# Welcast Steels Limited

November 10, 2020

**Ratings**

| Bank Facilities | Amount (Rs. crore) | Ratings[1] | Rating Action |
|---|---|---|---|
| Long-term bank facilities | 11.30 | **CARE BBB+; Outlook: Stable (Triple B Plus; Outlook: Stable)** | **Reaffirmed and removed from Under Credit watch with Developing Implications; Stable outlook assigned** |
| Long-term/Short-term bank facilities | 3.70 | **CARE BBB+; Stable/ CARE A2 (Triple B Plus; Outlook: Stable / A Two)** | **Reaffirmed and removed from Under Credit watch with Developing Implications; Stable outlook assigned** |
| **Total Facilities** | **15.00 (Rupees Fifteen Crore Only)** | | |

*Details of facilities in Annexure-1*

**Detailed Rationale & Key Rating Drivers**

*The ratings assigned to the bank facilities of Welcast Steels Ltd. (WSL) have been removed from 'Credit watch with Developing Implications' upon emergence of clarity arising from its announcement to continue the operations from its sole manufacturing unit and simultaneously withdraw its earlier notices filed with the concerned authorities for closure of its manufacturing unit.*

*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 its recent attempt to close down its manufacturing operations citing economically unviable operations, 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) & H1FY21 alongwith lower capacity utilization.*

**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 90%
- 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 the off-take arrangement between AIA & WSL resulting in adverse impact on its operations
- Any large debt-funded capex thereby deteriorating its overall gearing beyond unity on a sustained basis
- Sustained moderation in WSL's profitability arising from its inability to again make its operations economically viable
- Significant deterioration in credit profile of its parent i.e. AIA
- Any further attempt to close down its manufacturing operations

**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 High Chrome Media Internals (HCMI) industry. Over the years, AIA has grown multi-fold and it has a robust financial risk profile and healthy liquidity supported by large cash

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

accruals & very comfortable capital structure. WSL derives significant strength by virtue of being a subsidiary of AIA and having operational linkages with it. WSL also derives synergetic benefits in terms of technical know-how, R&D, marketing, etc. from AIA apart from benefitting in terms of better sourcing terms for its raw materials from the common 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. Further, AIA reported a PAT of Rs273 crore on a TOI of Rs.1423 crore during H1FY21 as per published results on the stock exchange.

***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 in FY20 as the demand for bigger 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.

***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, its capacity utilization declined to 56% and further to 32% in Q1FY21 with no major improvement in Q2FY21 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.

***Liquidity: Adequate***

Liquidity of WSL is adequate despite cash losses incurred in H1FY21 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 September 30, 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 which has been subsequently reduced to zero by October 31, 2020 and currently the utilization is NIL. 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 in end-FY20. Further, the parent of WSL i.e. AIA on a standalone basis had more than Rs.1,600 crore of free liquid investments as on September 30, 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.

**Key Rating Weaknesses**

***Recent attempt to close down its manufacturing operations citing economically unviable operations***

The Board of Directors of WSL in their Board meeting held on August 31, 2020 announced their decision to permanently close down its sole manufacturing operations at its plant in 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 was that since last year, there has been consistent decline in orders and consequent fall in production. Company had also informed that they do not have sufficient orders in hand and the available orders were 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 had 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, in stark contrast to its earlier decision, the Board of Directors of WSL in their Board meeting held on November 02, 2020, in the hope of revival in the economy based on current situation, decided to continue operations at its sole plant at Bengaluru and withdraw its earlier closure notices filed with the concerned authorities. Also, 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 & H1FY21***

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 H1FY21, the production volumes of WSL were further impacted due to Covid-19 induced lockdown which led to disruption of operations in India as well as in overseas markets. The company reported net loss of Rs.3.33 crore during H1FY21 mainly due to charging Rs.3.69 crore in its P&L account towards envisaged closure compensation and impairment of non-financial assets. Also, its financial statements for the period ended H1FY21 were not prepared on a going concern basis. However, on the back of its board of director's subsequent decision in November 2020 to continue the manufacturing operations of WSL, the provision for closure compensation made during Q2FY21 is expected to have a reversal effect in the forthcoming quarters according to the company management.

***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.

**Analytical approach:** ***Standalone along with factoring linkages with its parent company i.e. AIA Engineering Limited***

WSL has a contract manufacturing agreement with AIA, wherein AIA generally procures significant proportion 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: Notching by 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 September 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.54.25 crore with net losses of Rs.3.33 crore in H1FY21 as against TOI of Rs.81.55 crore with PAT of Rs.0.38 crore in H1FY20.

**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+; Stable |
| Non-fund-based - LT/ ST-BG/LC | - | - | - | 3.70 | CARE BBB+; Stable / CARE A2 |

**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+; Stable | 1)CARE BBB+ (Under Credit watch with Developing Implications) (09-Sep-20)<br>2)CARE A+; Stable (06-Aug-20) | 1)CARE A+; Stable (04-Oct-19)<br>2)CARE A+; Stable (15-Apr-19) | - | - |
| 2. | Non-fund-based - LT/ ST-BG/LC | LT/ST | 3.70 | CARE BBB+; Stable / CARE A2 | 1)CARE BBB+ / CARE A2 (Under Credit watch with Developing Implications) (09-Sep-20)<br>2)CARE A+; Stable / CARE A1+ (06-Aug-20) | 1)CARE A+; Stable / CARE A1+ (04-Oct-19)<br>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.*

## Contact Us

**Media Contact**
Mr. Mradul Mishra
Contact No.: +91-22-6837 4424
Email ID – mradul.mishra@careratings.com

**Analyst Contact**
Mr. Hardik Shah
Contact No.: +91-79-4026 5620
Email ID – hardik.shah@careratings.com

**Relationship Contact**
Mr. Deepak Prajapati
Contact No.: +91-79-4026 5656
Email ID – deepak.prajapati@careratings.com

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