Dalmia Refractories Limited

September 01, 2020

Ratings

Facilities	Amount (Rs. crore)	Rating[1]	Rating Action
Long-term Bank Facilities - Fund Based	40	**CARE A- (Single A Minus) (Under Credit Watch with Positive Implications)**	**Continues to be on Credit Watch with Positive Implications**
Long-term Bank Facilities – Non-Fund Based (stand by limit)	93	**CARE A- (Single A Minus) (Under Credit Watch with Positive Implications)**	**Continues to be on Credit Watch with Positive Implications**
Long-term/Short-term Bank Facilities - Non-Fund Based	40	**CARE A-/CARE A2+ (Single A Minus/ A Two Plus) (Under Credit Watch with Positive Implications)**	**Continues to be on Credit Watch with Positive Implications**
Total	**173 (Rupees One Hundred and Seventy Three crore only)**		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of Dalmia Refractories Limited (DRL) continue to be on credit watch with positive implications following the possible strengthening of the financial risk profile and increased business capabilities of the ultimate consolidated entity post the amalgamation of refractory businesses of DRL, GSB Refractories India Private Limited (GSB India), Sri Dhandauthapani Mines And Minerals Limited (SDMM), Ascension Commercio Private Limited (ACPL) and Dalmia Cement Bharat Limited (DCBL).

CARE will continue to monitor the developments in this regard and will take a view on the ratings once the exact implications of the above on the credit risk profile of the company are clear.

The ratings continue to derive strength from the strong parentage of the Dalmia group, long track record of operations, reputed clientele, captive mines for sourcing of a part of the raw material requirements and moderate financial risk profile marked by continued improvement in financial performance during FY20 (refers to the period from April 1 to March 31) and adequate liquidity. These rating strengths are, however, partially offset by its significant dependence on the cement industry which is inherently cyclical, fragmented and competitive nature of the refractory industry and susceptibility of profitability margins to volatility in raw material prices and exchange rate fluctuations.

DRL has sought moratorium on interest payments from its lenders for the period March to May 2020 as part of the COVID-19 - Regulatory Package announced by the RBI on March 27, 2020. CARE has not recognized this instance as a Default, as the same is permitted by the RBI as part of the relief measures announced recently. The company has already received the approval for the same from its lenders. Non-recognition of default in this case is as per the guidance provided by the SEBI circular SEBI/ HO/ MIRSD/ CRADT/ CIR/ P/ 2020/ 53 dated March 30, 2020.

Rating Sensitivities

Positive Sensitivities:

- Timely execution of the amalgamation schemes with requisite regulatory approvals.
- Expansion in the scale of operations and improvement in the profitability margins (PBILDT margin of more than 11%) leading to improvement in the financial risk profile on a sustained basis.
- Ability of the company to manage its working capital requirements while timely realizing its debtors in view of the lockdown.

Negative Sensitivities:

- Any significant deterioration in the capital structure capex incurred by the company adversely impacting the capital structure with the overall gearing exceeding 1.50x on a sustained basis.
- Decline in PBILDT margin of more than 3% from the current levels on a sustained basis going forward.

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

Detailed description of the key rating drivers

Key Rating Strengths

Strong parentage and long track record of operations

Dalmia Refractories Limited (DRL) belongs to Dalmia Bharat Group which operates in various industries including cement, sugar, power and refractory. The Dalmia Bharat Group is one of the leading Indian conglomerates with strong business track record of more than 75 years. The Group's presence spans across various countries and industries with an employee strength of over 9,000. DRL has been engaged in the refractories business for over four decades and enjoys strong market positioning in the refractories segment for the cement industry. The promoters of the company are Mr J.H. Dalmia and Mr Y.H. Dalmia. DRL leverages the strong presence of Dalmia Bharat Group in the cement sector through the flagship company Dalmia Cement Bharat Limited (DCBL) and through its refractory division and has strong and sustainable customer relationships across the spectrum of various user industries. Mr. Sameer Nagpal, CEO of refractories division of Dalmia Bharat Group is the managing director of DRL, with over 27 years of industry experience in business strategy and transformation. He is ably supported by the management team comprising of industry professionals having significant experience in the related domain of business operations.

