

Rating Advisory

February 10, 2023 | Mumbai

Sunflag Iron and Steel Co.Limited

Update as on February 10, 2023

This rating advisory is provided in relation to the rating of Sunflag Iron and Steel Co.Limited

The key rating sensitivity factors for the rating include:

Upward factors:

- Sustained revenue growth of over 15% with operating margin improving to above 16% on a sustained basis, backed by benefits from the capacity enhancement and improved efficiencies
- Significant improvement in the working capital cycle
- Sustenance of financial risk profile

Downward factors:

- Net cash accrual to repayment ratio of less than 2 times.
- Higher-than-expected increase in working capital requirement; larger-than-expected, debt-funded capex or acquisition; weakening the financial risk profile and liquidity

CRISIL Ratings has a policy of keeping its accepted ratings under constant and ongoing monitoring and review. Accordingly, it seeks regular updates from companies on business and financial performance. CRISIL Ratings is yet to receive adequate information from Sunflag Iron and Steel Co.Limited (SISCL) to enable it to undertake a rating review. CRISIL Ratings is taking all possible efforts to get the rated entity to cooperate with its rating process for enabling it to carry out the rating review.

CRISIL Ratings views information availability risk as a key factor in its assessment of credit risk. (Please refer to CRISIL Ratings' criteria available at the following link, https://www.crisil.com/content/dam/crisil/criteria_methodology/basics-of-ratings/assessing-information-adequacy-risk.pdf)

If SISCL continues to delay the provisioning of information required by CRISIL Ratings to undertake a rating review then, in accordance with circulars SEBI/HO/MIRSD/MIRSD4/CIR/P/2016/119 dt Nov 1, 2016, SEBI/HO/MIRSD/ MIRSD4/ CIR/ P/ 2017/ 71 dt June 30, 2017 and **SEBI/HO/MIRSD/CRADT/CIR/P/2020/2 dt January 3, 2020** issued by Securities and Exchange Board of India, CRISIL Ratings will carry out the review based on best available information and issue a press release.

About the Company

SISCL, incorporated in 1984 by Mr Ravi Bushan Bharadwaj, manufactures alloy steel and special steel products for the auto sector, power sector & other general engineering areas. SISCL has its manufacturing facility located at Warthi, Bhandara Road (Maharashtra) with installed capacity of 4 Lakh MTPA (Rolling mill), 5.25 Lakh MTPA (SMS), 2.40 Lakh MTPA (Mini Blast Furnace) and a captive power plant (CPP) of 32MW.

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Rating Rationale

December 31, 2021 | Mumbai

Sunflag Iron and Steel Co.Limited

Ratings upgraded to 'CRISIL A/Stable/CRISIL A1'

Rating Action

Total Bank Loan Facilities Rated	Rs.1134.75 Crore
Long Term Rating	CRISIL A/Stable (Upgraded from 'CRISIL A-/Stable')
Short Term Rating	CRISIL A1 (Upgraded from 'CRISIL A2+')

1 crore = 10 million

Refer to Annexure for Details of Instruments & Bank Facilities

Detailed Rationale

CRISIL Ratings has upgraded its ratings on the bank facilities of Sunflag Iron and Steel Co.Limited (SISCL) to '**CRISIL A/Stable/CRISIL A1**' from 'CRISIL A-/Stable/CRISIL A2+'.

The upgrade reflects the improvement in the group's business risk profile and financial risk profile driven by higher-than-expected revenue in fiscal 2021 on the back of volume growth with improved demand and increase in steel prices. Group is also focusing on gradually increasing its revenue share from non-auto sector (where company sells relatively higher margin products). With expected increase in demand from non-auto sector and recovery in auto sector production, the sales volumes are expected to see a steady growth driving up the revenue further, over the medium term. Group reported an operating income of Rs.1926 crore in fiscal 2021 - a 5% y-o-y growth (despite the sluggish demand scenario and lockdown restrictions during Q1 FY21). Operating margin improved to 13.3% in fiscal 2021 from 9.5% in fiscal 2020 supported by control on fixed expenses during the year and better realisation towards the last quarter of fiscal 2021. The healthy demand and increase in realization is continuing in current fiscal - company has achieved revenue of Rs.1353 crore (with operating margin of 17.2%) during H1 FY22 as against Rs.687.93 crore (with operating margin of 10.0%) during H1 FY21.

