Sunflag Iron and Steel Co. Limited

August 22, 2019

Ratings

Facilities	Amount (Rs. crore)	Rating[1]	Rating Action
Long-term Bank Facilities	452.75	**CARE A; Negative (Single A; Outlook: Negative)**	**Reaffirmed and outlook revised from stable**
Long-term/Short-term Bank Facilities	348.10	**CARE A; Negative /CARE A1 (Single A; Outlook: Negative/ A One)**	**Reaffirmed and outlook revised from stable**
Total facilities	**800.85 (Rs.Eight Hundred crore and Eighty Five 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 & Steel Co. Limited (SISCL) continues to derive strength from experienced promoter with long track record in alloy steel manufacturing industry supported by team of qualified professionals, tie up with suppliers for procurement of raw material and an established client base with approved vendor status and SISCL's comfortable capital structure The rating strengths, however, are constrained by moderation in total income and profitability owing to slow down in major end user industries such as automobile/ auto ancillary, susceptibility of operating margins to fluctuations in raw material prices and changes in government regulations, inherent cyclicality in the steel industry and working capital intensive nature of business, and ongoing project risk.

Going forward, the ability of the company to achieve envisaged scale of operations and profitability and manage working capital requirement efficiently shall be the key rating sensitivities. The ability to successfully complete the on-going capex without any cost or time overruns and reaping benefits from the same are the key rating sensitivities.

Also, any further sizeable increase in working capital borrowings and term debt, leading to an increase in the overall debt levels will remain a key rating monitorable.

Outlook: Negative

The revision in the outlook to 'Negative' from 'Stable' takes into account un-envisaged deterioration in profitability and consequent moderation in the debt coverage indicators for the last two successive quarters (refers to Jan 1 to Mar 31 & Apr 1 to June 30).

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 low reliance on working capital borrowings against the backdrop of ongoing capital expenditure programme.

Detailed description of the key rating drivers

Key Rating Strengths

Experienced promoters with long track record in alloy steel manufacturing 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 professionals from varied business background and qualifications.

Tie up with suppliers for procurement of raw material albeit absence of long term contracts

The company has established long standing relationship with its' suppliers resulting in ease of availability of raw materials mainly iron ore/fines, coke, ferro alloys etc. The requirement of thermal coal is met entirely from the captive coal mine located at Belgaon, Warora dist., Chandrapur, Maharashtra. Further, other major raw materials like iron ore/fines and coke is procured from domestic market. Furthermore, the requirement of sinter for blast furnace is met in house from semi integrated manufacturing facility.

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

Stable Total Operating Income and profitability margin during FY19, however, deterioration in financial risk profile during Q1FY20

SISCL reported marginal improvement in total operating income by ~5% to Rs.2240.67 crore in FY19 as against Rs.2127.51 crore in FY18. The PBILDT margin declined marginally stood at 11.11% during FY19 (PY: 11.60%) largely on account of increase in raw material and power costs. PAT margin declined and stood at 4.92% in FY19 (PY: 6.05%).
During Q1FY20, SISCL registered a TOI of Rs.489.01 crore as against Rs.558.93 crore in Q1FY19. The company reported a PAT of Rs.3.93 crore in Q1FY20 as against Rs.40.61 crore in Q1FY19.

Marketing and selling arrangements in place

The company has a strong and large marketing network across the country with its presence in all the major cities namely, Faridabad, Chennai, Pune, Mumbai, Nagpur, Delhi and Bangalore in India. SISCL is an approved source for supplies to Original Equipment Manufacturers (OEMs) of various Auto Makers and therefore able to get orders on a regular basis. The top ten customers of the company account approximately 33% of the net sales OEMs who in-turn are vendors to auto majors viz. Tata Motors Limited, Maruti Suzuki Limited, Bajaj Auto Limited and Mahindra & Mahindra Limited etc.

Comfortable capital structure and debt protection metrics

Capital structure of SISCL remained comfortable with debt to equity and overall gearing below unity as on March 31, 2019. While the debt to equity was at 0.10x as on March 31, 2019 (against 0.14x as on March 31, 2018); overall gearing was at 0.36x as on March 31,2019 (as against 0.44x as on March 31, 2018). The leverage position of the company has been improved y-o-y on account of scheduled repayment of debt obligations coupled with accretion of profits to reserves. Further, SISCL has comfortable debt coverage indicators with Total debt/GCA at 2.29x in FY19 (2.25x in FY18) and interest coverage of 6.43x in FY19 as against 6.93x in FY18. The interest coverage was seen at 2.59x in Q1FY20 (9.10x in Q1FY19)

Liquidity-*Adequate*

SISCL had elongated working capital cycle of around 95 days in FY19, similar to that in in FY18. Elongated operating cycle is mainly due to high inventory holding period of 89 days in FY19 as against 82 days in FY18. However the company has comfortable collection period of 47 days in FY19 which was similar in line with FY18 resulting in better management of working capital requirement.
The average working capital utilization of the company remained low at ~45-50%. The company has cash and bank balance of ~Rs.57 crore as on March 31, 2019 (as against Rs.76.73 crore as on March 31, 2017), out of which ~Rs.12 crore is free cash balance and other liquid investments while rest is earmarked as margin money.

