

July 22, 2022

VRKP Sponge and Power Plant LLP: [ICRA]BBB (Stable)/ [ICRA]A3+; assigned

Summary of rating action

Instrument*	Current Rated Amount (Rs. crore)	Rating Action
Cash Credit	40.00	[ICRA]BBB (Stable)/ [ICRA]A3+; assigned
Total	40.00	

*Instrument details are provided in Annexure-1

Rationale

The assigned ratings favourably factor in the extensive experience of the promoters and management of VRKP Sponge and Power Plant LLP (VRKP/firm) in the steel industry. ICRA notes that the company's operating profile benefits from the high capacity utilisation levels as well as its moderately integrated nature of operations, supported by captive power generation, sponge iron, billet and TMT bar manufacturing capacities, which in turn lead to an efficient cost structure. The steel industry witnessed a sharp rebound since H2 FY2021, which supported the overall earnings. That said, ICRA believes that earnings are likely to moderate in the current fiscal as elevated coal/ energy costs, steel price corrections following the levy of export duty on steel products and muted domestic demand so far nibbles at profit margins. In FY2021 and FY2022, VRKP channelised its free cash flows to pare down debt levels, leading to comfortable credit metrics, as indicated by a low gearing of 0.5 times as on March 31, 2022 and total debt to OPBDITA¹ of 1.3 times in FY2022. Also, VRKP demonstrated prudent working capital management with tight control over its receivables along with a high inventory turnover. This coupled with a sufficient headroom in undrawn working capital limits supported its liquidity position.

The ratings, are, however, constrained by the firm's exposure to the inherent cyclicity in the steel industry, leading to volatility in revenue and profitability indicators. ICRA observes that despite the commodity price rally, which lifted the profits of most steel companies to all-time high levels in FY2022, VRKP's profits during the last year remained weaker than the high watermark of FY2019. Additionally, the company faces increased competitive intensity in the commoditised semis /TMT bar segment, which accentuates margin volatility. VRKP remains exposed to geographical concentration risks as well, given its high dependence on the southern region. Nevertheless, its established and reputed customer base mitigates such risk to an extent. The ratings also reflect VRKP's modest scale of operations, making the company vulnerable to a prolonged industry downtime. Besides, the firm's status as a limited liability partnership exposes it to the risk of capital withdrawals. ICRA understands that the Group has sizeable expansion plans over the medium term, and any large capital withdrawal from VRKP to part-fund the same would remain a key rating monitorable.

The Stable outlook on the long-term rating reflects ICRA's opinion that the company will continue to benefit from the promoter's demonstrated track record in the steel business and the firm's integrated nature of operation. ICRA believes that the financial risk profile would remain comfortable, supported by low external borrowings and adequate liquidity.

¹ Operating Profit Before Depreciation, Interest, Taxes and Amortisation

Key rating drivers and their description

Credit strengths

Extensive experience of promoters in the steel business – VRKP, promoted by Mr. Vinod Kumar Agarwal, was incorporated in 2015. Mr. Agarwal has more than three decades of experience in the iron and steel industry and has established the firm as a leading TMT bar manufacturer in Karnataka, supported by a wide network of distributors.

Optimal capacity utilisation – VRKP operated the sponge iron and billet capacities beyond the nameplate utilisation levels in FY2022. Additionally, the TMT bar mill operated at a healthy capacity utilisation level of 93% in FY2022. VRKP's optimum capacity utilisation levels led to a low operating leverage, in turn supporting the overall earnings.

Backward integration into manufacturing sponge iron, billets and captive power generation supports cost competitiveness – VRKP has manufacturing facilities for sponge iron, which along with scrap serves as a feedstock for manufacturing MS billets. It further manufactures TMT bars using mostly in-house produced MS billets, which gives VRKP a cost advantage over other secondary steel producers, which are dependent on sourcing costlier inputs from the market. Additionally, VRKP has a 22-MW captive power generation plant run partly on waste gases and dolochar generated during manufacturing sponge iron, which decrease its dependence on costlier grid power.

Comfortable financial risk profile – The firm has external borrowings comprising auto loans and term loans of Rs. 0.86 crore and Rs. 1.38 crore, respectively and cash credit facility of Rs. 24.04 crore outstanding as on March 31, 2022. Low external debt levels and steadily rising net worth, aided by healthy accruals over the years, resulted in a comfortable capital structure with a consolidated gearing and TOL/TNW² of 0.5 times and 0.7 times, respectively as on March 31, 2022. Additionally, the firm's interest cover remained at a comfortable 4.1 times in FY2022.