The improved business risk profile has resulted in an enhanced financial risk profile as well, with a strong network of Rs.1174 crore (Rs.1013 crore in P.Y.) and low gearing of 0.16 time (0.30 time in P.Y.) as on March 31, 2021. Debt protection metrics are healthy as reflected in interest cover and net cash accruals to adjusted debt (NCAAD) ratio of 9.2 times (4.4 times in P.Y.) and 1.11 times (0.41 time in P.Y.) in fiscal 2021. There is no major debt funded capex expected over the medium term.

The ratings reflect SISCL's strong market position in the auto-grade micro-alloy steel business and healthy financial risk profile. These strengths are partially offset by large working capital requirement, susceptibility to changes in raw material prices and government regulations, and exposure to cyclicalities in the steel industry and the auto segment (key end user).

Analytical Approach

For arriving at the ratings, CRISIL has combined the business and financial risk profiles of SISCL, its subsidiaries, Sunflag Power Ltd (99.88% shareholding) and Khappa Coal Co Pvt. Ltd (63.27% shareholding). These entities are collectively referred to herein as SISCL. Previously, for arriving at the ratings, CRISIL Ratings had combined the business and financial risk profiles of SISCL, its subsidiaries, Sunflag Power Ltd (99.88%) and Khappa Coal Co Pvt Ltd (63.27%) and its joint ventures - Madanpur (North) Coal Company Private Limited (11.73%), Daido DMS India Private Limited (17.56%), Ramesh Sunwire Private Limited (49%) and C T Mining Private Limited (31.80%). However, now, CRISIL Ratings has not combined the business and financial risk profiles of the joint ventures as Madanpur (North) Coal Company Private Limited and C T Mining Private Limited are non-operational. And while Daido DMS India Private Limited and Ramesh Sunwire Private Limited are operational, however, there is no corporate guarantee extended by SISCL.

Please refer Annexure - List of entities consolidated, which captures the list of entities considered and their analytical treatment of consolidation.

Key Rating Drivers & Detailed Description

Strengths:

- **Strong market position:** SISCL's robust market position in the automobile grade alloy steel and special steel manufacturing industry is driven by substantial capacity, wide product mix, and established clientele. Group caters to reputed customers in both auto and non-auto sectors and top 10 customers contribute to only 20-25% of the total revenue.
- **Healthy financial risk profile:** The financial risk profile is supported by strong network of Rs 1174 crore, gearing of 0.16 time and total outside liabilities to adjusted network (TOLANW) ratio of 0.72 time, as on March 31, 2021. Financial risk profile metrics have remained healthy despite the debt-funded capital expenditure (capex) of Rs 450 crore undertaken during FY20 to FY22. Network is expected to be over Rs 1300 crore, while gearing and TOLANW ratio are expected to be below 0.5 time and 1 time, respectively, over the near term. Debt protection metrics were healthy, with interest coverage and net cash accrual to adjusted debt (NCAAD) ratios of 9.2 times and 1.11 times, respectively, in fiscal 2021. Interest cover and NCAAD are expected to be over 7 times and 0.5 time going ahead.

Weaknesses:

- **Large working capital requirement:** Gross current assets have been in the range of 140-180 days during the three fiscals ended 2021, driven by sizeable inventory of 100-125 days. Inventory remains large due to high lead time required in the manufacturing process; nonetheless, a majority of it is order-backed. Credit of 45-60 days is offered to customers. Operations are expected to remain working capital intensive over the medium term.
- **Susceptibility to changes in raw material prices, government regulations and exposure to cyclicity in the steel industry and the auto segment:** The operating margin has ranged between 9.5-13.5% during the five fiscals ended 2021 due to fluctuations in raw material prices. The company can however pass on increase in input prices to customers, but only with a lag of around a month. The margin is also vulnerable to regulatory changes, such as in duties and tariffs, which affect the final cost. Any unfavorable impact of change in import regulations will also increase competition from foreign manufacturers, restricting pricing power. The steel industry is vulnerable to downturns in demand, leading to decline in realisations and profitability. Moreover, bulk of the revenue (about 80%) comes from the domestic auto industry (primarily the passenger and commercial vehicle segments), which is cyclical in nature.

Liquidity: Strong

Group is expected to generate net cash accruals of Rs 220-240 crore per fiscal, which will be more than adequate to cover repayments of Rs 60-99 crore per fiscal, over the medium term. The surplus accruals will help support the incremental working capital requirements. The fund-based limit of Rs 407 crore was utilized at a maximum of 53% over the 12 months ended Oct'21. Company is in talks of enhancement in its limits – Rs 100 crore in fund-based limit and Rs 150 crore in non-fund-based limit which should further support the liquidity and to meet the incremental working capital requirements arising out of the enhanced capacities. Cash and bank balance was Rs 73.87 crore as on March 31, 2021, of which unencumbered cash & bank balance was Rs 18.63 crore. Current ratio was 1.83 times as on March 31, 2021. Unsecured loans (from promoters) stood at Rs 18.03 crore as on March 31, 2021.

