

Ratings

CRISIL

An S&P Global Company

Rating Rationale

July 25, 2016 | Mumbai

Birla Corporation Limited*Rating downgraded to 'CRISIL AA/Negative', Ratings removed from 'Watch Negative'*

Rs 5000 million non-convertible debentures	CRISIL AA/Negative (Downgraded from 'CRISIL AA+'; removed from 'Watch with Negative Implications')
Rs 2000 million short-term debt programme (including commercial paper)	CRISIL A1+ (Reaffirmed; removed from 'Watch with Negative Implications')

CRISIL has removed its ratings on the debt instruments of Birla Corporation Limited (BCL) from 'Watch with Negative Implications'. The long-term rating has been downgraded to 'CRISIL AA' from 'CRISIL AA+' while the short term rating has been reaffirmed at 'CRISIL A1+'. The rating outlook on the long-term debt instrument is 'Negative'.

CRISIL had, on February 5, 2016, placed the ratings on watch, following the company's announcement of an agreement with Reliance Infrastructure Ltd (R-Infra; rated 'CRISIL A-/Rating watch with Negative Implications') for acquisition of the latter's cement business. Clarity was awaited on the implications of the acquisition, and its impact on BCL's credit risk profile. Based on discussions with the management, CRISIL has now obtained clarity on the transaction, funding structure, and available synergies. Furthermore, with an amendment to the Mines and Minerals Development and Regulation (MMDR) Act, 2015, being passed by both houses of parliament and notification of The Minerals (Transfer of Mining Lease Granted Otherwise Than Through Auction for Captive Purpose) Rules, 2016, only customary approvals for the transaction from lenders etc. are pending. The ratings have, therefore, been removed from watch.

BCL will acquire R-Infra's entire equity in Reliance Cement Company Pvt Ltd (RCCPL; a wholly owned subsidiary of R-Infra) for an enterprise value (EV) of Rs 48 billion. RCCPL has an aggregate operational cement manufacturing capacity of 5.6 million tonne per annum (mtpa). It has three plants, including an integrated plant at Maihar in Madhya Pradesh, and grinding units at Kundanganj in Uttar Pradesh and Butiburi in Maharashtra. The EV of Rs 48 billion comprises RCCPL's existing debt of around Rs 24 billion (as on March 31, 2016). BCL will fund the balance consideration through existing cash and equivalents (Rs 18 billion as on March 31, 2016) and incremental borrowings. BCL expects to complete the acquisition during the quarter ending September 30, 2016.

The rating action factors in moderation in capital structure and debt protection metrics, although partially offset by likely improvement in business risk profile over the near to medium term and high financial flexibility.

Post the acquisition, BCL's consolidated debt (including RCCPL's) will increase to around Rs 45 billion (net debt of Rs 38-40 billion) as on September 30, 2016, from Rs 13 billion (net debt free) as on March 31, 2016. Furthermore, cash and equivalents of Rs 18 billion (as on March 31, 2016) will reduce to Rs 5-6 billion by September 30, 2016 after payout for the acquisition. Adjusted gearing will increase to 1.8-2.0 times (1.3-1.4 times on net debt basis) by March 31, 2017, from 0.5 time (debt free; net of liquidity) as on March 31, 2016. Operating performance has declined in recent years; however, BCL has taken several corrective steps to address mining issue in Chanderia, Rajasthan, optimise logistics cost, and reduce power cost. The benefits of these initiatives have started to accrue from the last quarter of fiscal 2016. RCCPL is in initial stage of operations with low capacity utilisation of 55-60% in fiscal 2016. The company has unabsorbed tax benefits of over Rs 20 billion. Given the synergy benefits on account of favourable location of its plants and volume ramp-up, operating performance is likely to improve significantly. While BCL, on a consolidated basis, capital structure and debt protection metrics will deteriorate over the near to medium term, they are likely to correct swiftly. Net debt to earnings before interest, tax, depreciation and amortisation (EBITDA) ratio is expected to peak in fiscal 2018 (the first full year of operations) to around 3.0 times and correct swiftly thereafter. Time-bound improvement in BCL's standalone performance, ramp-up of RCCPL's operations, and harnessing synergy and tax benefits will be key monitorables.

