Welcast Steels Limited

September 09, 2020

Ratings

Bank Facilities	Amount (Rs. crore)	Ratings[1]	Rating Action
Long-term bank facilities	11.30	**CARE BBB+ (Triple B Plus); Under credit watch with developing implications**	**Revised from CARE A+; Stable (Single A Plus; Outlook:Stable) & Placed on credit watch with developing implications**
Long-term/Short-term bank facilities	3.70	**CARE BBB+/ CARE A2 (Triple B Plus / A Two); Under credit watch with developing implications**	**Revised from CARE A+; Stable/ CARE A1+ (Single A Plus; Outlook: Stable / A One Plus) & Placed on credit watch with developing implications**
Total Facilities	**15.00 (Rupees Fifteen Crore Only)**		

Details of facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The revision in the ratings assigned to the bank facilities of Welcast Steels Ltd. (WSL) factors in commercially unviable manufacturing operations of the sole manufacturing plant of WSL leading to its announcement for closure of its manufacturing operations in coming two months' time. Simultaneously, the ratings have been placed on 'Credit watch with developing implications' due to lack of full clarity about the modalities of closure of its plant and the various obligations and liabilities which the company could be required to fulfil in order to go ahead with its announced plan of action. As such, CARE will continue to closely monitor further developments with respect to its plans to close down its operations and future plans of the company and would engage with WSL's management to gain more clarity on these aspects and would take a view on the ratings of the company once greater clarity emerges on the exact implications of this event on the credit risk profile of the company.

The ratings assigned to the bank facilities of WSL continue to draw strength from its strong parentage being a majority-owned subsidiary of AIA Engineering Limited (AIA) which has long track record of operations in the same line of business (mill internals) along with its operational linkage with AIA which procures majority of the production of WSL. The ratings further derive strength from WSL's experienced management and its comfortable leverage. CARE also notes that WSL has not availed any moratorium as a Covid relief measure, permitted by Reserve Bank of India (RBI) for interest payment on its bank facilities which also indicates its adequate liquidity profile.

The ratings, however, continue to remain constrained on account of inherently low profitability margins of WSL, its exposure to end use industry risks as some of them exhibit cyclicality along-with decline in it scale of operations and net loss incurred during FY20 (refers to the period from April 1 to March 31) & Q1FY21 leading to company's decision to shortly close its operations.

Rating Sensitivities

Positive Factors

- Significant improvement in the credit profile of its parent (i.e. AIA) along with continuation of WSL's off-take arrangement with AIA at a healthy level and demonstration of AIA's stated intent to support WSL being its majority-owned strategic subsidiary
- Sustained improvement in its capacity utilization above 95%
- Significant increase in its total operating income (TOI) along with greater diversification of its operations across product categories and customers
- Improvement in its PBILDT margin to more than 12%
- Effective management of scrap sourcing and working capital leading to improvement in its operating cycle to less than 100 days on a sustained basis

Negative Factors

- Dilution in stance of AIA to extend need-based support to WSL
- Discontinuation of off-take arrangement between AIA & WSL resulting in adverse impact on its operations
- Any industrial dispute arising out of its announcement for closure of manufacturing operations adversely impacting its credit profile
- Any large debt-funded capex thereby deteriorating its overall gearing beyond 0.50x on a sustained basis

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

- Sustained moderation in WSL's profitability
- Significant deterioration in credit profile of parent i.e. AIA

Detailed description of the key rating drivers

Key Rating Strengths

Strong parentage along with operational linkage with the parent which operates in the same line of business (mill internals)

AIA, the parent company of WSL, is one of the leading players in HCMI industry. Over the years, AIA has grown multifold and it has a robust financial risk profile and healthy liquidity supported by large cash accruals & very comfortable capital structure. Both AIA & WSL operate in the similar line of business which provides synergetic benefits in terms of shared brand name, technical know-how, R&D, marketing, etc. WSL also benefits in terms of better sourcing terms since it sources raw material from the suppliers of AIA. The performance of AIA during FY20 remained healthy and largely stable with stable TOI of Rs.3,123 crore along with improved PAT of Rs.590 crore (FY19: 511 crore) on the back of stable demand for smaller size diameter media balls.

Captive off-take agreement with the parent

WSL has entered into a contract manufacturing agreement with AIA wherein it is agreed upon that WSL shall manufacture grinding media balls for AIA according to the purchase order placed from time to time and as per technical specifications provided by AIA. Over the last few years around 85%-95% of sales of WSL were made directly to AIA except for FY20 as the demand for bigger size diameter balls for exports was low with AIA itself and hence this led to lower orders from AIA to WSL thus resulting in ~68% of sales by WSL to AIA. This agreement significantly reduces salability risk of WSL and minimizes the counter party credit risk, considering the strong credit profile of AIA. However, in the backdrop of WSL's decision to close its manufacturing facility, AIA's stance on placing future orders with WSL till its operations are legally shut down shall remain a key monitorable.