Reputed Clientele providing repeat business

With its long track record of operations and owing to its association with Dalmia Bharat Group, DRL has built its reputation as one of the established players in the refractory business and receives repeat orders from large and reputed players in the cement industry. DRL leverages the wider product portfolio of DCBL and thus is able to source different variants of refractory bricks such as silica bricks, alumina-silicon-carbide bricks, magnesia carbon/chrome bricks etc. from DCBL. This enables DRL to offer diversified and comprehensive product offerings to its customers as per their requirements and specifications. In addition to this, DRL also supplies refractories to DCBL. The refractory products manufactured by DRL and DCBL are sold under the common brand name of 'Dalmia OCL", further enabling DRL to leverage the brand equity of DCBL and gain acceptance of the new clients. The consolidated entity (post the amalgamation process) is expected to offer more diverse product offerings to the clientele with the manufacturing of other variants of refractory bricks such as magnesia carbon, silica bricks and monolithics etc., with the end use application not only in cement but also in steel, coke over and glass industries.

Captive mines for sourcing of a part of raw material requirements

The primary raw materials used in the manufacturing of refractories are bauxite and clay (which together comprise of 70-80% of consumption by volume). For the sourcing of the bauxite, DRL maintains an optimal mix of imports and domestic procurements, considering the requirements and specifications of the customers, the quality and material required, cost specifications and lead time to delivery and supply. The company majorly imports high grade bauxite from China, which is used in the production of the high value products and domestically procures bauxite from Rajasthan and Gujarat. In addition to this, the Group also owns 6 bauxite mines in Khambalia, Gujarat. These bauxite mines have total reserves of 6250 KMT and are available till 2098. This insulates the Group from raw material price fluctuations to certain extent. Out of these, currently 3 mines are being owned by DCBL and another 2 by DRL, however, with the completion of the amalgamation process, all the 5 mines would come under the ownership of the consolidated entity.

Moderate financial risk profile marked by comfortable capital structure and debt protection metrics

During FY20, DRL's total operating income witnessed a growth of 47% to Rs. 292.19 cr from Rs. 198.44 cr during FY19 primarily on account of the completion of the completion of the major tranche of the order received for building of three layered kilns, which also included supply of refractory materials by DRL. In addition to this, the average sales realization of refractories increased by ~11% (y-o-y) through renegotiation of the prices and terms of the contracts with customers leading to increase in the pricing of the contracts. The realizations improved to Rs. 24,476/MT during FY20 as compared to Rs. 22,014/MT in FY19. Thus, the PBILDT margin improved significantly to 10.06% (Rs. 29.39 cr) in FY20 vis-à-vis 6.45% (Rs. 12.79 cr) in FY19, which is also on account of softening of bauxite prices, decline in power and fuel and employee cost as the proportion of traded goods increased during FY20. This led to increase in PAT margin to 6% during FY20 as compared to 3.55% during the previous year. However, during Q1FY21, DRL witnessed a y-o-y decline of ~64% in its total operating income at Rs. 29.98 cr as compared to Rs. 84.20 cr during Q1FY20. This is on account of the company's operations being adversely impacted due to temporary shutdown of its manufacturing facilities following nationwide lockdown by the Government in order to contain the spread of COVID-19. The operations at the facilities subsequently started from mid of April with requisite permissions from the authorities and necessary precautionary measures undertaken. The loss of sales coupled with fixed cost (employee cost, rental cost, maintenance etc.) still being incurred, the PBILDT margin of the company to 10.07% vis-à-vis 11.79% witnessed in Q1FY20. The PAT margin also fell to 1.47% against 6.13% during the previous year.

The overall gearing of the company stood at 0.21x as on March 31, 2020 as compared to 0.11x as on March 31, 2018 on account of the increased utilization of working capital limits during March 2020 due to the delayed payments received from the customers and stoppage of transit of inventories subsequent to restricted movement of goods after the nationwide lockdown was imposed to contain the spread of COVID-19 in India. The total debt of the company outstanding for Rs. 36.03 cr as on March 31, 2020 is comprised of lease liabilities of Rs. 1.20 cr and working capital borrowing for Rs. 34.83 cr (PY: Rs. 20.47 cr). DRL (standalone) does not have any long term borrowings. The debt protection metrics are characterised by comfortable interest coverage and total debt / GCA ratio of 11.11x (PY: 7.82x) and 1.55 years (PY: 1.72 years) in FY20 respectively. The tangible net worth of the company stood at Rs. 172.65 cr as on March 31, 2020, which declined from Rs. 190.11 cr as on March 31, 2019 on account of the adjustment for valuation of investment made in Dalmia Group holding company, Dalmia Bharat Limited. For the acquisition of the German entities during FY19, DRL has extended SBLC to its foreign subsidiary. DRL had a total of non-current investments in associates/subsidiary companies for Rs. 71.02 cr (PY: Rs.101.77 cr) as on March 31, 2020. The adjusted overall gearing of DRL (incorporating outstanding foreign currency term loan amount advanced against SBLC facility to foreign subsidiary and adjusting the net worth for the investments made in subsidiaries/associates) stood at 1.18x as on March 31, 2020. (PY: 1.23x)

