Arfin India Limited

September 2, 2020

Ratings

Facilities	Amount (Rs. crore)	Rating[1]	Rating Action
Long-term Bank Facilities	1.21 (reduced from Rs.2.61 crore)	CARE BBB-; Negative (Triple B Minus; Outlook: Negative)	Revised from CARE BBB; Stable (Triple B; Outlook: Stable)
Long-term/Short-term Bank Facilities	104.90 (reduced from Rs.120.00 crore)	CARE BBB-; Negative/CARE A3 (Triple B Minus; Outlook: Negative/ A Three)	Revised from CARE BBB; Stable / CARE A3+ (Triple B; Outlook: Stable/ A Three Plus)
Total Facilities	106.11 (Rupees One Hundred Six crore and Eleven lakh only)		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The revision in ratings of the bank facilities of Arfin India Ltd. (AIL) is on account of net loss incurred by it due to sizeable write-off of its receivables during FY20 (refers to the period from April 1 to March 31), deterioration in its capital structure and debt coverage indicators along with further increase in its working capital intensity on the back of increase in its inventory holding. The ratings continue to derive strength from experience of AIL's promoters in the business of manufacturing ferrous and non-ferrous metals, its established relationship with reputed clients and it being an organized player in the fragmented aluminium recycling industry with moderately diversified product portfolio.

The ratings, however, continue to remain constrained by its moderate profitability with vulnerability to volatile raw material prices and foreign exchange rates as well as its elevated working capital requirements resulting in stretched liquidity. The ratings also remain constrained on account of its presence in a fragmented and competitive aluminium industry.

<u>Outlook: Negative</u>

The outlook on the long term rating of AIL is 'Negative' on CARE's expectation of AIL's scale of operations and debt coverage indicators remaining lower than previously envisaged in the medium term due to envisaged slowdown in demand from the end user industries and moderation in prices due to outbreak of the Covid-19 pandemic.

The outlook may be revised to 'Stable' in case of a sustained volume-driven increase in the company's scale of operations and profitability, along with rationalization of its inventory levels.

Rating Sensitivities

Positive Factors

- Increase in scale of operations through healthy volume driven growth along with improvement in its PBILDT margin and return on capital employed (RoCE) to more than 10% and 15% respectively on a sustained basis
- Improvement in total debt/ PBILDT to around 2x, on sustained basis
- Improvement in overall gearing to less than unity, on sustained basis
- Contraction of gross operating cycle to less than 90 days on sustained basis

Negative Factors

- Further deterioration in profitability and debt coverage indicators on sustained basis
- Deterioration in total debt/ PBILDT to more than 7x on sustained basis
- Elongation of gross operating cycle to more than 180 days on sustained basis and its adverse impact on its liquidity
- Deterioration in overall gearing to around 2x, on sustained basis

Detailed description of the key rating drivers

Key Rating Strengths

Experienced promoters in the metal industry: AIL's promoter, Mr. Mahendra R. Shah (Chairman), has more than two decades of experience in the manufacturing of ferrous and non-ferrous metal products. He looks after the entire operations of the

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

company and is assisted by his son, Mr. Jatin M. Shah (Managing Director), along with a qualified and experienced second tier management. The promoters are also associated with sister concerns namely Krish Ferro Industries Private Limited, Mahendra Corporation and Arfin Alucop Pvt. Ltd. which are engaged in similar line of business.

Moderately diversified product portfolio along with established relationship with reputed clientele: AIL has presence in various product-segments of the aluminium industry. The two main products of the company i.e. aluminium wire rod and aluminium deox together contributed nearly 44% of its sales in FY20 (49% in F19). Further, over the last three years, the company has gradually diversified its product portfolio with addition of products such as master & ferro alloys and aluminium conductors & cables.
With a moderately diversified product portfolio, AIL caters to the demand from some of the leading players in the steel, automobile, power and foundry industries; albeit it has high customer concentration with top five clients constituting around 66% of its TOI during FY20. The company majorly operates in the domestic market with a pan-India presence, and it also exports its products to Japan, Middle-East and African countries with exports contributing around 18% of its gross sales in FY20 (8% in FY19).

