Sunflag Iron and Steel Company Limited

October 07, 2020

Ratings

Facilities	Amount (Rs. crore)	Rating[1]	Rating Action
Long term Bank Facilities	743.08 (reduced from 749.02)	**CARE A; Negative (Single A; Outlook: Negative)**	**Reaffirmed**
Long term /Short term Bank Facilities	348.10 (enhanced from 347.28)	**CARE A; Negative/CARE A1 (Single A; Outlook: Negative/A One)**	**Reaffirmed**
Total	**1091.18 (Rs. One thousand ninety one crore and eighteen lakh only)**		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The reaffirmation of ratings to the bank facilities of Sunflag Iron and Steel Company Limited (SISCL) factors in rich experience of promoters exhibiting long track record in steel industry, integrated manufacturing steel plant located strategically in central part of the country, tie ups for procurement of raw material in place, strong and large marketing network and selling arrangements. The rating action also takes into account, continued strong financial health marked by overall gearing below unity, above average debt coverage indicators and strong liquidity demonstrated by low utilization of bank lines.

The rating strengths are tempered by decline in Total Operating Income (TOI) on the back of fall in sales quantum of rolled steel products by 21% in FY20 (refers to the period April 01 to March 31) y-o-y, reduced operating profit per ton of sold quantity, elongated working capital cycle days, decline in operating Retun on Capital Employed (ROCE) at 10% in FY20 which is lowest in past five years, susceptibility to volatility in raw material prices and foreign exchange risk, delayed on-going capex increasing project execution risk and presence in steel industry characterized by inherent cyclicality & competition from unorganized players. The rating strengths are further, offset by impact on economy on account of covid-19 pandemic resulting in significant decline in TOI and operating profit in Q1FY21 along with net losses reported by the company during the quarter.

Going ahead with unlocks across the nation and gradual recovery of economy, CARE expects 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.

Outlook: Negative

The Negative outlook continues on account of weak financial performance of the company resulting in net losses in Q1FY21 and CARE Ratings' expectation that the total revenue and profitability of the company would still remain lower than pre-covid scenario on account of elongated impact of the pandemic on the economy. The company is yet to demonstrate improvement in its performance in line with gradual recovery in the economic activities of the nation. The outlook may be revised to 'Stable' if the company is able to significantly improve its profitability margins and debt coverage indicators while maintaining comfortable capital structure against the backdrop of ongoing debt fund capital expenditure and low reliance on working capital borrowings.

Rating Sensitivities:

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

- Growth in scale of operations by 20% with PBILDT margin improving to above 12%.

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

- Prolonged slowdown in the economy marked by ill effect of the pandemic covid-19 or sluggish market demand from end user auto sector resulting in weaker financial performance of SISCL.
- Further leveraging the books resulting in overall gearing above unity.
- Any deterioration in working capital management resulting in increase in working capital borrowings from the envisaged levels.
- Any time and cost overrun of 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 Mr. P. B. Bhardwaj and Mr. Ravi Bushan Bhardwaj (Chairman). The promoters have rich experience of over five

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

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 the integrated manufacturing facility located in the central part of India at Bhandara, Maharashtra & it is 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.
- ***Arrangements for procurement of raw material are in place:*** SISCL has diversified raw material procurement source where in raw materials are procured largely from the domestic markets. Iron ore and coke are procured mainly from domestic market. Around 35-50% of raw material is obtained from the top ten suppliers. Furthermore, at present nearly 60% of the power requirement is met through captive power plant (Thermal and waste heat energy gas plant) of 32MW annual capacity while balance 40% 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. SISCL receives orders on monthly basis and is able to bag repeat orders from its regular customers. 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%.
- ***Comfortable capital structure as on March 31, 2020 and likely moderation of the same in the near term:*** Capital structure of SISCL continued to remain comfortable with debt to equity and overall gearing below unity at 0.23x and 0.46x as on March 31, 2020 as against 0.09x and 0.49x respectively as on March 31, 2019. During the year, there was increase in term debt by Rs.128 crore to fund the on-going capex. However, on account of lower utilization of bank lines as at the end of fiscal FY20, increase in total debt was absorbed by increase in tangible net worth of the company hence the overall gearing improved as on March 31, 2020 compared to last account closing date.
  Debt coverage indicators remained above average as on end of fiscal FY20, yet weakened with total debt/GCA at 3.98x and term debt/GCA at 2.04x as against 3.03x and 0.55x during FY19 respectively on account of increase in term liabilities coupled with fall in GCA during FY20.
  However, expected moderation in profitability in the near term in the backdrop of on-going capital expenditure programmes (largely debt funded) is expected to result in weakening of the debt and interest coverage metrics.

Key Rating Weakness

- ***Decline in total operating income coupled with profit levels in FY20:*** During the fiscal FY20, the company witnessed decline in TOI by 19.41% to Rs.1770.14 crore from Rs. 2196.43 in FY19 on the back of fall in sales quantity of rolled products by 21% over previous year which are the key revenue drivers. The said decline was on account of sluggish market scenario of auto and auto ancillary companies, the end users for SISCL. Further, with increase in total operating cost per ton by 3% in FY20 over same period last fiscal, the PBILDT per ton fell by 6% in FY20 over FY19. Following the same, the PBILDT margin of the company declined marginally by 0.98 bps to 10.32% in FY20. PAT margin improved marginally by 0.19 bps to 5.23% largely due to lower tax liability for the year.
- ***Elongated working capital cycle days:*** SISCL has working capital cycle of 116 days in FY20 as against 101 days in FY19. Elongated operating cycle is mainly due to high inventory holding period of 131 days in FY20 as against 95 days in FY19 as the company stocks up raw materials well in advance to ensure continuous running of plant. The collection period stood comfortable at 51 days in FY20 as against 48 days in FY19 resulting in better management of working capital requirement. Receivables to the tune of Rs.222.30 crore outstanding as on March 31, 2020, have been realized in full as on August 31, 2020.
- ***Susceptibility to volatility in raw material prices and forex risk:*** Raw material consumption is the single largest cost component for SISCL (constituting about 73% of total costs in FY20 and 75% in FY19). 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.
- ***Delayed on-going capex enhancing project execution risk:*** SISCL undertook expansion projects in its Blooming mill unit and Steel melt Shop (SMS). 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. However, the on-going capex has been delayed on account of the imposed lockdown to contain Covid-19 therefore COD for the project is shifted by a year to September 2021. No cost overrun has been estimated as of now. As on August 31, 2020, the company has incurred 76% of the project cost with Super Alloy project more or less on track and is expected to commence operation by December 2020.

