September 12, 2019

Sanghi Industries Limited: Rating reaffirmed at [ICRA]A(Negative)/A1

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-Convertible Debenture Programme (NCD)	258.00	258.00	[ICRA]A(Negative) Reaffirmed
Term Loan	200.00	200.00	[ICRA]A(Negative) Reaffirmed
Long-term Fund Based Limit	200.00	200.00	[ICRA]A(Negative) Reaffirmed
Short-term Fund Based limit	60.00**	60.00**	[ICRA]A1 Reaffirmed
Non-Fund Based Limit	15.00	15.00	[ICRA]A1 reaffirmed
Total	**733.00**	**733.00**	

**Instrument details are provided in Annexure-1*
*** Includes Rs. 25 crore interchangeability with non-fund based limits*

Rationale

The rating reaffirmation takes into consideration the benefits arising out of the integrated nature of the cement operations of Sanghi Industries Limited (SIL or the company) by way of easy access/low cost of raw materials. The same is due to SIL's captive mines and production scale economies, given its large sized single kiln operations and ease of cement/clinker off-take by way of a captive jetty. The rating also factors in the company's access to a captive power plant with multiple fuel in-take options. Further, the rating notes the improved performance of SIL in Q1 FY2020, after a weaker than expected FY2019, on the back of improved market conditions and restored cost structure leading to better margins and healthy cash accruals. ICRA also notes the project progress at Kutch (Gujarat) to be largely in line with expectations. The rating, moreover, favourably factors in the expected improvement in contribution margins on the back of improved price realisations, ramp-up in capacity utilisation levels as well as the increasing proportion of its blended cement.

The rating, however, remains 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 generated from Gujarat. The rating also factors in the vulnerability of SIL's profitability to fluctuations in fuel and other raw material prices. The financial performance of SIL weakened in FY2019 as compared to the previous year with the operating margin contracting to a five-year low of 14.5%, primarily due to significant increase in raw material, power and fuel costs accompanied with lower than expected average realisations. The rating further takes into consideration SIL's moderate return indicators (given its relatively moderate capacity utilisation level), modest projected coverage indicators and the moderate execution risks associated with its capacity expansion plan over the next six to nine months.

The Negative outlook factors in the weaker than expected profitability of the company during Q2–Q3 FY2019. While profitability has improved significantly in Q1 FY2020, ICRA would continue to monitor the performance for one to two quarters more to establish its sustainability before considering a change in outlook to Stable. An adverse impact on SIL's operating profitability and cash accruals is especially critical as the company is currently undertaking a large brownfield capacity expansion with estimated project debt-to-equity ratio of 1.78:1. Continuing healthy cash flows from the current cement operations are critical to maintain adequate liquidity given the high debt obligations post commissioning of the new plant.

Key rating drivers and their description

Credit strengths

Integrated cement operations; access to cheap raw materials and captive power plant with multiple fuel options support cost structure - SIL has an integrated cement production facility with easy access to high quality raw material, viz., limestone, at its captive mine about 3 km from its plant. Further, it has access to other raw materials like laterite, silica, clay and fly ash in the region 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 about 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 for its cement operations. In terms of its fuel mix, it has the option to switch fuel source to lignite/imported coal/pet coke at both its CPP and clinker unit, offering it the flexibility to control its energy costs depending on market conditions.

Gradual move towards high-margin cement variants - Though SIL's production and sales is inclined towards Ordinary Portland Cement (OPC), the company continues to focus on increasing sales of its Portland Pozzolana Cement (PPC) and Portland Slag Cement (PSC) variants, which together contributed about 34% of total cement sales in FY2019 and 37% in Q1 FY2020. Going forward, higher PPC concentration would be favourable for contribution margins.

Access to consumption centres along the coast as well as clinker export market aids volume growth and mitigates sales risks - Apart from the Gujarat market, SIL has access to the Mumbai and Kochi markets by way of sales arrangements through coastal transportation. Although its sales to Kochi remain limited, its Mumbai sales have improved significantly post the commissioning of two new barges in Q3 FY2018. Its Mumbai sales almost doubled (albeit on a low base) in FY2019 over the previous year and ICRA expects the same to increase even further. Additionally, its ability to sell clinker to West Asia, Africa and other markets through its captive jetty allows SIL access to wider markets and mitigates its sales risks.

