Welspun Speciality Solutions Limited

December 03, 2021

Ratings

Facilities/Instruments	Amount (Rs. crore)	Rating[1]	Rating Action
Long-term / Short-term Bank Facilities	27.36	CARE AA (CE); Stable / CARE A1+ (CE) [Double A (Credit Enhancement); Outlook: Stable/ A One Plus (Credit Enhancement)]	**Assigned**
Long-term Bank Facilities	72.64	CARE BBB- (CWD) (Triple B Minus) (Under Credit watch with Developing Implications)	**Assigned**
Total Bank Facilities	**100.00 (Rs. One hundred crore only)**		

Details of instruments/facilities in Annexure-1

 # The rating is backed by credit enhancement in the form of unconditional and irrevocable corporate guarantee provided by Welspun Corp Limited (WCL).

Un Supported Rating[2]	**CARE BBB- (Under Credit watch with Developing Implications) (Triple B Minus) (Under Credit watch with Developing Implications) [Assigned]**

Note: Unsupported Rating does not factor in the explicit credit enhancement

Detailed Rationale & Key Rating Drivers for the credit enhanced debt of Welspun Specialty Solutions Limited

The ratings assigned to the bank facilities of Welspun Specialty Solutions Limited (WSSL) factor in the credit enhancement in the form of an unconditional and irrevocable CG extended by WCL towards timely servicing of debt obligations. The above rating is solely based on CARE Ratings' view on guarantor's credit profile and accordingly the Rating Rationale highlights the credit risk assessment parameters for guarantor.

Detailed Rationale and Key Rating Drivers of Welspun Corp Limited (WCL; the guarantor)

The ratings reaffirmation to the bank facilities/instruments of Welspun Corp Limited (WCL) continue to factor in the strong business risk profile supported by its dominant position in the steel pipe business with diverse geographical presence in India, United States of America (US) and Saudi Arabia. The ratings also consider the robust financial risk profile marked by comfortable capital structure and debt service indicators which has been further strengthened by the pre-payment of entire long-term debt in its US subsidiary in July 2021. CARE Ratings notes the debt-funded (70%) greenfield expansion undertaken by WCL in terms of setting up "Pig Iron" (PI) and "Ductile Iron" (DI) manufacturing plants at Anjar, Gujarat, which is expected to moderate its capital structure and solvency indicators in the medium term. However, ample liquidity cushion is available in the form of cash and liquid investments as on July 31, 2021, which is further bolstered post receipt of proceeds from sale of its Plate and Coil division (PCMD, now classified as discontinued operations) along with generation of healthy cash accruals in FY21 (refers to the period April 1 to March 31) provide comfort. Though WCL encountered challenges on account of pandemic

[1]*Complete definition of the ratings assigned are available at www.careratings.com and other CARE publications*

[2]*As stipulated vide SEBI circular no SEBI/ HO/ MIRSD/ DOS3/ CIR/ P/ 2019/ 70 dated June 13, 2019. As per this circular, the suffix 'CE' (Credit Enhancement) is assigned to the ratings with explicit external credit enhancement, against the earlier used suffix 'SO' (Structured Obligation).*

in FY21 which led to moderation in its revenue profile and slow pace of order-book execution, WCL did not face any major moderation in Q1FY22 and reported a reasonable performance backed by steady order flow reflected by confirmed order book-position as on July 31, 2021, which provides medium-term revenue visibility. However, any slowdown on account of uncertainties around the pandemic and any other material developments impacting the sales volume and incremental orders in the key markets remains a key rating monitorable.

The above rating strengths are offset by the volatility associated with the crude oil & gas and steel prices impacting the demand for pipelines and order book in line pipe segment and regulatory risk in the geographies in which it operates.