Adequate Liquidity
The liquidity profile of DRL is adequate with its current ratio at 1.21x with cash and bank balances of Rs. 1.94 cr (Rs. 2.14 cr including margin money) as on March 31, 2020 and cash and bank balances of Rs. 3.51 cr as on July 31, 2020. DRL had unencumbered cash and bank balances of Rs. 6.06 cr (PY: Rs. 1.06 cr) as on March 31, 2019. The company is generating healthy accruals and does not have any major capex plans with the overall gearing of 0.21x as on March 31, 2020. DRL availed for the moratorium for the servicing of the interest on its CC limits for the period March 2020 to May 2020. The operations of the firm are working capital intensive majorly owing to the large inventory requirements particularly of raw materials, whereby the firm has to maintain sufficient amount of inventory of various raw materials (major being bauxite and clay) used in the manufacturing of refractories as per the client's specifications. During FY20, the inventory period of DRL stood at 80 days as against 104 days during FY19 on account of the completion of the major orders during the year and delivery of the finished goods, leading to improvement in the operating cycle at 68 days vis-à-vis 92 days during FY19. DRL has the sanctioned working capital limits (including CC limits and non-fund based limits) for an amount of Rs. 80 cr for the business operations. The utilization of the working capital limits for the last 12 months ending June 2020 stood moderate with average utilization of ~57% and average maximum utilization of ~73%.

Key Rating Weaknesses
Significant dependence on the cement industry which is inherently cyclical
The company produces high alumina bricks and castables and mainly caters to the cement industry, which is cyclical in nature and hence, the company's performance is largely dependent on the performance and growth in the cement industry. During FY21, the COVID-19 pandemic has adversely impacted the demand of the cement industry leading to decline in the capacity utilization of cement companies. The decline in the demand due to muted construction activities might pressurize the realizations of the cement companies. However, with the gradual pick-up in the infrastructure spending by the government and the release of the pent-up demand, the gradual revival is expected to start from Q3FY21 with full resumption of the activities post easing of the lockdown restrictions.
In addition to this, the consolidated entity (post amalgamation) is expected to offer diverse product offerings including magnesia carbon, silica bricks, monolithics etc. in order to cater to steel and glass industries as well. This is expected to capture the demand from steel sector, the largest consumer of refractories product and minimize the impact from cyclicality of cement sector.

Fragmented and competitive nature of the refractory industry
The refractory industry is highly fragmented with more than 150 players of which around 15-16 are major players. The industry is highly competitive due to excess capacity available for refractory production in India and increased imports of refractory products. Indian refractory industry faces a huge threat in the form of competition from cheap refractory products dumped from China which has captured more than 25% of the total market.
Due to highly competitive nature of the refractory industry, players experience limited pricing flexibility as they deal with large cement players and hence, work under high margin pressure. However, during FY20, DRL has been able to pass on the hike in the raw material prices to its customers to certain extent by renegotiating the existing terms and also due to strong brand position enjoyed by DRL, which has further strengthened after the acquisitions in Germany. The consolidated entity (post amalgamation) would also have higher bargaining power with its customers owing to increase in scale of operations and diverse product portfolio being offered.

