected improvement in contribution margins on the back of a ramp-up in the capacity utilisation levels as well as the increasing proportion and acceptability of its Portland Pozzolana Cement (PPC) products.

The ratings, however, remain constrained by the vulnerability of the cement industry to cyclical trends and the geographical concentration risks in the company's cement business, given that over 80% of its sales are derived from Gujarat. The ratings also factor in the vulnerability of SIL's profitability to fluctuations in fuel and other raw material prices, the moderate return indicators (given its relatively moderate capacity utilisation levels), the modest projected coverage indicators and the execution risks associated with its sizeable expansion plans over the next year.

Outlook: Negative

The Negative outlook factors in the possibility of a further weakening of the cash flows in the subsequent quarters, due to the sustained pressure on realisations and cost structure. The outlook may be revised to Stable if there is an improvement in the company’s performance resulting in improved return indicators and coverage metrics. The ratings may be downgraded in case of any significant deterioration in the coverage metrics, substantial increase in operating costs, reduction in realisations, elongation in cash conversion cycle or time/cost overruns in the ongoing expansion project.

Key rating drivers

Credit strengths

Integrated cement operations; access to cheap raw materials and CPP with multiple fuel options support cost structure - SIL has an integrated cement production facility with easy access to high quality limestone, its major raw material, at its captive mine ~3 km from its plant. Further, it has access to other raw materials (like laterite, silica, clay and fly ash) with captive mines available for most of them. SIL has its own source of power with its 61.5-MW captive power plant (CPP) located ~10 km from the clinker plant and 2 km from the cement plant, adjacent to its captive jetty. The captive jetty allows SIL to directly import coal/pet coke for operating its CPP as well as cement operations. In terms of fuel mix, it has the option to switch fuel source to lignite/imported coal/pet coke at both its CPP and clinker units, offering it flexibility to control its energy costs depending on market conditions.

Move towards high-margin cement variants; access to consumption centres and clinker export markets aid volume growth and mitigates sales risks - The company continues to increase the sales of its PPC variants, which stood low at ~34% of the total cement sales in FY2018. Going forward, higher PPC concentration would be favourable for the contribution margins. In addition, SIL has access to the Mumbai and Kochi markets by way of sales arrangements through coastal transportation. Although the Kochi sales remain limited, the Mumbai sales are expected to improve, post the commissioning of its two new barges. Further, SIL's ability to sell clinker to West Asian, South Asian and other markets through its captive jetty provides access to wider markets and mitigates sales risks.

Cost reduction initiatives to improve EBITDA margins - In FY2018, the company completed capex of ~Rs. 200 crore, which primarily included the procurement of two barges and the establishment of a 13-MW Waste Heat Recovery System (WHRS). The company started operating the barges in Q3 FY2018, while the WHRS was made completely operational in Q1 FY2019. These additions will support a sustainable reduction in SIL's operating costs and improve the cost structure further.

Favourable capital structure - The company refinanced its Rs. 325-crore debt (Rs. 256 crore in Q4 FY2018 and Rs. 69 crore in Q1 FY2019), which resulted in the savings of 5% on interest cost. This will have a positive effect on the net margins, going forward. SIL's capital structure, as reflected by gearing, has remained at acceptable levels and witnessed a gradual decline over the years, with a sharp decline in FY2018 as well as H1 FY2019 (despite increased debt levels) mainly owing to the issuance of fresh equity.

Credit challenges

Geographical concentration risks and cyclical trends in cement industry - SIL faces significant geographical concentration risks given that over 80% of its sales are derived from Gujarat. Moreover, there is intense competition in Gujarat with the presence of multiple industry players, owing to healthy demand prospects. Thus, existing players like SIL are susceptible to volatility in prices and reduction in market share. While the company has been gradually trying to increase sales in other regions through split packaging/sales units in Maharashtra and Kerala, the same has not yielded any significant diversification in sales. However, SIL's sales volume in Maharashtra is expected to improve with the acquisition of new barges in Q3 FY2018.