Key Rating Weaknesses

Exposure to volatility in raw material prices

Raw material consumption is the single largest cost component for SISCL (constituting about ~60-66 % of TOI in FY19). The company mainly needs to purchase iron ore and coke from the market. Any adverse movement in the raw material price without corresponding movement in finished good price might affect the performance of the company. Though the prices of finished goods move in tandem with raw material prices, there is a time lag.

Cyclicality inherent in the steel industry**:** Steel is a highly capital intensive industry which is cyclical in nature. Its growth is intertwined with the growth of the economy at large and, in particular, the steel user industries such as automobile, housing, infrastructure and others.

Ongoing project risk**:**

With a view to utilize the full potential of rolling mill at Blooming mill, the company has undertaken expansion of this unit to produce Rolled products demanding a higher degree of reduction ratio from bigger size blooms as far as possible by rolling with a single heating and thus reducing energy, cost and scale loss and inventory of intermediate products. Also, the company is expanding its existing Steel Melt shop to produce high quality clean steel. This will enable the company to diversify its products. Overall capital outlay for these projects is estimated at approximately ~Rs.450 crore and shall be executed over a period of FY19-FY23.
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.

Industry outlook

Finished steel production growth is likely to decelerate to 3%-4% during the year FY20 on a y-o-y basis. The steel demand is expected to accelerate after the completion of monsoon season as construction activities will see a pickup in pace. India's steel consumption is expected to grow by 5%-6% on the back of government's expenditure towards infrastructure and construction. With the same government coming to power, the focus will continue to remain on infrastructure development in the country. An uptick in construction activities post monsoon season will result in higher steel demand which, in turn, is expected to bring some relief to long steel products' prices on m-o-m basis. Also, likely recovery in automotive industry during H2FY20 is expected to provide some support to the flat steel products' prices sequentially.

Analytical approach: Consolidated. CARE has analyzed SISCL's credit profile by considering the financial statements of its subsidiaries (Sunflag Power Limited, Khappa Coal Company Limited) and associates & Joint ventures (Daido DMS India Private Limited, Madanpur North Coal Company Private Limited, CT Mining Private Limited and Ramesh Sunwire Private Limited) for the year ended March 31, 2019 apart from financials of SISCL.

Applicable Criteria:
Criteria on assigning Outlook to Credit Ratings
CARE's Policy on Default Recognition
Criteria for Short Term Instruments
Financial ratios – Non-Financial Sector
Factoring Linkages in Ratings
Rating Methodology-Steel Companies
Rating Methodology-Manufacturing Companies

About the Company
Incorporated in 1984, Sunflag Iron & Steel Co. Limited (SISCL) is the flagship company of the Nagpur (Maharashtra) based Sun Flag Group, promoted by Bharadwaj brother i.e. *Late* Mr. P B. Bharadwaj and Mr. Ravi Bhusan 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 SISCL has collaboration with Daido Steel Co. Ltd., Japan from 2010. The association is useful for process & Quality enhancements, new grade developments, localization of Indian steel by the automobile companies, continual improvements, etc. The company has a semi integrated steel manufacturing facility located at Warthi, Bhanddara Road, Maharashtra with 32 MW captive power plant based on thermal and waste heat recovery.
SISCL captures the demand mainly from automobile segment for steel used in engine, drives, transmissions, suspensions etc. This apart, SISCL also supplies steel to Indian Railways, Ordnance factories, General Engineering & Power Sectors. SISCL is catering the requirement of steel in domestic as well as foreign market.

Brief Financials (consolidated) (Rs.crore)	FY18 (A)	FY19 (A)	Q1FY19 (UA)	Q1FY20 (UA)
Total operating income	2127.57	2240.67	558.93	489.01
PBILDT	245.85	248.95	82.35	27.90
PAT	128.67	110.28	40.61	3.93
Overall gearing (times)	0.44	0.36#	NA	NA
Interest coverage (times)	6.93	6.43	9.10	2.59

A: Audited; NA: not available; FY19 Annual Report not available; financials for FY19 are as per results submitted to the stock exchange; UA: unaudited

Brief Financials (Standalone) (Rs.crore)	FY18 (A)	FY19 (A)	Q1FY19 (UA)	Q1FY20 (UA)
Total operating income	2127.57	2240.61	558.91	488.99
PBILDT	245.85	248.90	82.33	27.88
PAT	128.67	110.59	40.62	4.09
Overall gearing (times)	0.44	0.36#	NA	NA
Interest coverage (times)	6.93	6.43	9.10	2.59

A: Audited; NA: not available; FY19 Annual Report not available; financials for FY19 are as per results submitted to the stock exchange; UA: unaudited
#Current portion of long term debt has not been considered, as the same is not available separately

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	-	-	December 2020	45.68	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 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	45.68	CARE A; Negative	1)CARE A; Stable (03-Apr-19)	-	1)CARE A; Stable (05-Mar-18)	-
6.	Fund-based - LT-Cash Credit	LT	407.07	CARE A; Negative	1)CARE A; Stable (03-Apr-19)	-	1)CARE A; Stable (05-Mar-18)	-
7.	Non-fund-based - LT/ ST-BG/LC	LT/ST	348.10	CARE A; Negative / CARE A1	1)CARE A; Stable / CARE A1 (03-Apr-19)	-	1)CARE A; Stable / CARE A1 (05-Mar-18)	-

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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