

## Sunflag Iron and Steel Co. Limited

March 23, 2020

### Ratings

Facilities	Amount (Rs. crore)	Rating <sup>1</sup>	Rating Action
Long term Bank Facilities	749.02 (enhanced from 452.75)	<b>CARE A; Negative (Single A; Outlook: Negative)</b>	Reaffirmed
Long-term/Short-term Bank Facilities	347.28 (reduced from 348.10)	<b>CARE A; Negative / CARE A1 (Single A; Outlook: Negative/ A One)</b>	Reaffirmed
<b>Total Facilities</b>	<b>1096.30</b> <b>(Rupees One Thousand Ninety Six crore and Thirty Lakh only)</b>		

*Details of instruments/facilities in Annexure-1*

### Detailed Rationale & Key Rating Drivers

The reaffirmation of ratings to the long term and short term bank facilities of Sunflag Iron & Steel Co. Limited (SISCL) continues to derive strength from experienced promoters supported by team of qualified professionals, company's long established track record in manufacturing auto grade steel, robust marketing and selling arrangements in place, tie up with suppliers for procurement of raw material and approved vendor status from established client base.

The ratings take cognizance of improvement in profitability of the company for the past two quarters (refers to July 01 to Sep 30 & Oct 01 to Dec 31) subsequent to un-envisaged decline in profitability during Q4FY19 and Q1FY20 (refers to Jan 1 to Mar 31 & Apr 1 to June 30). The ratings also take note of company's comfortable capital structure and liquidity position as on December 31, 2019.

The rating strengths, however, are constrained by cyclicity inherent in the steel and end user auto industry, susceptibility of operating margins to fluctuations in raw material prices and changes in government regulations, working capital intensive nature of business and ongoing project risk.

### Rating Sensitivities

#### *Positive factors*

- Ability of the company to scale up operations as envisaged while improving its profitability with operating margin in the range of 12%-14% from current levels going forward on a sustained basis.
- Ability to derive benefits envisaged from the ongoing capex

#### *Negative factors*

- Prolonged slowdown in the end user auto sector
- Total debt to GCA exceeding the levels of 5-5.50 times
- 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

### **Outlook: Negative**

The Negative outlook continues to reflect CARE Ratings' expectation that the total revenue and profitability of the company to remain subdued and lower than FY19 on account of reduction in deliverables due to weak demand and ongoing slowdown in the end user auto industry witnessed in the 9MFY20 and also expected weakening in the debt coverage indicators in near term against the backdrop of ongoing debt funded capital expenditure programme. 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 and lower reliance on working capital borrowings.

<sup>1</sup>Complete definitions of the ratings assigned are available at [www.careratings.com](http://www.careratings.com) and in other CARE publications.

## Detailed description of the key rating drivers

### Key Rating Strengths

#### ***Experienced promoters and long track record in manufacturing auto grade alloy steel industry supported by a team of qualified professionals***

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 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.

#### ***Established marketing and selling arrangements in place***

SISCL has a robust marketing network across the country with presence in the major cities like Delhi, Ludhiana, Faridabad, Mumbai, Pune, Nagpur, Bangalore and Chennai. SISCL enjoys approved vendor status for a large group of Original Equipment Manufacturers (OEMs) and auto ancillaries, thereby bagging repeat orders from its customers on a regular basis. The top 10 customers contributed nearly 10% of revenue in FY19 reduced from 33% in FY18 mitigating customer concentration risk to a large extent.

#### ***Arrangements for procurement of raw material are in place albeit absence of any long term contracts continues***

The company has established long standing relationship with its suppliers domestically resulting in ease of availability of raw materials mainly iron ore/fines, coke, Ferro alloys etc. However, the entire requirement of thermal coal is normally met through the captive coal mine located at Belgaon (Maharashtra), which reduces costs to a certain extent.

#### ***Stable revenue and profitability margin during FY19, however, weakened during 9MFY20***

SISCL registered a marginal growth of around 5% in total operating income (TOI) to Rs.2239.64 crore in FY19 from Rs.2127.51 crore in FY18. Despite reduction in rolled products deliverables during FY19, the company was able to fetch better sales realization coupled with optimal capacity utilization of the rolling mill at nearly 95%. PBILDT margin was seen at 11.07% in FY19 as against 11.60% in FY18. PBILDT/ton was seen at nearly Rs.7000/ton during FY19 as against Rs.6500/ton in FY18. Interest costs increased to Rs.38.74 crore in FY19 as against Rs.35.49 crore in FY18, largely on account of increase in other borrowings costs such as Letter of credit (LC) opening charges. The company reported a PAT of Rs.110.28 crore in FY19 as against Rs.129.73 crore in FY18. PAT margin stood at 4.92% in FY19 as against 6.10% in FY18.