Vulnerability of profitability to fluctuations in fuel cost - Power and fuel cost accounts for a significant portion of SIL's total cost and any adverse movement in the fuel prices can affect its profitability. For SIL, the power and fuel cost remained in the range of 23-26% of its OI during the last three years. However, in 9M FY2019, this rose to ~29% on account of lower availability of low-cost lignite, increase in international coal prices and unfavourable exchange rate movements. Going forward, however, ICRA expects this proportion to come down, given the renewed lignite supply from Gujarat Mineral Development Corporation (GMDC). Similarly, the raw material cost, which stood at 6.4% of the OI in FY2018, increased to 9% in 9M FY2019 on account of unplanned interruption in clinker production and issues with slag cost. This, however, is temporary and ICRA expects the raw material cost to come down, going forward.

Moderate return indicators given relatively moderate capacity utilisation and high capital cost of plant - As the company incurred significant capital costs for setting up the existing plant and exiting the corporate debt restructuring (CDR) cell, its overall returns remained moderate with return on capital employed (RoCE) at 9.2% in FY2018. This further deteriorated in H1 FY2019 owing to a drop in the EBITDA margin, because of increased operating costs.

Project risks associated with large-scale debt-funded capacity expansion - In January 2018, SIL announced its final plan to expand its cement capacity to 8.1 million tonne per annum (MTPA) from 4.1 MTPA. ICRA notes that the project has a competitive capital cost of US$ 48/tonne of cement (~50% of the industry average) on account of its brownfield nature and the fact that several common infrastructures have already been put in place. The company has planned to fund the project in a debt-to-equity ratio of 1.78:1 with upfront equity coming in (Rs. 400 crore raised in February 2018), which will prevent any pressure on the cash flows of the existing unit and support liquidity requirements during the project development stage. ICRA expects the leveraging levels (Total Debt/OPBDIT) to increase and peak at ~6x times in FY2020, post which it should decline with sales commencement from the new capacity. Nonetheless, given its large scale and the associated execution and market risks, the project's timely progress without time and cost overruns will be a key monitorable.

Exposed to exchange risks due to net importer status and limited hedging - SIL has been a net importer during most of its years of operations. The company does not hedge its foreign exchange exposure, which exposes its profitability to exchange rate fluctuations.

Liquidity position

SIL's liquidity position remained moderate with a surplus cash and bank balance of ~Rs. 304 crore as on September 30, 2018 (Rs. 428 crore as on March 31, 2018) owing to the issuance of fresh equity through the qualified institutional placement (QIP) route in January 2018. The company used some portion of its cash balance to fund the ongoing expansion plan and expects to deploy a significant portion of the balance for the same purpose over the next 15 to 18 months. The company also had sanctioned fund-based facilities of Rs. 260 crore as on December 31, 2018, the average utilisation of which remained high at over 80% during the past 12 months.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Cement Industry
Parent/Group Support	Not applicable.
Consolidation/Standalone	The ratings are based on the standalone financial profile of the company.

About the company

Sanghi Industries Limited, the flagship company of the Ravi Sanghi Group and is engaged in the production and distribution of cement under the brand, Sanghi Cement. The manufacturing facility is located at Sanghipuram in the Kutch district of Gujarat. SIL's clinker plant has the production capacity of 3.3 million MTPA of clinker and 4.1 million MTPA of cement. The company produces superior quality 53-grade Ordinary Portland Cement (OPC) and PPC cement. It has a captive jetty to handle its export/coastal cargo, captive mines to meet its major raw material requirements, a captive water desalination plant and a 61.5-MW captive power plant to meet its power requirements. The company also enjoys being two-way connected to the Government's power grid, enabling the sale of surplus power.

Key financial indicators (audited)

	FY2017	FY2018
Operating Income (Rs. crore)	997.5	1026.4
PAT (Rs. crore)	63.2	93.3
OPBDIT/OI (%)	19.9%	21.0%
RoCE (%)	8.2%	9.2%
Total Debt/TNW (times)	0.54	0.46
Total Debt/OPBDIT (times)	3.0	3.4
Interest coverage (times)	3.1	3.0

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

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