Credit challenges

Geographical concentration risks and cyclical trends in the cement industry - SIL faces significant geographical concentration risks given that over 80% of its sales are driven by the Gujarat region. Moreover, with the high competitive pressure in Gujarat, amid multiple industry players owing to healthy demand prospects, existing players like SIL are susceptible to volatility in prices and reduction in market share. The company has been gradually trying to increase its sales in other regions through split packaging/sales units in Maharashtra and Kerala.

Vulnerability of profitability to fluctuations in power fuel cost - Power and fuel costs account for a significant portion of the total cost for SIL and any untoward movement in fuel price can affect its profitability. For SIL, the power and fuel cost remained in the range of 21-24% of its operating income over FY2016-FY2018. However, in FY2019, this rose to 28% on account of lower availability of low-cost lignite, increase in international coal prices and unfavourable exchange rate movements. Going forward, given the renewed supply of lignite from Gujarat Mineral Development Corporation (GMDC) and moderation of the international coal prices, ICRA expects the power and fuel cost percentage to come down.

Moderate coverage indicators given the large ongoing capex - Given that SIL is currently undertaking a large capacity expansion funded by a debt-to-equity of 1.78:1, its gross leveraging (Debt/OPBDITA) stood high at 5.3 times as on March 31, 2019 and interest coverage ratio stood at 2.7 times in FY2019. ICRA expects the gross leveraging (Debt/OPBDITA) to peak at 6.0 times in FY2020 and the interest coverage ratio to bottom out at 2.5 times in FY2021 (first year of operation of the new capacity), post which these indicators should show rapid improvement.

SIL remains exposed to exchange risks, given the net importer status and limited hedging - SIL has been a net importer during most of its previous years of operations. The company does not hedge its operational foreign exchange exposure and the profitability remains exposed to exchange rate fluctuations.

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 MT from 4.1 million MT per annum. ICRA notes that the project has a competitive capital cost of $48/MT of cement (about 50% of industry average) owing to the brownfield nature of the project and the fact that several common infrastructures have already been put in place. The company has planned to fund the project at a debt-to-equity ratio of 1.78:1 with upfront equity coming in (Rs. 400 crore raised in February 2018 via qualified institutional placement or QIP), which will prevent any pressure on cash flows of the existing unit and support the liquidity requirements during the project development stage. The progress on the development is healthy with ~65% civil work and ~30% mechanical fabrication work completed as on June 30, 2019. Nonetheless, given the large scale of the project and the associated execution and market risks, the timely progress of the project without time and cost overruns will be a key monitorable.

Liquidity position: Adequate

As on June 30, 2019, SIL's liquidity position remained adequate with surplus free cash and bank balance of ~Rs. 30 crore excluding the balance earmarked to fund the ongoing expansion. The company also had fund-based facilities of Rs. 260 crore as of June 30, 2019, the average utilisation of which has remained high at about 90% over the past 12 months.

Rating sensitivities

Positive triggers: Given the negative outlook, a rating upgrade over the next one year is less likely. However, a change in outlook to Stable or an upward movement in rating could happen if the company is able to sustain an OPBDITA of over Rs. 900/MT and demonstrate improvement in its capacity utilisation on a sustained basis.

Negative triggers: Negative pressure on SIL's rating could arise if, for reasons including any extended change in the market conditions, the OPBDITA falls and remains below Rs. 600/MT on a sustained basis, or if there is any significant time or cost overruns in the completion of the ongoing capacity expansion project.

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 rating is based on the standalone financial profile of the company

About the company

Sanghi Industries Limited is 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 of the company is located at Sanghipuram in the Kutch district of Gujarat. The clinker plant has a capacity of 3.3 million MT clinker and 4.1 million MT cement per annum. The company produces superior quality 53-Grade OPC, PPC and PSC variants of cement. SIL also has a captive jetty to handle its export/coastal cargo, captive mines to meet its major raw material requirement, captive water desalination plant and a 61.5-MW captive power plant to meet its power requirements. The company also enjoys a two-way connection to the Government's power grid, including for the sale of surplus power.