Experienced management with long track record of operations

WSL has almost four decades of successful track record in manufacturing of high chrome grinding media balls. Incorporated in 1972, its present installed capacity is 42,000 MTPA. Over the years, with strong management team and support from its parent AIA, WSL was able to achieve ~90-95% capacity utilization in last three years ended FY19. During FY20, the capacity utilization declined to 56% due to combined effect of Covid-19 induced lockdown in India & overseas market and lower demand for bigger size diameter balls for exports in which WSL specializes. Mr. Mohan Rao VVR, presently serving as chief executive officer (CEO) of WSL holds B.E. and MBA degree. He has vast experience of 51 years in manufacturing industry. Mr. Bhadresh K. Shah, presently serving as Non-executive Director of WSL and Managing Director of AIA holds B. Tech in Metallurgy from IIT, Kanpur. He has vast experience of over 48 years in the manufacturing and design of various kinds of value-added product, impact-abrasion & corrosion resistant high chrome castings.

Comfortable leverage and moderate debt coverage indicators

As on March 31, 2020 WSL had a comfortable overall gearing of 0.12 times. However, on account of moderation in operating profitability and net loss reported in FY20, the debt coverage indicators moderated with interest coverage of 2.81x during FY20 (8.13x during FY19) and Total debt/ GCA ratio at 2.99 years during FY20 (0.39 years during FY19).

High entry barriers

HCMI industry can be categorized as an industry with customer stickiness, technical expertise and limited competition. The customer stickiness in HCMI industry is high due to its vital role in the grinding process of various end user industries whereby their failure or inefficiency can result in major loss of production. Secondly, the technical knowhow is critical for HCMI manufacturers unlike forged media balls and acts as entry barrier as industry players require high expertise in metallurgy and process technology which limits the competition.

Major part of HCMI demand is generated as replacement demand. Nearly ~80-85% of the total global demand of HCMI is in nature of replacement demand. Accordingly, even though there is slowdown in new capacity additions in end user industries, replacement demand provides a cushion for HCMI manufacturers.

Key Rating Weaknesses

Announcement to discontinue manufacturing operations of WSL's sole plant citing economically unviable operations; albeit its parent AIA has reiterated its stance to provide need-based support to it

The Board of Directors of WSL in their Board meeting held on August 31, 2020 announced their decision to permanently close down its sole plant operations at Bengaluru after giving 60 days' notice under the Industrial Dispute Act, 1947. The reason for closing down of the plant as mentioned by the company is that since last year, there has been consistent decline in orders and consequent fall in production. Company has also informed that they do not have sufficient orders in hand and available orders are also not economically viable. Also, there does not appear to be any chance of getting economically viable orders to be given to the workmen. WSL's management has further articulated that the operations of the company will be gradually run-down over next two months and all its obligations and liabilities shall be met in a timely manner. However, the announcement being very recent, there is lack of full clarity about the modalities of closure of WSL's plant and the various obligations and liabilities which the company could be required to fulfil in order to go ahead with its announced plan of action. CARE will continue to closely monitor further developments with respect to its plans to close its operations and its future plans and would engage with WSL's management to gain more clarity on these aspects. However, comfort is derived from the fact that AIA's management has reiterated its stance to continue to provide all need-based support to WSL in a timely manner as it is its majority-owned subsidiary.

Inherently low profitability margins along with decline in scale of operations and net losses incurred during FY20 & Q1FY21
WSL has acted as a production centre wherein AIA off-takes almost entire production of WSL. Thereby, WSL was highly dependent on its parent w.r.t its sales, technical know-how, operational and financial support resulting in negligible operational risk; albeit this arrangement also resulted in WSL earning inherently low profitability margins and its sales being dependent upon volume of order flow from its parent.
During FY20, total operating income (TOI) of WSL declined by 44% on y-o-y basis to Rs.150.33 crore. In line, the PBILDT margin also moderated and stood at 0.81% while it reported net loss of Rs.0.26 crore. During FY20, there was low export demand for bigger size media balls (which WSL manufactures) with AIA which led to lower orders from AIA to WSL leading to significant decline in TOI of WSL. During Q1FY21, the production volumes for WSL were further impacted due to Covid-19 induced lockdown which led to disruption of operations in India as well as in overseas markets.

Exposure to end use industry risks some of which exhibit cyclicality
HCM balls manufactured by WSL have applications mainly in three user industries viz. Mining, Thermal power generation & Cement. Accordingly, WSL is exposed to the risks associated with these user industries. Out of these three user industries, demand from mining industry normally outpaces the demand from other two industries. However, mining industry is also sensitive to the shifting business cycles, including changes in the general economy, interest rates and encounter seasonal changes in the demand and supply conditions in the market. Even cement sector exhibits cyclicality in demand linked to overall infrastructure scenario.