- ***Adverse impact on Q1FY21 performance on account of covid-19:*** As an effect of pandemic, the performance of the company has remained at all-time low for the quarter with total operating income of Rs.199.97 crore, PBILDT of Rs.8.02 crore, net loss of Rs.15.75 crore and GCA of Rs.1.30 crore. During Q1FY21, the company had sales only in the month of June 2020 for rolled products with average sales realization of Rs.68,000 to Rs.70,000 per ton (pre covid-Rs.62,619 per ton). The PBILDT margin of the company was at significant low at 4.01%
- ***Steel industry characterized by inherent cyclicality, competition from unorganized players and impact of cvoid-19 pandemic:*** CARE expects domestic steel demand to witness steady improvement on opening up of the economy. Demand for steel during the short to medium term period is likely to be supported by automobile and pipes manufacturing sector, improving infrastructure activity (including the railway and metro projects) along with the construction sector (road and bridges construction). However, demand recovery from the real estate sector is likely to take a longer time. Higher exports, improving realizations and lower raw material prices is likely to support the profitability margins of players grappling with contraction in domestic demand owing to the pandemic. The long-term prospects of the industry remain favorable with significant potential to increase the per capita steel consumption in India which stood at 74 KG as against world average of 229 KG in CY19 as per World Steel Association.

Liquidity: Strong- The company has strong liquidity position demonstrated by cash flow from operational activities which are expected to be nearly Rs.121.13 crore in FY21 against the debt repayment obligation of Rs.22.70 crore for FY21. Also the fund based working capital limits of the company have remained utilized nearly to 20% to 30% (sanctioned limit of Rs. 407.07 crore) as on August 31, 2020. Further, the company has unencumbered cash and bank balance of Rs.6.15 crore as on March 31, 2020. The company availed moratorium on its loan repayment obligations for a period of 6 months from March 2020 to August 2020 as part of the COVID -19 Regulatory Package announced by the RBI.

Analytical approach: Consolidated
CARE has analysed 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
Sunflag foundation	100.00
Associate & Joint Venture	
Madanpur (North) Coal Company Private Limited	11.73
Daido DMS India Private Limited	20.00
Ramesh Sunwire Private Limited	49.00
C T Mining Private Limited	31.80

However, except Sunflag Foundation, Daido DMS India Private Limited and Ramesh Sunwire Private Limited, all other entities are non-operating as on September 15, 2020

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
Rating Methodology - Manufacturing Companies
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) Mr. 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, 2020. 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)	FY19 (A)	FY20 (A)	Q1FY21 (Prov.)
Total operating income	2239.64	1769.66	199.97
PBILDT	247.92	182.17	8.02
PAT	110.28	92.07	(15.75)
Overall gearing (times)	0.49	0.46	--
Interest coverage (times)	6.40	4.27	1.25

A: Audited; Prov.: Provisional

Brief Financials (Standalone) (Rs. crore)	FY19 (A)	FY20 (A)	Q1FY21 (Prov.)
Total operating income	2196.43	1770.14	199.97
PBILDT	248.21	182.65	8.02
PAT	110.59	92.56	(15.75)
Overall gearing (times)	0.49	0.46	--
Interest coverage (times)	6.41	4.28	*1.25*

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	-	-	September 2026	336.01	CARE A; Negative
Fund-based - LT-Cash Credit	-	-	-	407.07	CARE A; Negative
Non-fund-based - LT/ ST-BG/LC	-	-	-	348.10	CARE A; Negative / CARE A1

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.	Commercial Paper-Commercial Paper (Carved out)	ST	-	-	-	-	1)Withdrawn (29-Mar-19)	1)CARE A1 (28-Dec-17)
2.	Fund-based - LT-Term Loan	LT	336.01	CARE A; Negative	-	1)CARE A; Negative (23-Mar-20) 2)CARE A; Negative (22-Aug-19) 3)CARE A; Stable (03-Apr-	-	1)CARE A; Stable (05-Mar-18)

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
						19)		
3.	Fund-based - LT-Cash Credit	LT	407.07	CARE A; Negative	-	1)CARE A; Negative (23-Mar-20) 2)CARE A; Negative (22-Aug-19) 3)CARE A; Stable (03-Apr-19)	-	1)CARE A; Stable (05-Mar-18)
4.	Non-fund-based - LT/ ST-BG/LC	LT/ST	348.10	CARE A; Negative / CARE A1	-	1)CARE A; Negative / CARE A1 (23-Mar-20) 2)CARE A; Negative / CARE A1 (22-Aug-19) 3)CARE A; Stable / CARE A1 (03-Apr-19)	-	1)CARE A; Stable / CARE A1 (05-Mar-18)

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.
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 9019/8879300881
Email ID- monika.goenka@careratings.com

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

About CARE Ratings:
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