During FY2019, SIL reported an operating income (OI) of Rs. 1,061.0 crore and profit after tax (PAT) of Rs. 52.6 crore. During FY2018, SIL had reported an OI of Rs. 1,026.4 crore and PAT of Rs. 93.3 crore.

Key financial indicators (audited)

	FY2018	FY2019
Operating Income (Rs. crore)	1,026.4	1,061.0
PAT (Rs. crore)	93.3	52.6
OPBDIT/OI (%)	21.0%	14.5%
RoCE (%)	9.4%	5.6%
Total Debt/TNW (times)	0.5	0.5
Total Debt/OPBDIT (times)	3.4	5.3
Interest coverage (times)	3.0	2.7
DSCR (times)	2.8	2.2

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

S. No	Instrument	Current Rating (FY2020)				Chronology of Rating History for the past 3 years											
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating	Date & Rating in FY2019						Date & Rating in FY2018				Date & Rating in FY2017	
					12-September 2019	26-February 2019	14-February 2019	05-December 2018	19-November 2018	11-July 2018		27-February 2018	16-January 2018	10-July 2017	09-May 2017	15-February 2017	08-June 2016
1	Non-Convertible Debenture	Long Term	258.00	256.00	[ICRA]A (Negative)	[ICRA]A (Negative)	[ICRA]A (Negative)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)		[ICRA]A- (Stable)	-	-	-	-	-
2	Term Loan	Long Term	200.00	163.59	[ICRA]A (Negative)	[ICRA]A (Negative)	[ICRA]A (Negative)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)		[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	-	-
3	Long-term Fund Based Limit	Long Term	200.00	-	[ICRA]A (Negative)	[ICRA]A (Negative)	[ICRA]A (Negative)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)		[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA] BBB (Stable)
4	Short-term Fund Based Limit	Short Term	60.00	-	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1	-	-		-	-	-	-	-	-
5	Non-Fund Based Limit	Short Term	15.00	-	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1		[ICRA]A2+	[ICRA]A2+	[ICRA] A2+	[ICRA] A2+	[ICRA] A2+	[ICRA] A3+

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 Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE999B07028	Non-Convertible Debenture	7-Mar-2018	10.50%	7-Mar-2023	258.00	[ICRA]A(Negative)
NA	Term Loan	Mar-2017	10.75%	Mar-2024	200.00	[ICRA]A(Negative)
NA	Long-term Fund Based Limit	NA	NA	NA	200.00	[ICRA]A(Negative)
NA	Short-term Fund Based Limit	NA	NA	NA	60.00*	[ICRA]A1
NA	Non Fund Based Limit	NA	NA	NA	15.00	[ICRA]A1

** Includes Rs. 25 crore interchangeability with non-fund based limits*

Source: Sanghi Industries Limited

Annexure-2: List of entities considered for consolidated analysis – Not applicable

ANALYST CONTACTS

K. Ravichandran
+91 44 4596 4301
ravichandran@icraindia.com

Ankit Patel
+91 79 4027 1509
ankit.patel@icraindia.com

Parth Shah
+91 79 4027 1527
parth.shah@icraindia.com

RELATIONSHIP CONTACT

Jayanta Chatterjee
+91 80 4332 6401
jayantac@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries:

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

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.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

ICRA Limited

Corporate Office
Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002
Tel: +91 124 4545300
Email: info@icraindia.com
Website: www.icra.in

Registered Office
1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001
Tel: +91 11 23357940-50

Branches

Mumbai	+ (91 22) 24331046/53/62/74/86/87
Chennai	+ (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,
Kolkata	+ (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008,
Bangalore	+ (91 80) 2559 7401/4049
Ahmedabad	+ (91 79) 2658 4924/5049/2008
Hyderabad	+ (91 40) 2373 5061/7251
Pune	+ (91 20) 2556 0194/ 6606 9999