Liquidity: ***Adequate***
Liquidity of WSL is adequate despite cash losses incurred in Q1FY21 on account of absence of any term debt repayment obligations during FY21. Also, with an overall gearing of 0.12 times as of March 31, 2020, the issuer has sufficient gearing headroom to raise additional debt in case of any exigency. The operating cycle of WSL, although increased, stood comfortable at 60 days during FY20. WSL has sanctioned fund-based working capital limit of Rs.11.30 crore and non-fund based working capital limit of Rs.3.70 crore from its bank. The average fund based working capital limit utilization of WSL stood at ~38% for the trailing 12 months ended June 2020. As on August 31, 2020, the outstanding in WSL's cash credit account with its bank was Rs.2.10 crore against the total sanctioned limit of Rs.11.30 crore while the current account balance with the company was higher than the same (according to the company management). Accordingly, its unutilized bank lines are adequate to meet its incremental working capital needs over the next one year. The current ratio stood comfortable at 2.46x during FY20. Further, the parent of WSL i.e. AIA on a standalone basis had more than Rs.1,400 crore of free liquid investments as on March 31, 2020. Also, WSL has not availed any moratorium as a Covid relief measure, permitted by Reserve Bank of India (RBI), for interest servicing on its existing bank facilities which underscores its adequate liquidity.

Analytical approach: ***Standalone along with factoring linkages with its parent company i.e. AIA Engineering Limited***
WSL has contract manufacturing agreement with AIA, wherein AIA generally procures nearly 90- 95% of WSL's production. AIA also provides need based financial, technical and operational support to WSL as it is its majority-owned subsidiary.

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

About the Company

Incorporated in 1972, Welcast Steels Limited (WSL) is a High Chrome Grinding Media manufacturer. In 1996, AIA Engineering Limited (AIA) bought 41.32% stake in WSL and since then AIA had gradually increased its holding in WSL. As on June 30, 2020, AIA holds 74.85% equity stake in WSL, with balance equity stake held by public. High Chrome Grinding Media is used in various industries for crushing and grinding operations. These grinding balls are impact, abrasion and corrosion resistant, which makes it suitable for crushing large quantity mineral ore, clinker/lime stone and coal in mining, cement and thermal power generation sector respectively. WSL has a single manufacturing facility located at Bengaluru having total installed capacity of 42,000 Metric Tonne Per Annum (MTPA). WSL has capability of manufacturing various grades of grinding balls in various sizes ranging 40-90 mm diameter based on the customer’s requirements.

AIA is an Ahmedabad based manufacturing company, which operates in the same line of business and manufactures High Chrome Grinding Media, Mill Liners and Diaphragms, etc. collectively known as High Chrome Mill Internals (HCMI). AIA was promoted by Mr. Bhadresh K. Shah in 1978. AIA has total eight manufacturing units with cumulative capacity of 3,90,000 MTPA as on March 31, 2020. AIA also has nine marketing subsidiaries overseas and provides customer centric solution across the geographies. Furthermore, AIA is in the process to expand its installed capacity by 50,000 MTPA.

Brief Financials (Rs. Crore)	*FY19 (A)	FY20 (A)
Total operating income	269.96	150.33
PBILDT	3.95	1.22
PAT	1.84	(0.26)
Overall gearing (times)	0.03	0.12
Interest coverage (times)	8.13	2.81

***A:** Audited; *Re-stated as per audited annual financial results for FY20*

As per published results, WSL reported TOI of Rs.23.83 crore with net losses of Rs.0.87 crore in Q1FY21 as against TOI of Rs.27.99 crore with net losses of Rs.0.26 crore in Q1FY20.

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/ Bank Facilities	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Fund-based - LT-Cash Credit	-	-	-	11.30	CARE BBB+ (Under Credit watch with Developing Implications)
Non-fund-based - LT/ ST-BG/LC	-	-	-	3.70	CARE BBB+ / CARE A2 (Under Credit watch with Developing 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	11.30	CARE BBB+ (Under Credit watch with Developing Implications)	1)CARE A+; Stable (06-Aug-20)	1)CARE A+; Stable (04-Oct-19) 2)CARE A+; Stable (15-Apr-19)	-	-
2.	Non-fund-based - LT/ ST-BG/LC	LT/ST	3.70	CARE BBB+ / CARE A2 (Under Credit watch with Developing Implications)	1)CARE A+; Stable / CARE A1+ (06-Aug-20)	1)CARE A+; Stable / CARE A1+ (04-Oct-19) 2)CARE A+; Stable / CARE A1+ (15-Apr-19)	-	-

Annexure 3: 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/ 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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