CARE Ratings notes the scheme of arrangement which provides for acquisition of the steel business of Welspun Steel Limited (WSL, rated 'CARE A-/ CARE A2; under credit watch with developing implications') and investments held in Welspun Specialty Solutions Limited (WSSL; 50.03%), Anjar TMT Steel Private Limited (ATSPL; 100%) and Welspun Captive Power Generation Limited (WCPGL, rated 'CARE A+; Stable/ CARE A1+'; 2.95%) [cumulatively referred to as demerged company] which is subjected to approval of National Company Law Tribunal (NCLT). As per the scheme, the transaction is a related party transaction and the same is being done on arm's length basis post through due diligence. The scheme does not provide for any cash consideration as WCL would issue and allot only Cumulative Redeemable Preference Shares (CRPS) to the eligible shareholders of the Demerged Company as on the record date which would translate to Rs.362.73 crore at face value, redeemable at the option of the holder, upon the expiry of 18 months from the date of issue. The CRPS would not be listed on the stock exchanges. CARE Ratings would continue to monitor the developments in this regard.

Key Rating Drivers of Welspun Specialty Solutions Limited for Unsupported Rating

CARE Ratings has placed the ratings assigned to the bank facilities of WSSL on "credit watch with developing implications (CWD)". The above action has been taken in view of merger announcement by WCL wherein that it proposes to acquire the division of the Welspun Steel Limited (WSL) steel operating business which manufactures BIS-certified steel billets and direct reduced iron (DRI), specialty steel and thermo mechanical treatment (TMT) bars and businesses directly or indirectly carried out through the investments held in WSSL, Anjar TMT Steel Private Limited and Welspun Captive Power Generation Limited (WCPGL, rated 'CARE A+; Stable/ CARE A1+'). WCL's management has articulated that it expects to complete the proposed scheme within FY22. From WSSL's standpoint, the share capital held by WSL (50.03% as on September 30, 2021) will be held by WCL upon completion of the aforesaid scheme resulting in a new parent entity. CARE Ratings would continue to monitor the developments in this regard.

The ratings assigned to the bank facilities of WSSL considers the strong operational and financial linkages with Welspun group entities, viz., WCL and Welspun Steel Limited (WSL; rated 'CARE A-/ CARE A2 [under credit watch with developing implications']). The ratings derive strength from the redefined product mix with management discontinuing its alloy steel business and focusing on production of stainless steel/pipe products from FY21 onwards. The modernization capex undertaken by WSSL over the period FY18-FY20 is completed and benefit from the same coupled with new product mix is expected to accrue in projected years. CARE Ratings notes the likely benefit for WSSL if the merger scheme as articulated by WCL is completed as it would bring in synergistic benefits to WCL, WSSL and other group entities involved, resulting from operational rationalization (including reduction in overheads, administrative, managerial, and other expenditure), leading to improved operational efficiency. The proposed arrangement is likely to provide WSSL a stronger presence across market segments, access to new markets and product offerings while having access to WCL's marketing capabilities. This could translate into better earnings predictability and improved operational cash flows.

The above rating strengths are offset by the sub-par operational performance of WSSL with company reporting negative operating profit for the past five years (FY17-FY21) including H1FY22 (refers to the period April 01, 2021 to September 30, 2021). This has resulted in weak financial risk profile and stretched liquidity position and led to dependence on the group companies for repayment obligations as well as to avail financing from lenders. The ratings also remain constrained by the inherent cyclicality in the steel industry.

Rating Sensitivities of Welspun Specialty Solutions Limited

Positive Factors - Factors that could lead to positive rating action/upgrade:

- Improvement in credit metrics with breakeven and sustained growth visible at PBILDT level
- Improvement in sales volume for stainless steel and pipes leading to growth and sustenance of revenue beyond Rs.500 crore

Negative Factors- Factors that could lead to negative rating action/downgrade:

- Any further deterioration in the credit metrics and withdrawal of support from group entities, particularly from WSL and WCL
- Delay in stabilization of new capacity for stainless steel and seamless pipes resulting in lower-than-expected revenues and margin

