Sunflag Iron and Steel Company Limited

July 06, 2021

Ratings

Facilities/Instruments	**Amount (Rs. crore)**	**Ratings**	**Rating Action**
Long Term Bank Facilities	303.00	CARE A; Positive (Single A; Outlook: Positive)	Assigned
Long Term Bank Facilities	554.09 (Reduced from 743.08)	CARE A; Positive (Single A; Outlook: Positive)	Reaffirmed; Outlook revised from Negative
Long Term / Short Term Bank Facilities	348.10	CARE A; Positive / CARE A1 (Single A; Outlook: Positive/ A One)	Reaffirmed; Outlook revised from Negative
Total Bank Facilities	**1,205.19 (Rs. One Thousand Two Hundred Five Crore and Nineteen Lakhs Only)**		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The reaffirmation of ratings on the bank facilities of Sunflag Iron and Steel Company Limited (SISCL) factors in improved topline on the back of higher sales volumes and realizations in FY21 (FY refers to the period April 01 to March 31), continued upward trend of tolling margin, strong financial health demonstrated from below unity overall gearing, above average debt coverage indicators, healthy Return on Capital Employed (ROCE) and strong liquidity demonstrated by low utilization of bank lines. The rating action also takes benefit of rich experience of promoters exhibiting long track record in steel industry, integrated manufacturing steel plant located strategically in central part of the country, strong and large marketing network and selling arrangements. CARE also takes benefit of the company's presence in steel industry having positive outlook.

The rating strengths are tempered by elongated working capital cycle driven by high inventory holdings, susceptibility to volatility in raw material prices and foreign exchange risk, delayed Commercial Operation Date (COD) of blooming mill capex by nearly one and half years resulting in increased project execution risk.

Outlook: Positive

The outlook revision reflects CARE's expectation of improvement in performance of the steel sector and in turn the company over medium term which would be largely driven by increase in demand of rolled steel products from auto and auto ancillary companies. SISCL would see healthy capacity utilisations on the back of established brand presence and strong demand outlook.

Rating Sensitivities:

Positive factors-Factors that could lead to positive rating action/upgrade:

- Sustenance of healthy topline and profitability level leading to gross cash accruals of above Rs.175 crore.
- Improvement in working capital cycle while managing the healthy financial profile.

Negative factors- Factors that could lead to negative rating action/downgrade:

- Further leveraging the books resulting in overall gearing above unity.
- Sizeable stretch in working capital cycle.
- Any time and cost overrun on the on-going capital expenditure diluting the profit yields.

Detailed description of the key rating drivers

Key Rating Strengths

- ***Experienced promoters with long track record in the iron and steel industry***: The Sunflag group was promoted by the Bhardwaj brothers i.e. Late P. B. Bhardwaj and Mr. Ravi Bushan Bhardwaj (Chairman). The promoters have rich experience of over five decades in the iron and steel industry. Mr. Pranav Bhardwaj, Managing Director (MD), is second generation entrepreneur, responsible for overall in charge of running the business affairs of the company. The promoters are also supported by team of qualified professionals from varied business backgrounds.
- ***Strategic location of plant and integrated facility coupled with product diversification:*** SISCL has an integrated manufacturing facility located in the central part of India at Bhandara, Maharashtra,70 Kms from Nagpur, where in it is strategically placed to cater to the requirements of various organized and unorganized auto companies across domestic markets. The product portfolio of SISCL has a mix of products from various categories like forging, spring steel, free & semi free cutting steel, engine valve steel, stainless steel rebar, super alloys and tool steels. Further, at present nearly 40% of the power requirement is met through captive

power plant (Thermal and waste heat energy gas plant) of 32MW annual capacity while balance 60% of power requirement is served from electricity purchased from Maharashtra State Electricity Board (MSEB).