Moderate scale of operations; albeit declining trend: AIL has moderate scale of operations which, apart from being impacted by volatility in sales volume, also remains susceptible to volatile aluminum prices which are linked to international indices.
After an 11% y-o-y dip in the company's total operating income (TOI) during FY19 largely due to dip in its sales volume, the TOI further declined by 13% y-o-y during FY20 to Rs.360.19 crore due to lower sales realization of its key products, with decline in aluminum prices. The prices were also impacted due to outbreak of the Covid-19 pandemic globally from December 2019 onwards, apart from other geopolitical factors such as international trade wars and sluggish demand from key end user industries such as automobiles. Sales volume of the company registered a marginal y-o-y growth of 2%, with some change in the overall product mix.
During Q1FY21, AIL's TOI declined by 56% y-o-y to Rs.41.79 crore due to impact of the lockdown announced by the government in the wake of outbreak of the pandemic, resulting in disruption of operations and slowdown in demand for its products.

Key Rating Weaknesses
Moderate profitability with y-o-y decline in gross cash accruals; along with sizeable write-off of receivables resulting in net loss during FY20: AIL's PBILDT margin has remained moderate at below 6% in last two years ended FY20 (calculated after excluding a one-time write-off of receivables from the operating profitability during FY20). Furthermore, sequential rise in interest cost on y-o-y basis during these years due to higher working capital debt has led to a continuous decline in its cash accruals.
Furthermore, during FY20, AIL wrote-off receivables of Rs.25.24 crore from erstwhile Essar Steel India Ltd. (ESL), in-line with the judgment passed by the Hon'ble Supreme Court giving priority to financial creditors over operational creditors for distribution of funds from Arcelor Mittal's bid for ESL. Consequently, it incurred a net loss of Rs.21.57 crore during FY20.

Deterioration in capital structure and debt coverage indicators: AIL's overall gearing deteriorated from 1.45x as on March 31, 2019 to 1.83x as on March 31, 2020 due to erosion in its networth base owing to write-off of receivables of Rs.25.24 crore; despite decline in total o/s debt from Rs.123.77 crore as on March 31, 2019 to Rs.116.99 crore as on March 31, 2020. AIL's debt coverage indicators also weakened during FY20 due to higher interest cost, coupled with lower operating profit and cash accruals.
AIL's overall gearing, although improved marginally to 1.71x as on June 30, 2020 with decline in o/s working capital bank borrowings on the back of reduction in its scale of operations during Q1FY21, it continued to remain high.

Liquidity: Stretched
AIL's liquidity was stretched marked by an elongated operating cycle, almost full utilization of its working capital limits, availment of interest moratorium on its debt as well as emergency credit line as a Covid-19 relief measure from its lenders in line with RBI's guidelines.
AIL had an elongated operating cycle of 133 days during FY20 (121 days during FY19) with further increase in inventory holding period from 87 days in FY19 to 108 days in FY20 (as against 66 days in FY18). Its quick ratio has been witnessing a deteriorating trend and stood low at 0.33 times as on March 31, 2020.
Collection period however declined from 53 days in FY19 to 40 days in FY20 due to decline in o/s receivables with write off of debtors from ESL; along with payments largely being received within extended credit period from the company's clients.
With increase in working capital intensity of operations and consequent high reliance on external borrowings in light of declining cash accruals, average utilization of working capital limits remained high at 94% for the past 12 months ended June 2020. Also, AIL's fund based working capital limits were reduced from Rs.120 crore to Rs.91 crore in June 2020, which resulted in high utilization level as the company's inventory levels continued to remain elevated even at the end of June 2020, owing to raw material procurement done by AIL during the quarter to avail the benefit of decline in aluminium prices.

Company had registered healthy cash flow from operations (CFO) of Rs.23.47 crore in FY20 which enabled its timely debt servicing during the year. Going forward, it has scheduled principal repayments in the range of Rs.1.31-Rs.4.57 crore over the next three years, which are expected to be tightly matched with its envisaged cash accruals. Rationalization of inventory levels going forward would be crucial for generating operating cash flows.
AIL has availed interest moratorium on its working capital facilities for the period from March 2020 till August 2020. AIL has also availed Covid emergency credit line of Rs.5.90 crore in order to aid its liquidity which was impacted due to the lockdown announced on account of spread of Covid-19 pandemic.