Rating Sensitivities of Welspun Corp Limited

Positive Factors - Factors that could lead to positive rating action/upgrade

- WCL's ability to improve upon its consolidated operating profitability margin to more than 16% on a sustained basis
- Low leveraged capital structure with overall gearing (including corporate guarantee) not more than 0.30x
- Sustenance in return on capital employed (ROCE) above 25% and improvement in interest coverage ratio above 8.00x

Negative Factors- Factors that could lead to negative rating action/downgrade

- Decline in profitability margins on a consolidated basis below 11% in the projected period
- Continued contraction in the order-book position leading to lower sales volumes in the projected period
- Increase in adjusted overall gearing (including corporate guarantee) above 1.00x during the projected period
- Any delay, in the proposed capex plan, resulting into time and cost over-run.

Detailed description of the key rating drivers of Welspun Specialty Solutions Limited

Key Rating Strengths

Strong operational and financial linkages with Welspun group entities, viz., WCL and Welspun Steel Limited

In November 2019, the Welspun group took over the shareholding of erstwhile promoters. Since then, there are operational and financial linkages between WSSL and other group entities of the Welspun group, i.e., WCL and WSL, which have strengthened over the period of years evident with promoter group increasing its shareholding from 49.81% in FY20 to 53.62% in FY21, upon conversion of share warrants.

Change in product mix to help drive volumes and improve sales realization

Prior to FY21, WSSL was into the carbon steel/alloy business which involved manufacturing alloy-based ingots, blooms. Post FY21, WSSL has moved away from carbon steel business to stainless steel product mix wherein margins and operating cycle is more accretive compared to former. This is expected to improve operational performance of WSSL from Q4FY22 onwards.

Synergistic benefits from likely merger with WCL

WCL proposes to acquire the steel operating business of WSL and businesses directly or indirectly carried out through the investments held in WSSL, Anjar TMT Steel Private Limited and Welspun Captive Power Generation Limited. CARE Ratings expects the above-mentioned scheme to derive synergic benefits, both for WCL and WSSL, with former entering the stainless steel (SS) long and SS seamless pipe/tube segments and WSSL having access to marketing capabilities and customer profile of WCL. The Welspun group has relevant experience and established track record of two decades in selling and marketing of steel products. WSSL may leverage on the in-house expertise of the resultant promoter to market their own products. Welspun groups' strong relations with the suppliers and timely supply of good raw material for smooth running of operations would remain key rating monitorable.

Key Rating Weaknesses

Weak financial risk profile leading to dependence on group companies

WSSL financial risk profile remains weak marked by capacity underutilization and reporting operating loss for the past five years (FY17-FY21) and during H1FY22. The continued losses have resulted in eroding of net worth and negative interest coverage for the said period. WSSL has been relying on the support from the group companies for repayments and availing finance from lenders.

Inherent cyclicity in steel industry

Prospects of steel industry are strongly co-related to economic cycles. The demand for steel is sensitive to trends of particular industries, viz., automotive, construction, infrastructure, and consumer durables, which are the key consumers of steel products. These key user industries in turn depend on various macroeconomic factors, such as consumer confidence, employment rates, interest rates and inflation rates, etc., in the economies in which they sell their products. When downturns occur in these economies or sectors, steel industry may witness decline in demand.

<u>Liquidity: Stretched</u>

Liquidity remains stretched marked by modest cash balance of Rs.3.17 crore (including lien marked fixed deposit) as on September 30, 2021. The average utilization of fund-based limits stands at 76% for the past twelve months ending October 2021, whereas for the non-fund-based limits, it stands at 59% for the same period. WSSL has repayment obligations of Rs.2.61 crore and Rs.8.44 crore in remaining part of FY22 and FY23, respectively, which is expected to be met through support from group companies.