Financial flexibility continues to be comfortable, backed by liquidity, sizeable surplus land parcels, and support available from the MP Birla group. Even on completion of the acquisition, BCL will have a cash and equivalent surplus of Rs 5-6 billion as on September 30, 2016, which is expected to improve further with healthy cash accrual, over the medium term. BCL has already re-financed a large part of its existing debt with longer tenor debt. The consolidated debt repayment for the next two years is Rs 2.0-2.5 billion per annum. BCL has flexibility to monetise its surplus land parcels valued at around Rs 10 billion. Support from the promoter group, which had cash and equivalent surplus estimated at over Rs 15 billion as on March 31, 2016, also enhances financial flexibility.

The acquisition will result in a substantial improvement in BCL's market position. While overall cement manufacturing

capacity will increase to 15.4 mtpa from 9.8 mtpa, capacity in the central region, which has healthy demand growth and operating rates, will increase to 8.6 mtpa from 3.5 mtpa. Furthermore, RCCPL has mineral concessions in Madhya Pradesh, Maharashtra, Rajasthan, Karnataka, Andhra Pradesh, and Himachal Pradesh for further expansion. RCCPL's cement plants are relatively new and enjoy various tax incentives. Given BCL's presence in the central region, the acquisition offers sizeable synergy benefits. Operating efficiency is likely to improve over the medium term.

The ratings reflect BCL's established position in the cement industry, healthy operating efficiency, and high financial flexibility. These strengths are partially offset by a leveraged capital structure, and susceptibility to cyclicalities in the cement industry.

To arrive at the ratings, CRISIL has combined the business and financial risk profiles of BCL and RCCPL. CRISIL believes RCCPL's acquisition is strategic for BCL, and BCL will extend financial, operational, and management support to RCCPL.

Outlook: Negative

CRISIL believes BCL's capital structure and debt protection metrics will remain constrained over the near to medium term. The company will, nevertheless, continue to benefit from high financial flexibility and a healthy business risk profile. The ratings may be downgraded if improvement in capital structure takes longer than expected, or cash accrual is lower on account of delay in ramp-up of operations or harnessing of synergy benefits. The outlook may be revised to 'Stable' if timely ramp-up in operations leads to higher offtake and operating margin or if additional liquidity support from the promoter group strengthens capital structure.

About the Company

BCL is the flagship company of the MP Birla group. The company was originally incorporated as Birla Jute Manufacturing Company Ltd in 1919, and was renamed in 1998 to reflect its diversified operations. Under the chairmanship of Mr Madhav Prasad Birla (Mr M P Birla), the company diversified into manufacturing cement, polyvinyl chloride (PVC) goods, and automotive trim parts. As on date, cement is the largest contributor to the company's revenue (over 90%) with the balance coming from jute and other products. BCL has seven cement plants across four states: Rajasthan, Uttar Pradesh, Madhya Pradesh, and West Bengal.

After Mr M P Birla passed away, the group was being run by his wife, Ms Priyamvada Birla, who passed away in 2004. Ms Birla had appointed Mr R S Lodha and his son Mr Harsh V Lodha as her successors through a will. Currently, the ownership is being contested by members of the Birla family against Mr Harsh V Lodha, the company's current chairman, in the court of law.

For fiscal 2016, net profit was Rs 1.57 billion on operating income of Rs 32.60 billion, against net profit of Rs 1.66 billion on operating income of Rs 31.94 billion for the previous fiscal.

Links to related criteria
CRISIL's Approach to Financial Ratios
Rating Criteria for Manufacturing Companies
Rating Criteria for Cement Industry
CRISIL's Criteria for Consolidation
Criteria for rating Short-Term Debt (including Commercial Paper)

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