Outlook: Stable

CRISIL believes SISCL will continue to benefit from its established market position and healthy financial risk profile.

Rating Sensitivity factors

Upward factors:

- Sustained revenue growth of over 15% with operating margin improving to above 16% on a sustained basis, backed by benefits from the capacity enhancement and improved efficiencies
- Significant improvement in the working capital cycle
- Sustenance of financial risk profile

Downward factors:

- Net cash accrual to repayment ratio of less than 2 times.
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About the Company

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Key Financial Indicators - Consolidated

Particulars	Unit	2021	2020
Revenue	Rs crore	1926	1829

Profit After Tax (PAT)	Rs crore	141	92
PAT Margin	%	7.3	5.0
Adjusted debt/adjusted network	Times	0.16	0.30
Interest coverage	Times	9.2	4.4

Any other information: Not applicable

Note on complexity levels of the rated instrument:

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Annexure - Details of Instrument(s)

ISIN	Name of instrument	Date of allotment	Coupon rate (%)	Maturity date	Issue size (Rs crore)	Complexity Levels	Rating assigned with outlook
NA	Cash Credit & Working Capital Demand Loan	NA	NA	NA	406.93	NA	CRISIL A/Stable
NA	Letter of credit & Bank Guarantee	NA	NA	NA	347.28	NA	CRISIL A1
NA	Proposed Fund-Based Bank Limits	NA	NA	NA	140.18	NA	CRISIL A/Stable
NA	Term Loan	NA	NA	Aug-27	240.36	NA	CRISIL A/Stable

Annexure – List of entities consolidated

Names of entities consolidated	Extent of consolidation	Rationale for consolidation
Sunflag Iron and Steel Co. Ltd	Full	Financial, operational and managerial linkages
Sunflag Power Ltd		
Khappa Coal Company Pvt Ltd		

Annexure - Rating History for last 3 Years

Instrument	Current			2021 (History)		2020		2019		2018		Start of 2018
	Type	Outstanding Amount	Rating	Date	Rating	Date	Rating	Date	Rating	Date	Rating	Rating
Fund Based Facilities	LT	787.47	CRISIL A/Stable		--	28-09-20	CRISIL A-/Stable	20-11-19	CRISIL A-/Stable	16-07-18	CRISIL A/Stable	CRISIL A2+ / CRISIL A-/Stable
			--		--		--	06-09-19	CRISIL A-/Stable	28-02-18	CRISIL A2+ / CRISIL A-/Positive	--
Non-Fund Based Facilities	ST	347.28	CRISIL A1		--	28-09-20	CRISIL A2+	20-11-19	CRISIL A2+	16-07-18	CRISIL A1	CRISIL A2+
			--		--		--	06-09-19	CRISIL A2+	28-02-18	CRISIL A2+	--

All amounts are in Rs.Cr.

Annexure - Details of Bank Lenders & Facilities

Facility	Amount (Rs.Crore)	Rating
Cash Credit & Working Capital Demand Loan	126	CRISIL A/Stable
Cash Credit & Working Capital Demand Loan	88.17	CRISIL A/Stable
Cash Credit & Working Capital Demand Loan	77.18	CRISIL A/Stable

Cash Credit & Working Capital Demand Loan	77.18	CRISIL A/Stable
Cash Credit & Working Capital Demand Loan	38.4	CRISIL A/Stable
Letter of credit & Bank Guarantee	77.4	CRISIL A1
Letter of credit & Bank Guarantee	67.77	CRISIL A1
Letter of credit & Bank Guarantee	57.38	CRISIL A1
Letter of credit & Bank Guarantee	41.1	CRISIL A1
Letter of credit & Bank Guarantee	103.63	CRISIL A1
Proposed Fund-Based Bank Limits	140.18	CRISIL A/Stable
Term Loan	37.34	CRISIL A/Stable
Term Loan	34.19	CRISIL A/Stable
Term Loan	70	CRISIL A/Stable
Term Loan	23.83	CRISIL A/Stable
Term Loan	75	CRISIL A/Stable

Criteria Details

Links to related criteria
CRISILs Approach to Financial Ratios
Rating criteria for manufacturing and service sector companies
CRISILs Bank Loan Ratings - process, scale and default recognition
Rating Criteria for Auto Component Suppliers
Rating Criteria for Steel Industry
CRISILs Criteria for rating short term debt
CRISILs Criteria for Consolidation

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