Detailed description of the key rating drivers of Guarantor

Key Rating Strengths

Strong business risk profile supported by dominant position in the steel pipe business

WCL is one of the dominant players in the steel line pipe business with established track record of over two decades and demonstrated capabilities in supply of line pipes for complex projects in the oil & gas as well as water segments. WCL has global pipe production capacity of 2.55 million tonnes per annum (MTPA) with an aggregate capacity of 1.65 MTPA at four locations across India, 0.52 MTPA capacity in US and 0.375 MTPA capacity through joint venture in Saudi Arabia. Over the past three years, the company has consistently sold more than 1000 KMT of pipes globally which is aided by its established relationship with reputed overseas and domestic customers. Owing to requirement of sophisticated infrastructure in such business results in high entry barriers for new players thereby limiting competition thus strengthening WCL's business risk profile.

Robust financial risk profile and profitability indicators, moderation expected in medium term

The financial risk profile marked by overall gearing (including acceptances) and total debt to gross cash accruals (TDGCA) remains comfortable at 0.28x and 1.59, respectively, as on March 31, 2021 (PY: 0.57x and 1.92, respectively). Pre-payment of long-term debt in its US subsidiary along with receipt of entire consideration from sale of its PCMD division has further strengthened its financial risk profile with free cash and liquid investments of Rs.2,252 crore as on September 30, 2021, on the consolidated basis. Tangible net worth remains healthy at Rs.3,811.65 crore with PBILDT interest coverage improving to 12.89x (PY: 8.78x) in FY21. The profitability margin, viz., PBILDT margins improved by 65 bps to 13.26% in FY21 on account of high margin export order realization in coastal gas link project in Canadian market. The PAT margins increased by 292 bps to 9.83% on account of company's cost optimization measures at US subsidiary. Going ahead, the financial risk profile is expected to moderate on account of greenfield capex in terms of setting up of DI and PI manufacturing plant at Anjar, Gujarat. WCL has extended/proposed to extend corporate guarantee for the debt facilities availed/to be availed for capex purpose. The overall project cost is estimated to be Rs.1777 crore which would be 70% funded through debt and balance through equity. As on July 31, 2021, WCL has already infused around Rs.540 crore as a part of promoter contribution with balance amount expected to be infused in the remainder of FY22. However, the peak overall gearing is expected to be less than unity in the projected years.

Satisfactory order-book position providing medium-term revenue visibility

WCL's globally confirmed order book position stands at 579 KMT translating in sales value of around Rs.4,900 crore as on September 30, 2021, thus providing medium-term revenue visibility for the company. In addition to above, the company has an active bid book of around 1400 KMT with around 80% of such orders in the oil and gas segment, whereas the balance is for the water segment. For the Indian market, the demand for large-diameter pipes in oil & gas segment is mainly driven by gas grid development and oil pipeline network by domestic oil companies, while the demand for small diameter pipes is driven by city gas distribution projects. The US operations entirely supplies to the oil & gas segment, while In Saudi Arabia, the order book is majorly driven by water orders from SWCC. The order-book across geographies has aided the group to diversify its revenue profile over the years.

Impact of COVID-19 on the business profile

During FY21, WCL reported moderation in revenue and net income by 35% and 4%, respectively, on account of pandemic effect and decline in oil prices. The uncertainty around the pandemic led to cautious approach of midstream and exploration and production companies of US in their large capex program. Additionally, the major pipeline projects in US got stalled due to concerns related to environment safety and presidential elections in November 2020. To some extent, WCL was able to offset loss of orders in US by securing orders from new markets, viz., Australia and Latin America. The Indian operations were supported, to some extent, by the intent of government to double down on the capex expenditure to revive the economy which led to increased tender activity from public sector companies. The Saudi JV operations were severely impacted due to prolonged shutdown from March 2020 till June 2020 due to COVID impact which led to backlog in terms of order execution resulting in low sales. Additionally, the market was impacted by oil prices decline and sharp increase in steel prices.