Credit challenges

Intense competition and susceptibility of profitability to volatility in raw material and product prices – The firm is in the commoditised TMT bar, MS billets and sponge iron businesses. Intense competition in the secondary steel sector limits the pricing flexibility of the players, including VRKP. As raw material costs play a crucial role in profitability, the margins remain susceptible to a large increase in raw material prices, which may not be matched with a commensurate increase in realisation of products sold. Going forward, with falling steel realisation and elevated thermal coal prices following Russia-Ukraine war, the cash flows of the steel players are likely to be impacted.

Modest scale of operations makes the company vulnerable to a prolonged industry downturn – The firm's scale of operations remains modest, which makes it vulnerable to a prolonged period of industry downturn.

Geographical concentration risk – The firm's operations are mainly concentrated in the southern region, exposing it to the geographical concentration risk. A slowdown in steel demand in its key addressable markets in the southern region could lead to an overall decline in its revenues and profits in the future.

Risk of capital withdrawal by the partners, which could adversely impact capital structure and leverage metrics – Given VRKP's constitution as an LLP, it is exposed to discrete risks, including the possibility of capital withdrawal by the partners (as experienced in the past), which could adversely impact VRKP's capital structure and leverage metrics.

² Total Outside Liabilities/ Tangible Net Worth

Liquidity position: Adequate

VRKP's liquidity position is adequate, supported by healthy cash flows from operations and limited scheduled annual repayments. Moreover, limited capex plans led to positive free cash flows between FY2020 and FY2022. ICRA expects the firm to report positive free cash flows in FY2023 as well. The liquidity profile is further supported by unutilised fund-based limits of Rs. 15.9 crore as of March 2022. Utilisation of fund-based limits remained at a moderate level (average of 54% over the last 12 months) owing to the firm's prudent working capital management practices.

Rating sensitivities

Positive factors – The ratings could be upgraded if the company is able to report a sustained period of healthy earnings, leading to an improvement in liquidity while maintaining comfortable credit metrics.

Negative factors – The ratings could be downgraded in case of a significant decline in VRKP's profitability, which adversely impacts its credit metrics and liquidity position. Further, any large debt-funded capex or acquisition could also lead to ratings downgrade. Specific metric for ratings downgrade include an interest cover of less than 3.0 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Ferrous Metals Entities
Parent/Group Support	Not Applicable
Consolidation/Standalone	Standalone financial statement of the issuer

About the company

VRKP Sponge and Power Plant LLP (VRKP), incorporated in 2015 by Bangalore-based Mr. Vinod Kumar Agarwal, manufactures sponge iron, MS Billets, TMT bars and captive power generation besides trading in various steel products in relatively limited quantities. The manufacturing facilities are located at Bellary, Karnataka. The entity has an installed manufacturing capacity of 90,000 metric tonnes per annum (MTPA) sponge iron plant, 96,000-MTPA MS Billets plant, and 72,000-MTPA TMT bars plant. The entity has a 22-MW captive power plant as well.

Key financial indicators

VRKP (Standalone)	FY2020 (Audited)	FY2021 (Audited)	FY2022 (Provisional)
Operating Income (Rs. crore)	340.1	371.2	633.1
PAT (Rs. crore)	4.9	4.0	14.1
OPBDIT/OI (%)	8.8%	7.4%	4.8%
PAT/OI (%)	1.4%	1.1%	2.2%
Total Outside Liabilities/Tangible Net Worth (times)	2.5	1.2	0.8
Total Debt/OPBDIT (times)	2.6	1.8	1.3
Interest Coverage (times)	3.9	4.3	4.1

Source: VRKP Audited/ Provisional Financials; PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2023)				Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding as on Mar 31, 2022 (Rs. crore)	Date & Rating on 22-Jul-2022	Date & Rating in FY2022	Date & Rating in FY2021	Date & Rating in FY2020
1	Cash Credit	Long Term/ Short Term	40.00	22.28	[ICRA]BBB (Stable)/ [ICRA]A3+	NA	NA	NA

Source: Company data

Complexity level of the rated instruments

Instrument	Complexity Indicator
Cash Credit	Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analyzing an entity's financial, business, industry risks or complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments, is available on ICRA's website: www.icra.in

Annexure-1: Instrument details

ISIN No/Banker Name	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (RS Crore)	Current Rating and Outlook
NA	Cash Credit	NA	NA	NA	40.00	[ICRA]BBB (Stable)/ [ICRA]A3+

Source: Company

[Please click here to view details of lender-wise facilities rated by ICRA](#)

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Not Applicable		

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Branches



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