Exposure to raw material price volatility and foreign exchange fluctuation risk: The main raw material for AIL is aluminium scrap which it imports mainly from European countries, whereas its sales is majorly in the domestic market which exposes AIL's profitability to exchange rate fluctuations. Also, the raw material prices are linked to international commodity indices, which exposes it to inherent volatility associated with aluminium prices, while its sales prices are dictated largely by the demand-supply in the domestic market for various products, exposing the company to adverse movement in prices which it may not be able to pass on to its customers.

Highly fragmented nature of industry characterized by intense competition along with AIL's high end-user industry concentration: The spectrum of the aluminium industry in which the company operates is highly fragmented and competitive marked by presence of numerous small and unorganized players in India. Hence the players in the industry have limited pricing power and are exposed to competitive pressure on their profitability. This apart, its products, largely being of intermediary usage, are subject to the risks associated with the industry cyclicality and price volatility. Despite gradual diversification in product portfolio and end user industry, AIL's dependency on steel sector remained high. The steel sector contributed nearly 63% of its TOI during FY20, followed by automobile and power sectors which contributed 17% and 9% respectively.

Analytical approach: Standalone

Applicable Criteria
Criteria on assigning Outlook to Credit Ratings
CARE's Policy on Default Recognition
Criteria for Short Term Instruments
Liquidity analysis of non-financial sector entities
Rating Methodology - Manufacturing Companies
Rating Methodology – Non Ferrous Metals
Financial ratios - Non- Financial Sector

About the Company
Incorporated in 1992, Gujarat based AIL is promoted by Mr. Mahendra R. Shah. The company is engaged in manufacturing of aluminium products such as aluminium wire rod, aluminium deox, cored wire, aluminium alloy ingots, conductors & cables from aluminium scrap. AIL's manufacturing facility is located at Chhatral near Gandhinagar in Gujarat with installed capacity of 59,000 metric tonnes per annum (MTPA) as on March 31, 2020.
Brief financials of AIL are tabulated below:

Brief Financials (Rs. crore)	FY19 (A)	FY20 (A)
Total operating income	413.44	360.19
PBILDT	24.08	-3.99
Adjusted PBILDT#	24.08	20.90
PAT	6.56	-21.57
Overall gearing (times)	1.45	1.83
Interest coverage (times)	2.07	-ve

A: Audited; -ve: Negative; # excluding write-off of past receivables in FY20

Furthermore, during Q1FY21, AIL reported TOI of Rs.41.79 crore with PAT of Rs.0.05 crore as against TOI of Rs.95.91 crore and PAT of Rs.1.06 crore reported 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	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Fund-based - LT-Term Loan	-	-	October 2022	1.21	CARE BBB-; Negative
Fund-based-LT/ST	-	-	-	96.90	CARE BBB-; Negative / CARE A3
Non-fund-based - LT/ ST-Bank Guarantees	-	-	-	8.00	CARE BBB-; Negative / CARE A3

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-Term Loan	LT	1.21	CARE BBB-; Negative	-	1)CARE BBB; Stable (02-Jul-19) 2)CARE BBB; Stable (05-Jun-19)	1)CARE BBB+; Negative (22-Feb-19) 2)CARE BBB+; Stable (22-Jun-18)	-
2.	Fund-based-LT/ST	LT/ST	96.90	CARE BBB-; Negative / CARE A3	-	1)CARE BBB; Stable / CARE A3+ (02-Jul-19) 2)CARE BBB; Stable (05-Jun-19)	1)CARE BBB+; Negative (22-Feb-19) 2)CARE BBB+; Stable (22-Jun-18)	1)CARE BBB; Positive (16-Oct-17)
3.	Non-fund-based - LT/ ST-Bank Guarantees	LT/ST	8.00	CARE BBB-; Negative / CARE A3	-	1)CARE BBB; Stable / CARE A3+ (02-Jul-19) 2)CARE A3+ (05-Jun-19)	1)CARE A2 (22-Feb-19) 2)CARE A2 (22-Jun-18)	1)CARE A3+ (16-Oct-17)

Annexure-3: Complexity level of various instruments rated for this company

Sr. No.	Name of the Instrument	Complexity Level
1.	Fund-based - LT-Term Loan	Simple
2.	Fund-based-LT/ST	Simple
3.	Non-fund-based - LT/ ST-Bank Guarantees	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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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.

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