During Q2FY22, US market continue to remain muted on account of continuing cautious stance maintained by the mid-stream oil players thus resulting in low new incremental orders for WCL. The order-book execution pace remained low in the Saudi JV resulting in low JV contribution at negative Rs.2.83 crore during H1FY22 (H1FY21: Rs.69.75 crore). However, Indian operations remained stable and WCL reported Rs.2,694.93 crore of revenue and net income of Rs.181.44 crore during H12FY22. *(PY: Rs.3,309.97 crore and Rs.207.75 crore, respectively, during H1FY21)*

Key Rating Weakness

Susceptible to slowdown in end-user industries and to government policies

WCL derives more than 50% of revenue from the oil and gas segment. Significant volatility in the prices of crude price can question the viability of new explorations thereby impacting demand for line pipes in oil and gas segment. Furthermore, the recent upward rally in the steel prices may defer the capex plans of large steel customers. The above effect coupled with COVID impact had impacted operations and crippled demand in FY21. Amid the pandemic-induced slowdown in oil prices in March 2020, WCL witnessed deferment/cancellation of few orders by customers. Revival of new projects in oil and gas segment in the key markets of US and Middle East is critical to sustain improvement in overall operations. Any major and continued slowdown in end-user industries will weaken demand for line pipes, and impact performance. Furthermore, operations remain exposed to government policies and regulations in the geographies it operates.

Liquidity: Strong

WCL has strong liquidity, driven by expected cash accrual of more than Rs.550 crore per annum in fiscal 2022, against yearly repayment obligation of around Rs.228 crore. WCL has already prepaid its entire long-term debt in its US subsidiary. The liquidity profile is further strengthened by unencumbered cash and liquid investments at Rs.2,252 crore as on September 30, 2021. WCL also has access to fund-based limit of Rs.290 crore, which remained utilised at 39% average over the 12 months ended June 2021. The current ratio stood at 2.04x and operating cycle elevated to 97 days during FY21 (PY: 75 days) on account of increase in the inventory position which is normal as per the contract and revenue recognition policies of WCL

Analytical approach:

For Credit Enhanced debt: CARE Ratings' rating on the bank facilities of WSSL factors in the credit enhancement in the form of an unconditional and irrevocable corporate guarantee extended by Welspun Corp Limited *(WCL; rated 'CARE AA; Stable/ CARE A1+')* towards timely servicing of debt obligations.

For Unsupported Rating: Standalone approach. Furthermore, financial, and operational linkages with WSL have been taken into consideration.

Applicable Criteria

CARE's Criteria on Rating Outlook and Credit Watch
CARE's Policy on Default Recognition
Criteria for Short Term Instruments
Financial ratios – Non-Financial Sector
Liquidity Analysis of Non-Financial Sector Entities
Rating Methodology - Steel Companies

Rating Methodology: Credit Enhanced debt
Rating Methodology: Factoring linkages parent sub-JV group

About the Company – Welspun Corp Limited

Welspun Corp Limited (WCL) is a flagship company of USD 2.7 billion Welspun group. WCL is a welded pipe manufacturing company engaged in offering solution in line pipes with a capacity to manufacture longitudinal submerged arc welded *(LSAW, used for onshore and offshore oil, gas transmission)*, spiral helical submerged arc welded pipes *(HSAW, used for onshore oil, gas and water transmission*) and electrical resistance welded (*ERW, used for downstream distribution of oil, gas and water)* pipes. The company also offers coating, bending and double jointing facilities. WCL has 2.55 million tonnes per annum (MTPA) capacity of steel pipes manufacturing with plants located in India, US and Saudi Arabia.