- ***Strong Marketing and selling arrangements:*** The company has a strong and large marketing network across the country with its presence in all the major cities like Delhi, Ludhiana, Faridabad, Mumbai, Pune, Nagpur, Bangalore and Chennai. The company enjoys preferred vendor status from the major Original Equipment Manufacturers (OEMs) in automotive industry and other auto ancillary companies. Over last three years, there is increased diversification in client base however revenue concentration from top 10 customers has remained between 10-33%.
- ***Improved operating performance resulting in higher total operating income coupled with profit levels in FY21 over FY20:*** Despite the impact of COVID-19-led disruptions, SISCL reported growth in income level by 7.53% to Rs.1891.55 crore in FY21 as compared to FY20 on the back of improved capacity utilization. While operations were initially at a standstill during Q1FY21 due to the COVID-19 led lockdown, SISCL gradually ramped up its output. Synergy of increased sales volume of products and better sales prices during FY21 led to higher revenue. During FY21, the company witnessed relatively lesser demand for rolled products, key revenue driver contributing 85% to topline as against 95% in FY20 however demand for pig iron/hot metal product was better compared to previous year contributing 13% in FY21 which use to remain less than 5% in past fiscals.
  Tolling margin of the company reported growth on y-o-y basis to Rs. 39,457/ton from Rs.33464/ton in FY20. During FY21, improvement in tolling margin was driven by better sales realizations. Further, operating profit per ton of the company has also improved to Rs.10, 326/- in FY21 from Rs.6,614 in FY20 owing to relatively lower raw material expenses for FY21. The operating metrics of the company is expected to remain healthy on the back of strong demand outlook.
- ***Healthy financial risk profile:*** Net worth of the company and gearing were healthy at around Rs.1183.83 crore and 0.24x, respectively as on March 31, 2021 improving from Rs.1023.64 crs and 0.46x respectively as on March 31, 2020. SISCL has healthy ROCE improved to 12% in FY21 from 10% in FY20 on account of higher profit for the year and healthy capacity utilization.
  Debt coverage indicators of the company has also improved in FY21 with total debt/ GCA at 1.41x (4.04x in FY20) and term debt/ GCA at 1.25x (2.09x in FY20). Better coverage is on account of significantly improved profit levels of the company for the year FY21.

Key Rating Weakness

- ***Elongated working capital cycle days albeit improved:*** SISCL has operating cycle of 97 days in FY21 improved 116 days in FY20 on account of relatively lower collection and inventory holding period of 40 days and 122 days respectively as against 51 days and 131 days in FY20. The company has a comfortable collection period days however modest operating cycle is due to high inventory holding period mainly, as the company has an integrated steel plant and ready availability of raw material is critical. Receivables to the tune of Rs.210.22 crore outstanding as on March 31, 2021, have been realized largely.
- ***Susceptibility to volatility in raw material prices and forex risk:*** Raw material consumption is the single largest cost component for SISCL, constituting about 70-75% of total costs. The key raw materials used by the company are iron ore/iron ore fines; coke and coal/coal fines, ferro alloys etc. Also, the company imports various raw materials such as ferro alloys, refractory materials, Lam coke, Fluorspar etc. Any adverse movement in the raw material price/ any major adverse fluctuation in the foreign currency without corresponding movement in finished goods price might result in moderation in profitability of the company.
  The risk is though mitigated to an extent as the prices of finished goods move in tandem with increase in raw material prices, though there is a time lag of one to two months.
- ***Delayed on-going capex enhancing project execution risk:*** SISCL undertook expansion projects in its Blooming mill unit and Steel melt Shop (SMS) for production of high-end steel which will be utilized in defense and aerospace industry. The company is expected to have benefit of high margin from said capex on account of limited competition for these end user industries. The capital outlay for these projects was estimated at Rs.450 crore (Blooming mill-Rs.345 crore and Super Alloy Project-Rs.105 crore) to be funded through mix of debt and equity in the ratio of 70:30 with execution timeline of over a period of 2 years ending September 2020. As on May 30, 2021, total outlay for the said capex was Rs.285.88 crore. Capex related to SMS unit has commenced operation as per schedule however, blooming mill capex got delayed on account of the imposed lockdown to contain Covid-19 and therefore delay in machinery transport China which is now expected to be delivered by August-September 2021 as against earlier estimate of Dec 2020-Jan 2021. Therefore, COD for blooming mill project is shifted to March 2022 as against earlier estimate of September 2021. Hence, the benefit which was earlier expected in FY20-21, could now be seen in FY23-24 from said capex.
- ***Steel industry characterized by inherent cyclicality, competition from unorganized players and impact of covid-19 pandemic**:* Steel is highly capital intensive industry and is cyclical in nature. Growth in this sector depends on the growth of the economy at large and, in particular, the steel end user industries such as automobile, housing, infrastructure and others. The industry also faces headwinds in the form of volatile raw material prices as well. Competition plays a role in the profitability of steel manufacturer’s mainly arising out of unorganized players and Chinese imports. Domestic demand for steel had picked up pace in the second half of FY21 however the second wave of coronavirus has mildly hit demand from certain sectors. CARE expect domestic demand to be lower in the Q1FY22 however in Q2 demand is expected to return with unlocking of restrictions, more