Susceptibility of profitability margins to volatility in raw material prices and exchange rate fluctuations
The major raw materials used by DRL are bauxite and clay, the prices of which are volatile. The raw materials costs constituted ~60% of the total operating income of DRL for the past 3 years; hence any volatility in the prices of the raw materials has a direct impact on the profitability margins of the firm. The company majorly imports high grade bauxite from China, which is used in the production of the high value products and sources bauxite domestically from Rajasthan and Gujarat. During FY19, the spot prices of bauxite in China witnessed an increasing trend on account of limited supply in

China owing to dwindling reserves of bauxite ore and shutdown of manufacturing facilities due to anti-pollution measures undertaken by Chinese government. During FY20, with the supplies being restored with quantities being imported from other countries like Australia and Guinea and general slowdown in the demand, the prices have softened.
With procurement in foreign currency and sales realization in domestic currency, the company is exposed to the fluctuation in exchange rates. DRL uses foreign exchange forward contracts to hedge the risks, which varied from one purchase order to another, depending on the views of the bankers and internal forex team of the company. In addition to this, DRL's proportion of exports increased during FY20 to Rs. 32.06 cr (~11% of total operating income) as compared to Rs. 18.17 cr (~9% of total operating income) during FY19, which acted as a natural hedge for DRL to a certain extent. DRL reported net foreign exchange gain of Rs.4.27 cr in FY20 as compared to forex loss of Rs. 1.55 cr during FY19.

Industry Outlook
The Indian refractory industry is characterized by use of magnesia, alumina or silica for the manufacturing process and being consumed by cement and glass, ceramics, petrochemicals and boiler industries. They are the necessary materials for the various high-temperature equipments like in the internal linings of blast furnaces and converters used for steel making and in furnaces for heating materials before further processing etc. During FY20, India imported refractory bricks, blocks, tiles and similar refractory ceramic constructional goods and high alumina refractory cement that are used in the steel and cement companies. Refractory products are vital in all high-temperature processes in the making of metals, cement, glass and ceramics. The steel industry, one of the biggest consumers of refractory products, accounts for nearly 60-70 per cent of the total production.
The Indian refractory market saw a sharp fall in demand in line with the near absence of construction activity and thus consumption of these end products in view of the lockdown in Q4FY20 and Q1FY21 to contain the spread of COVID-19 in the country. Although the steel industry was allowed to operate during the lockdown period, the output slumped in line with the fall in demand from user industries. The domestic steel production has taken a substantial hit in the months of March, April and May when the country was under lockdown as most user industries witnessed halt in production. In line with this trend, refractory makers produced less than the usual monthly production in April and May. However, with the continuous efforts of the government to boost the demand and utilization levels of the essential and continuous process sectors such as steel, power plants, petrochemical plants and cement to the pre-COVID levels, the demand for the refractories is expected to witness recovery from H2FY21.

Analytical approach
Standalone. The ratings, however, take into account the strong operational & management linkages DRL has with its group companies and financial support it has extended to its foreign subsidiary.

Applicable Criteria
Criteria on assigning 'outlook' and 'credit watch' to Credit Ratings
CARE's Policy on Default Recognition
Financial Ratios - Non-Financial Sector
Liquidity Analysis of Non-Financial Sector Analysis
Rating Methodology - Manufacturing Companies
Criteria for Short term Instruments
Rating Methodology - Consolidation and Factoring Linkages in Ratings

About the Company
DRL, formerly Shri Nataraj Ceramic and Chemical Industries Ltd, belongs to Dalmia Group which has presence in various industries including cement, sugar, power and refractory. The name of the company was changed to Dalmia Refractories Limited on March 28, 2014, to reflect the group and the brand 'Dalmia Refractories' under which the company's products are marketed.
DRL produces high alumina refractory bricks and castables which are supplied to cement, steel, coke oven and glass industries. Presently, the company has 2 manufacturing units located at Dalmiapuram (Tamil Nadu) and Khambalia (Gujarat). The current installed capacity as on March 31, 2020 stands at 1,08,600 metric tons per annum (MTPA) for Refractory and 24,000 MTPA for Calcined Bauxite. The company used to previously undertake job work for Dalmia Bharat Ltd (DBL) which has been discontinued w.e.f. April 1, 2014 and the refractories produced are directly marketed to the user industries by DRL. However, DRL leverages the strong presence of Dalmia Bharat Group in the cement sector previously through DBL and presently through Dalmia Cement Bharat Limited (DCBL). Mr. Sameer Nagpal, CEO of refractories division of Dalmia Bharat Group is the managing director of DRL, with over 27 years of industry experience.

DRL and DCBL, at their respective Board meetings held on 14th November 2019, have approved Schemes of Arrangement through which their respective refractory businesses will be consolidated under a single operating entity, which is proposed to be renamed as Dalmia OCL Limited (DOL). DOL in turn would be held by a holding company, which is proposed to be renamed as Dalmia Bharat Refractories Limited (DBRL). DBRL would initially be listed on Metropolitan Stock Exchange of India Limited (MSEI), The Calcutta Stock Exchange Limited (CSE).