Brief Financials (Rs. crore)	FY20 (A)	FY21 (A)	H1FY22 (UA)
Income from Continuing Operations	10019.98	6527.47	2694.90
PBILDT	1263.96	865.51	397.67
PAT *(after discontinued operations)*	654.06	630.64	181.44
Overall Gearing (Including LC Acceptances) (times)	0.57	0.28	NA
Interest coverage (times)	8.78	12.89	11.34

A: Audited; UA: unaudited; NA: not available

About the Company – Welspun Specialty Solutions Limited

Incorporated in December 1980, Welspun Specialty Solutions Limited *(WSSL; earlier known as RMG Alloy Steel Limited)* is a part of Welspun group with 50.03% stake held by Welspun Steel Limited as on September 30, 2021. WSSL operates an electric arc furnace (for alloy steel) and induction furnace (for stainless steel) based steel melting shop, a rolling mill and a seamless pipe manufacturing facility in Bharuch, Gujarat. It has a capacity of 150,000 tonnes per annum (TPA) in steel melting shop; 100,000 TPA in rolling mill along with 10,000 TPA in pipes division.

Brief Financials (Rs. crore)	31-03-2020 (A)	31-03-2021 (A)	H1FY22 (UA)
Total operating income	299.86	94.49	39.22
PBILDT	-66.35	-18.63	-10.54
PAT	-81.37	93.18	-24.12
Overall gearing (Including LC Acceptances) (times)	-3.55	5.82	NA
Interest coverage (times)	-4.31	-1.62	-1.63

A: Audited; UA: unaudited; NA: not available

Status of non-cooperation with previous CRA: None

Any other information: None
Rating History for last three years: Please refer Annexure-2
Covenants of rated instrument / facility: *Detailed explanation of covenants of the rated instruments/facilities is given in Annexure-3*
Complexity level of various instruments rated for this company: Annexure 4

Annexure-1: Details of Facilities

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Fund-based - LT-Proposed fund based limits	-	-	-	-	72.64	CARE BBB- (CWD)
Fund-based/Non-fund-based-LT/ST	-	-	-	-	27.36	CARE AA (CE); Stable / CARE A1+ (CE)
Un Supported Rating-Un Supported Rating (Long Term)	-	-	-	-	-	CARE BBB- (CWD)

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2021-2022	Date(s) & Rating(s) assigned in 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019
1	Term Loan-Long Term	LT	-	-	-	-	-	1)Withdrawn (07-Dec-18) 2)CARE D (06-Apr-18)
2	Non-fund-based - ST-BG/LC	ST	-	-	-	-	-	1)Withdrawn (07-Dec-18) 2)CARE D (06-Apr-18)
3	Fund-based - LT-Cash Credit	LT	-	-	-	-	-	1)Withdrawn (07-Dec-18) 2)CARE D (06-Apr-18)
4	Fund-based - LT-Proposed fund based limits	LT	72.64	CARE BBB- (CWD)				
5	Fund-based/Non-fund-based-LT/ST	LT/ST*	27.36	CARE AA (CE); Stable / CARE A1+ (CE)				
6	Un Supported Rating-Un Supported Rating (Long Term)	LT	0.00	CARE BBB- (CWD)				

** Long Term / Short Term*

Annexure-3: Detailed explanation of covenants of the rated facilities: not applicable

Annexure 4: Complexity level of various instruments rated for this company

Sr. No	Name of instrument	Complexity level
1	Fund-based - LT-Proposed fund-based limits	Simple
2	Fund-based/Non-fund-based-LT/ST	Simple
3	Un Supported Rating-Un Supported Rating (Long Term)	Simple

Annexure 5: Bank Lender Details for this Company
To view the lender-wise details of bank facilities please **click here**

Note on complexity levels of the rated instrument: *CARE Ratings has classified instruments rated by it on the basis of complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

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About CARE Ratings:

CARE Ratings commenced operations in April 1993 and over two decades, it has established itself as one of the leading credit rating agencies in India. CARE is registered with the Securities and Exchange Board of India (SEBI) and also recognized as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI). CARE Ratings is proud of its rightful place in the Indian capital market built around investor confidence. CARE Ratings provides the entire spectrum of credit rating that helps the corporates to raise capital for their various requirements and assists the investors to form an informed investment decision based on the credit risk and their own risk-return expectations. Our rating and grading service offerings leverage our domain and analytical expertise backed by the methodologies congruent with the international best practices.

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