people getting vaccinated and return to work in the coming months. Domestic steel prices continue to remain at a sharp discount to international steel prices which indicates there is room for further price hike.

Liquidity: Strong. The company has strong liquidity position marked by unencumbered cash and bank balance of ~Rs.60 crore as on May 30, 2021 against which the company has a debt repayment obligation of Rs.13.48 crore for the year FY22. This apart, the company is expected to have cash flow from operations to the tune of Rs.21.38 crore for FY22. Also, the fund based working capital limits of the company have remained very less utilized nearly at 18.84% for last 12 months ending May 2021.

Analytical approach: Consolidated.
CARE has analyzed SISCL's credit profile by considering the consolidated financial statements of the company owing to financial, business, operational and management linkages between the parent and subsidiaries.

Subsidiary	% of shareholding
Sunflag Power Limited	100.00
Khappa Coal Company Private Limited	63.27
Joint Ventures	
Madanpur (North) Coal Company Private Limited	11.73
Daido DMS India Private Limited	17.56
Ramesh Sunwire Private Limited	49.00
C T Mining Private Limited	31.80

However, except Daido DMS India Private Limited and Ramesh Sunwire Private Limited, all other entities are non-operating as on June 30, 2021.

D. Applicable criteria
CARE's Criteria on assigning outlook and credit watch to Credit Ratings
CARE's Policy on Default Recognition
Criteria for Short Term Instruments
Financial ratios – Non-Financial Sector
Liquidity analysis of non-financial sector entities
Rating Methodology - Steel industry
Rating Methodology: Consolidation and Factoring Linkages in Ratings

About the Company
Incorporated in September 1984, Sunflag Iron and Steel Company Limited (SISCL) is the flagship company of the Nagpur (Maharashtra) based Sunflag Group, promoted by the Bharadwaj brothers i.e. Late P B. Bharadwaj and Mr. Ravi Bhushan Bhardwaj. The company started operations in 1989 as a spring steel producer however, at present the company is engaged in manufacturing of mild-steel and alloy steel products of varieties like carbon steel, free & semi free cutting steels, micro-alloyed steel, stainless steel, spring steels, valve steel, bearing steels, quality steels, tool steel etc. The product range of SISCL includes: Rolled products, Billet/Bloom, Ingots, and Bright Bars etc. of varied shape and size range. These products are mainly used for manufacturing Automotive Transmission Gears, Drive Shafts, Steering System, Bearings, Exhaust System and other Engine Components. The company also supplies to Indian Railways, Ordnance Factories, Power Sectors & other General Engineering areas for manufacture of critical application components. SISCL has been collaborated with Daido Steel Co. Ltd (Japan's leading specialty steel producer), since November 2010 which also has equity stake in SISCL to the tune of 10.00% as on June 30, 2021. The association with Daido helps SISCL in improvement in production Process and Product Quality, Development of New Grades, Localization of Steel by the Automobile OEMs. 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.
Covenants of rated instrument / facility: *Detailed explanation of covenants of the rated instruments/facilities is given in Annexure-3*

Brief Financials (consolidated) (Rs. crore)	FY20 (A)	FY21 (A)
Total operating income	1769.66	1902.88
PBILDT	182.17	264.58
PAT	92.07	140.62
Overall gearing (times)	0.46	0.24
Interest coverage (times)	4.27	9.23