Covenants of rated instrument / facility: *Detailed explanation of covenants of the rated instruments/facilities is given in Annexure-3*

Brief Financials (Rs. crore)	FY19 (A)	FY20 (A)
Total operating income	198.44	292.19
PBILDT	12.79	29.39
PAT	7.04	17.53
Overall gearing (incl. acceptances) (times)	0.14	0.24
Adjusted Overall Gearing* (times)	1.23	1.18
Interest coverage (times)	7.82	11.11

A: Audited

*The adjusted overall gearing has been computed by incorporating outstanding foreign currency term loan amount advanced against SBLC facility to foreign subsidiary and adjusting the net worth for the investments made in subsidiaries/associates.

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating History for last three years: Please refer Annexure-2

Annexure-1: Details of Instruments/Facilities

Name of the Instrument	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Fund-based - LT-Cash Credit	-	-	-	40.00	CARE A- (Under Credit watch with Positive Implications)
Non-fund-based - LT/ ST-BG/LC	-	-	-	40.00	CARE A- / CARE A2+ (Under Credit watch with Positive Implications)
Non-fund-based - LT-Standby Letter of Credit	January 07, 2019	-	-	93.00	CARE A- (Under Credit watch with Positive Implications)

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 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018
1.	Fund-based - LT-Cash Credit	LT	40.00	CARE A- (Under Credit watch with Positive Implications)	-	1)CARE A- (Under Credit watch with Positive Implications) (28-Feb-20) 2)CARE A- (Under Credit watch with Developing Implications)	1)CARE A-; Stable (03-Apr-18)	-

						(25-Nov-19) 3)CARE A-; Stable (27-Sep-19) 4)CARE A-; Stable (03-Apr-19)		
2.	Non-fund-based - LT/ ST-BG/LC	LT/ST	40.00	CARE A- / CARE A2+ (Under Credit watch with Positive Implications)	-	1)CARE A- / CARE A2+ (Under Credit watch with Positive Implications) (28-Feb-20) 2)CARE A- / CARE A2+ (Under Credit watch with Developing Implications) (25-Nov-19) 3)CARE A-; Stable / CARE A2+ (27-Sep-19) 4)CARE A-; Stable / CARE A2+ (03-Apr-19)	1)CARE A-; Stable / CARE A2+ (03-Apr-18)	-
3.	Non-fund-based - LT/ ST-Loan Equivalent Risk	LT/ST	-	-	-	-	1)Withdrawn (03-Apr-18)	-
4.	Non-fund-based - LT-Standby Letter of Credit	LT	93.00	CARE A- (Under Credit watch with Positive Implications)	-	1)CARE A- (Under Credit watch with Positive Implications) (28-Feb-20) 2)CARE A- (Under Credit watch with Developing Implications) (25-Nov-19) 3)CARE A-; Stable (27-Sep-19)	-	-

Annexure-3: Detailed explanation of covenants of the rated instrument / facilities

Name of the Instrument	Detailed explanation
A. Financial covenants	
1. Letter of credit/ Buyer's credit	There is full interchangeability between BG and LC limits and one-way full interchangeability from fund based working capital limits non-fund based limits
2. Standby Letter of Credit	The DSCR is to be maintained more than 1.25 at all times on consolidated level and net debt to net worth is to be maintained at less than 1.5 times with fixed asset coverage ratio of more than 1.2 at all times basis market value of fixed assets of DRL (standalone).
B. Non-financial covenants	
1. Cash Credit	Collateral security and personal guarantee as per the details to be obtained for all facilities Entire stocks and securities are to be got comprehensively insured for full value as per Bank's extant guidelines
2. Standby Letter of Credit	There is third party security provider in form of exclusive first charge overall the fixed assets and hypothecation overall the movable fixed assets both present and future of GSB Refractories India Private Limited

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

Sr. No.	Name of the Instrument	Complexity Level
1.	Fund-based - LT-Cash Credit	Simple
2.	Non-fund-based - LT-Standby Letter of Credit	Simple
3.	Non-fund-based - LT/ ST-BG/LC	Simple

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

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About CARE Ratings:
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