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CARE REVISES THE RATINGS ASSIGNED TO VARIOUS ISSUES OF MUKAND LTD.

CARE has revised the rating assigned to the existing short-term debt (STD) issue of Mukand Ltd (Mukand) aggregating Rs 75 crore to 'PR2+' [PR Two Plus] from the rating of 'PR1' [PR One]. The STD issue is not carved out of the sanctioned working capital limits of the company.

Additionally, CARE has revised the ratings assigned to the long-term and short-term bank facilities aggregating Rs 1250.51 crore (including sanctioned but not yet availed term loan) as at Jun.30, 2008 of Mukand Ltd (Mukand). CARE has revised the rating assigned to the long-term bank facilities (having tenure of over one year) of Mukand to 'CARE BBB+' [CARE Triple B Plus] from the rating of 'CARE A-' [Single A Minus]. Also, CARE has revised the rating assigned to the short-term bank facilities (having tenure up to one year) of Mukand to 'PR2+' [PR Two Plus] from the rating of 'PR1' [PR One].

Instruments with 'CARE BBB+' rating are considered to offer moderate safety for timely servicing of debt obligations. Such instruments carry moderate credit risk. Instruments with 'PR2+' rating would have adequate capacity for timely payment of short-term debt obligations and carry higher credit risk as compared to instruments rated higher.

The ratings derive their strength from the strong parentage of Mukand, management capability, long-term relationships with well-known clients, large variety of customized products, and growth potential of the speciality steel sector in domestic and export markets. The ratings are constrained by high gearing with reliance on short-term debt, diminishing cost advantages, relatively high exposure to a single industry viz. auto component, dip in profitability due to spurt in input costs and the fact that Mukand is under the purview of a corporate debt restructuring (CDR) programme. Stable demand from the automobile and auto component sector, export growth, ability to reduce time lag in passing on raw material costs to customers, ability to manage working capital and maintain adequate interest coverage will be the key rating sensitivities.

Incorporated in 1937, Mukand is part of the Bajaj group. Mukand manufactures specially engineered long steel products in the alloy and stainless steel categories. It also manufactures industrial machinery and has a road construction business which it is phasing out. Mukand is headed by Mr. Niraj Bajaj, Chairman and Managing Director, who is ably supported by a team of experienced and qualified personnel.

The company underwent a corporate debt restructuring (CDR) programme in FY03, necessitated by the steel downturn in 2001. Mukand has been repaying its debts as scheduled by the CDR.

Mukand's manufacturing facilities are located at Kalwe (Maharashtra) and Hospet (Karnataka). Mukand has its own captive power plant (CPP) at Kalwe. It is in the process of building another CPP and a coke-oven power plant to utilize the fume gases emitted by the mini-blast furnace and coke-oven plant.

The company has captive sources of iron ore at Hospet from which it sources its iron ore requirements. However, it has not been able to utilize these sources due to a dispute with the supplier and hence it has been unable to avail of potential cost advantages. Another key raw material is coking coal which the company imports.

Mukand had initiated a capex programme of Rs 380 crore in FY07. The capex is expected to enhance capacity to 623,000 tpa from 400,000 tpa in FY07. The cost of the project has been revised upward to Rs.430 crore, due to increase in capacity planned for both the CPPs. Of this Rs.300 crore has been spent till Mar.31, 2008. The expansion is being funded primarily by internal accruals. The increase in project cost is being funded through sanctioned term loan from Bank of India. The project is expected to come on-stream by September 2008, except for the coke oven plant and its CPP, which are expected to be commissioned by October 2009.

The company has planned further expansion of industrial machinery division at Sinner in Nasik for which it has acquired land for Rs.5 crore. It has also acquired land at Lonand

for steel finishing facilities for Rs.92 lakh. The capex for developing these facilities is expected to be incurred from FY10 onwards, once the current expansion is complete. Mukand has entered into a JV with Bekaert for production of stainless steel wires. The land has been acquired at Lonand and construction is in progress. Out of the total proposed investment of Rs.25 crore, Mukand has already invested Rs.6 crore up to Mar. 31, 2008.

Mukand's total income grew at a CAGR of 10% from FY05-08 on the back of strong steel demand. Mukand's realizations from steel products rose by an average of 13% in FY08 due to healthy demand. However, quantity sold fell by 3% in FY08 primarily because of lower sales of stainless steel owing to high nickel prices. Hence, total income for FY08 rose by a muted 6% y-o-y.

Due to a significant rise in input prices viz., iron ore and coking coal for alloy steel and nickel for stainless steel, which Mukand could not pass on immediately due to a time lag in hike in sales prices, PBILDT dipped by 5% in FY08 over FY07. This also led to a dip in PBILDT margin to 13.42% from 15.38% in FY07. Interest cost rose despite fall in long-term debt due to increased working capital requirements in the wake of rising raw material costs. Almost full utilization of enhanced working capital limits and additional short-term debt of Rs.142 crore resulted in higher interest cost. Depreciation did not increase materially as most of the capital expansion is still in progress. PAT dipped by 36% in FY08 over FY07 due to the combined effect of decline in PBILDT and higher interest cost. Accordingly, PAT margin almost halved to 2.5% from 4.7% in FY07.

Scheduled repayment of long-term debt under the CDR programme resulted in reduction in long-term debt to equity ratio. However, the increased short-term debt including bank borrowings led to an increase in overall gearing in FY08 to 2.14x from 1.85x in FY07. Although interest coverage deteriorated in FY08 to 1.39x from 1.70x in FY07 due to higher interest cost and reduced cash accruals, the adjusted interest coverage (after adjusting interest income from working capital related assets) is adequate at 1.77x. Mukand's liquidity position appears slightly strained in view of rise in working capital related debt due to spurt in input costs. Its current ratio fell to 1.17x in FY08 from a healthy 1.67x in FY07 on the back of higher bank borrowings and short-term debt.

Mukand had invested Rs 326 crore either in the form of equity or by way of loans, advances or credit in few companies as at Mar.31, 2008. The networth of some of these companies has eroded and hence realizing the full value of these investments / advances seem uncertain. The valuation report of some of these companies estimates the realizable value of the Rs 326 crore exposures at Rs 237 crore based on the realizable value of the fixed assets of these companies. The balance Rs 89 crore is the estimated unrecoverable amount for which no provision has been made. If the expected loss on investment value (after netting off realizable value) is reduced from net worth, overall gearing would be 2.5x in FY08. The management has maintained that it is confident that it will recover all the dues.

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