SISCL achieved a TOI of around Rs.1399 crore in 9MFY20 amidst the challenging environment of ongoing sluggishness in the auto sector as against ~Rs.1709 crore in 9MFY19. Slowdown in automotive industry and moderation in construction activities weakened steel demand during 9MFY20 resulted in below average deliverables during the period. As a result, company reported a PAT of Rs.48.03 crore in 9MFY20 (Unaudited) as against Rs.99.82 crore in 9MFY19 (Unaudited).

#### ***Comfortable capital structure and debt coverage indicators as on March 31, 2019 and likely moderation of the same in the near term***

With a strong net worth of Rs.941.60 crore as on March 31, 2019 (PY: Rs.839.42 crore), the company has been improving its capital structure through scheduled repayment of term debt and sales tax loan coupled with accretion of substantial profits to reserves. Capital structure of the company remained comfortable with debt to equity and overall gearing below unity as on March 31, 2019. While the debt to equity improved to 0.09x as on March 31, 2019 from 0.14x as on March 31, 2018; overall gearing (including acceptances on LCs) stood at 0.49x as on March 31, 2019 as against 0.44x as on March 31, 2018. Increase in gearing levels is on account of increase in acceptances on LCs which were seen at Rs.111.66 crore during FY19 as against Rs.29.94 crore in FY18. Moreover, SISCL continues to have comfortable debt coverage indicators yet weakened during FY19 with TDGCA at 3.06x as at March 31, 2019 as against 2.25x as at March 31, 2018. Interest coverage stood satisfactory at 6.40x in FY19 as against 6.96x in FY18.

However, expected moderation in profitability in the near term in the backdrop of ongoing capital expenditure programmes (largely debt funded) witnessed in the 9MFY20 financials, is expected to result in weakening of the debt and interest coverage metrics. Further, any large debt funded capital expenditure programme beyond envisaged levels which is expected to result in deterioration of capital structure would remain a key rating sensitivity.

### Key Rating Weaknesses

#### ***Cyclical nature inherent in the steel and auto industry***

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. SISCL

generates nearly 80-85% of revenue from auto sector which is also cyclical in nature. And with the ongoing slowdown in the auto sector, SISCL continues to remain exposed to the pricing pressure from large OEMs and major auto ancillary companies. However, SISCL's continues to focus on quality and development of newer grade steels & super alloy steels etc. to cater to automotive as well as non-automotive sectors coupled with diversification of customer base to Railways, Defense and Aerospace, is expected to derive better pricing in the market backed by long standing association with leading clientele.

#### ***Susceptibility to volatility in raw material prices***

Raw material consumption is the single largest cost component for SISCL (constituting about 77% of total costs in FY19 and FY18). The key raw materials used by the company are iron ore/iron ore fines; coke and coal/coal fines, Ferro alloys etc. Apart from coal, SISCL normally buys iron ore and coke from open market at prevailing rates and their prices fluctuate globally on a demand-supply basis which generally has a direct bearing on the profitability margins of the large and mid/small steel manufacturers. Therefore, lack of backward integration in the form of any captive operational iron ore or any long-term supply contracts with miners/ suppliers remains to be a challenge. Nevertheless, the prices of finished goods move in tandem with increase in raw material prices, however with a time lag.

#### ***Ongoing project risk***

SISCL planned and undertook expansion projects in its Blooming mill unit and Steel melt Shop (SMS). Expansion took up in its existing Blooming Mill to utilize the full capacity of the Mill together with installation of finishing facilities like Bright Bar Machines for value addition to the final products of Rolling Mill. The Company has also taken up the installation of certain Balancing Equipment to expand its existing Steel Melt Shop to produce high quality clean steel to expand its market base and diversify its products. Overall capital outlay for these projects was estimated at Rs.450 crore to be executed over a period of 2-3 years. The said capex is to be funded through a mix of debt and internal accruals (Debt: Equity = 70:30). As of December 31, 2019, the company had spent around Rs.230 crore which was largely funded through internal accruals (around Rs.140 crore) and remaining through term debt. The first phase is expected to be commissioned in early Q1FY21 and the second phase of expansion is expected to be commissioned by Q4FY21. Timely completion of the same with minimal cost overrun would be important. Further, any large debt funded capex deteriorating the capital structure would be a key rating monitorable.

#### ***Working capital intensive nature of business***

Working capital cycle of the company during FY19 remained similar in line with FY18 days of around 97 days. Elongated operating cycle is mainly due to high inventory holding period of 91 days in FY19 as against 82 days in FY18. Accordingly, SISCL manages its working capital requirements through comfortable terms with creditors, LC backed orders and further conversion of the receivables through bill discounting facilities. The collection period stood comfortable at 47 days in FY19 (47 days in FY18) resulting in better management of working capital requirement.