A: Audited;
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	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Fund-based - LT-Term Loan	-	-	2029	147.02	CARE A; Positive
Fund-based - LT-Cash Credit	-	-	-	407.07	CARE A; Positive
Non-fund-based - LT/ ST-BG/LC	-	-	-	348.10	CARE A; Positive / CARE A1
Fund-based - LT-Term Loan- Proposed	-	-	2029	245.00	CARE A; Positive
Non-fund-based - LT-Letter of credit	-	-	-	58.00	CARE A; Positive

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 2021-2022	Date(s) & Rating(s) assigned in 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019
1.	Commercial Paper-Commercial Paper (Carved out)	ST	-	-	-	-	-	1)Withdrawn (29-Mar-19)
2.	Fund-based - LT-Term Loan	LT	147.02	CARE A; Positive	-	1)CARE A; Negative (07-Oct-20)	1)CARE A; Negative (23-Mar-20) 2)CARE A; Negative (22-Aug-19) 3)CARE A; Stable (03-Apr-19)	-
3.	Fund-based - LT-Cash Credit	LT	407.07	CARE A; Positive	-	1)CARE A; Negative (07-Oct-20)	1)CARE A; Negative (23-Mar-20) 2)CARE A; Negative (22-Aug-19) 3)CARE A; Stable (03-Apr-19)	-
4.	Non-fund-based - LT/ ST-BG/LC	LT/ST	348.10	CARE A; Positive / CARE A1	-	1)CARE A; Negative / CARE A1 (07-Oct-	1)CARE A; Negative / CARE A1 (23-Mar-	-

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2021-2022	Date(s) & Rating(s) assigned in 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019
						20)	20) 2)CARE A; Negative / CARE A1 (22-Aug-19) 3)CARE A; Stable / CARE A1 (03-Apr-19)	
5.	Fund-based - LT-Term Loan	LT	245.00	CARE A; Positive	-	-	-	-
6.	Non-fund-based - LT-Letter of credit	LT	58.00	CARE A; Positive	-	-	-	-

Annexure 3: Detailed explanation of covenants of the rated facilities

Name of the Instrument	Detailed explanation
A. Financial covenants	
I. Adverse deviation in any of the following two ratios : • Fixed Asset Coverage Ratio not less than 3.15% • Total Debt to Tangible Net Worth not exceed 1.70x • Interest Coverage Ratio not less than 5.90x • Debt Service Coverage Ratio not less than 1.63x	Adverse deviation above 10% , 50 bps penal interest
B. Non-financial covenants	
I. Prepayment charges	Prepayment attracts prepayment penalty of 2% on the amount prepaid. Pre-payment charges will not be levied: (a) In case payment has been made out of cash sweep/ Insurance proceeds; (b) Payment at the instance of lenders; (c) Loans prepaid out of higher cash accruals from the project / refinancing under 5/25 on the date of refinancing / equity infusion by promoters
II. Non Submission of Stock Statement within 20 days	Monthly stock and book debt statement submit to bank by 20th of consequent month, delay in submission will attract 1% (maximum 2%) penal interest over and above regular interest.
III. Non submission of Financial Statement of previous year within 8 months from end of period	--

Annexure 4: 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.	Fund-based - LT-Term Loan	Simple
3.	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
Mradul Mishra
Contact no. – +91-22-6837 4424
Email ID – mradul.mishra@careratings.com

Analyst Contact
Monika Goenka
Contact no. - 020-4000 9019/887930081
Email ID- monika.goenka@careratings.com

Relationship Contact
Aakash Jain
Contact no. : 020-4000 9000
Email ID : aakash.jain@careratings.com

About CARE Ratings:
CARE Ratings commenced operations in April 1993 and over two decades, it has established itself as one of the leading credit rating agencies in India. CARE is registered with the Securities and Exchange Board of India (SEBI) and also recognized as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI). CARE Ratings is proud of its rightful place in the Indian capital market built around investor confidence. CARE Ratings provides the entire spectrum of credit rating that helps the corporates to raise capital for their various requirements and assists the investors to form an informed investment decision based on the credit risk and their own risk-return expectations. Our rating and grading service offerings leverage our domain and analytical expertise backed by the methodologies congruent with the international best practices.