#### ***Industry outlook***

Around 4% of growth in Steel production is expected for FY20 which appears achievable on the back of some pick up in prices which has happened from Mid-November and expectation of higher demand in Q4 largely on the back of push in infrastructure activities and expectation of improvement in demand from automobiles and white goods industry.

#### ***Liquidity-Adequate***

Liquidity of SISCL is characterized by sufficient cushion in accruals vis-à-vis repayment obligations. Gross cash accrual (GCA) is expected to be in the range of Rs.100 crore-Rs.107 crore against the repayment obligations of nearly Rs.34 crore for FY20. However, going forward, with the ongoing debt funded capex, the repayment obligations are expected to be in the range of Rs.50 crore-Rs.60 crore at least for the next three years against which SISCL is expected to generate adequate cash accruals. Furthermore, the company had a cash and bank balance of ~Rs.62 crore as on September 30, 2019, out of which ~Rs.12 crore is free cash balance and other liquid investments while rest is earmarked as margin money. Average CC utilization (of the total sanctioned limit of Rs.407 crore) for the 12 months ended January 31, 2020 stood at around 44%. These unutilized bank lines provide additional liquidity cushion for the growing business needs. In addition to the above, the promoters have been extending need based support in the form of unsecured loans.

#### **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.

<b>Subsidiary</b>	<b>% of shareholding</b>
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 yet to commence the business operations as on March 31, 2019.

#### 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](#)

[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 March 31, 2019. 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 (Rs. crore)- Consolidated	FY18 (A)	FY19 (A)	9MFY19(UA)	9MFY20(UA)
Total operating income	2127.51	2239.64	1709.44	1399.60
PBILDT	246.86	247.92	212.88	129.96
PAT	129.73	110.28	99.82	48.03
Overall gearing (times)*	0.44	0.49	NA	0.37
Interest coverage (times)	6.96	6.40	7.59	4.09

A: Audited; UA: Unaudited; NA: Not Available

\*Adjusted for acceptances on LCs

Brief Financials (Rs. crore)- Standalone	FY18 (A)	FY19 (A)	9MFY19(UA)	9MFY20(UA)
Total operating income	2127.57	2239.92	1709.40	1399.56
PBILDT	245.85	248.21	212.85	129.92
PAT	128.67	110.59	100.23	48.65
Overall gearing (times)*	0.44	0.49	NA	0.37
Interest coverage (times)	6.93	6.41	7.59	4.09

A: Audited; UA: Unaudited; NA: Not Available

\*Adjusted for acceptances on LCs

**Status of non-cooperation with previous CRA:** None

**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	-	-	2026	342.09	CARE A; Negative
Fund-based - LT-Cash Credit	-	-	-	406.93	CARE A; Negative
Non-fund-based - LT/ ST-BG/LC	-	-	-	347.28	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 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017
1.	Term Loan-Long Term	LT	208.39	Suspended	-	-	-	1)Suspended (12-Apr-16)
2.	Non-fund-based-Short Term	ST	325.00	Suspended	-	-	-	1)Suspended (12-Apr-16)
3.	Fund-based-LT/ST	LT/ST	410.00	Suspended	-	-	-	1)Suspended (12-Apr-16)
4.	Commercial Paper-Commercial Paper (Carved out)	ST	-	-	-	1)Withdrawn (29-Mar-19)	1)CARE A1 (28-Dec-17)	-
5.	Fund-based - LT-Term Loan	LT	342.09	CARE A; Negative	1)CARE A; Negative (22-Aug-19) 2)CARE A; Stable (03-Apr-19)	-	1)CARE A; Stable (05-Mar-18)	-
6.	Fund-based - LT-Cash Credit	LT	406.93	CARE A; Negative	1)CARE A; Negative (22-Aug-19) 2)CARE A; Stable (03-Apr-19)	-	1)CARE A; Stable (05-Mar-18)	-
7.	Non-fund-based - LT/ ST-BG/LC	LT/ST	347.28	CARE A; Negative / CARE A1	1)CARE A; Negative / CARE A1 (22-Aug-19) 2)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
<b>A. Financial covenants</b>	
I. Adverse deviation in any of the following two ratios :	Adverse deviation above 10% , 50 bps penal interest



<ul style="list-style-type: none"> <li>Fixed Asset Coverage Ratio not less than 3.15%</li> <li>Total Debt to Tangible Net Worth not exceed 1.70x</li> <li>Interest Coverage Ratio not less than 5.90x</li> <li>Debt Service Coverage Ratio not less than 1.63x</li> </ul>	
<b>B. Non-financial covenants</b>	
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 20 <sup>th</sup> 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	

**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](http://www.careratings.com). Investors/market intermediaries/regulators or others are welcome to write to [care@careratings.com](mailto:care@careratings.com) for any clarifications.

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