October 31, 2022

Shyam Century Ferrous Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long Term-Fund Based-Working Capital	30.00	28.00	[ICRA]BBB+ (Stable); reaffirmed
Short Term Non-Fund Based	4.00	6.00	[ICRA]A2+; reaffirmed
Total	**34.00**	**34.00**	

**Instrument details are provided in Annexure-I*

Rationale

The rating reaffirmation for Shyam Century Ferrous Limited (SCFL) favorably takes into account the company's improved financial performance in FY2022, led by rising ferro-silicon prices that have significantly improved the turnover and profitability margins in FY2022. The steel industry witnessed a sharp rebound last fiscal, in turn benefitting ferrosilicon producers. ICRA notes that the overall operating income of the company increased by 62% in FY2022 vis-a-vis FY2021, whereas the OPBIDTA[1] rose by 272% in FY2022 vis-a-vis FY2021. The operating margins grew to ~35.7% in FY2022 from 10.3% in FY2021 due to the uptick in realisations. The credit metrics remain healthy, indicated by its net debt-free status as on March 31, 2022, interest coverage of 117.1 times and total debt to OPBITDA of 0.01 times in FY2022. SCFL's liquidity profile remains strong, supported by a significant headroom available in the form of undrawn limits of working capital and sizeable cash and liquid investments. The significant improvement in profits last fiscal has aided SCFL to generate healthy free cash flows, which in turn has strengthen its balance sheet liquidity. The rating also factors in the financial flexibility enjoyed by SCFL backed by a strong liquidity, and this has helped the company to raise funds at competitive interest rates. Further, the availability of power from the state discom at an attractive tariff supports the company's cost competitiveness. While ferrosilicon prices have moderated in the current fiscal due to the global slowdown post the Russia-Ukraine conflict, the operationalisation of a third furnace from July, 2022 would increase the production by 15%-20%. Higher production/ sales volumes going forward is expected to partly cushion SCFL's earnings due lower product spreads. The rating action also notes SCFL's demonstrated ability to report net profits across business cycles in a market that is prone to volatility in demand and prices, which reflects its ability to withstand market downturns.

The rating, is, however, constrained due to the company's exposure to the inherent cyclicality of the steel industry leading to volatility in the revenue and profitability indicators. Additionally, the increased competitive intensity accentuates the margin volatility faced by the company. SCFL's scale of operations remain small, which makes the company vulnerable to a period of sustained industry downturn. ICRA also notes that many industries based out of Meghalaya, including SCFL remains exposed to regulatory risks as any unfavorable change in the Government policy may impact its raw material availability, especially for coke and coal. Suboptimal capacity utilization levels (50-70%) and captive power plant of SCFL , which has been idle, (due to bottlenecks in coal availability in Meghalaya) has constrained return on capital indicators. Also, the steadily deteriorating coke quality is leading to increasing input costs and adversely impacting the company's margins. The ratings are also tempered by the company high customer concentration risk. Nevertheless, its established and reputed customer base, and the policy of supplying against payment security mitigates the counterparty credit risks to a large extent.

The Stable outlook on the long-term rating is supported by the healthy domestic steel demand, prudent working capital management, and the comfortable credit metrics of the company.

[1]*OPBIDTA: Operating profit before depreciation, interest, taxes and amortisation*

Key rating drivers and their description

Credit strengths

Significant improvement in turnover and profitability margins in FY2022- The company had a significant improvement in its turnover as well as profitability margins in FY2022. While the company's operating income (OI) increased from Rs 127.6 crore in FY2021 to Rs 207.4 crore in FY2022, the operating margins improved from 10.3% in FY2021 to 35.7% in FY2022 on the back of buoyant realisations of ferrosilicon. The net profits of the company have also improved to Rs. 56.86 crores in FY2022 from Rs. 2.8 crores in FY2021. It clocked a return on capital employed (RoCE) clocked was around 41% in FY2022 vis-s-vis 9% in FY2021, backed by significant rise in ferrosilicon prices.

Operationalization of the third furnace towards the end of Q1 FY2023 is expected to lead to higher production /sales - The company currently has an installed capacity of 21,600 MTPA of Ferro silicon. It has three furnaces of which two furnaces were in operation till FY2022 and the company has started operating the third furnace from July, 2022 after the repair and maintenance work. In Q1 FY2023 the company has already sold around 2,337 MT of Ferro Silicon and is expecting a total production of 16,000 MT in FY2023, supported by the relighting of the third furnace. With demand picking up pace, the additional volumes from the third furnace is expected to partly cushion SCFL's earnings due lower product spreads in the current fiscal. The overall capacity utilizationis therefore expected to improve from 69% in FY2022 to 74% in FY2023 due to the operation of the third furnace.

Availability of power from the state discom at attractive tariff supports cost competitiveness– The company is currently able to procure power at a favorable rate of ~Rs 4.9 per unit from Meghalaya Power Distribution Corporation Limited, and this is lower than the company's cost of generation from captive power plant. ICRA notes that with power accounts for ~45% of SCFL's cost of production, access to power at an affordable tariff remains a source of competitiveness. ICRA observes that the company's power tariff for FY2023 has been marginally revised upwards by Rs. 0.2/unit over FY2022 and this is expected to keep its operating cost under check in the current fiscal. However, any sharp rise in power tariff in FY2024 and beyond would be a key credit monitorable.

Comfortable capital structure and debt coverage indicators – The significant improvement in profits last fiscal has led to a comfortable financial risk profile, characterized by healthy TOL/TNW of 0.1 times as on March 31, 2022. This apart, the other coverage indicators stood healthy with Total Debt/OPBDITA of 0.03 times and interest coverage of 180.1 times in FY2022.

Strong liquidity profile and high financial flexibility – The company's liquidity is strong supported by significant headroom in undrawn working capital limits and sizeable cash and liquid investments. As on March 31, 2022 ,the company has undrawn working capital facilities of ~Rs 29.94 crore as well as cash and liquid investments to the tune of ~Rs 86.6 crore. The company has announced a buyback amounting to Rs. 28 crore, which is expected to be comfortably funded from the internal reserves. A strong liquidity also imparts a financial flexibility to SCFL, as demonstrated by its ability to raise funds at competitive interest rates.

Favourable demand outlook for the steel industry – The outlook for the steel sector was revised to stable from positive due to the elevated input cost pressures along with steel price corrections following the imposition of export duty. Consequently, ICRA has revised the industry's operating profit estimate downwards by 30% over the earlier forecasts made before the Russia-Ukraine conflict. However, backed by the Government's infrastructure capex plans, domestic steel demand is expected to grow at a healthy 7-8% in FY2023, which should support the adequate capacity levels of domestic steel mills.

Credit challenges

Exposure to regulatory risks associated with raw material availability and steadily deteriorating coke quality – ICRA notes that many Meghalaya based industries, including SCFL ,are exposed to regulatory risks as any unfavorable change in Government policy may impact their raw material availability, especially coke and coal. In the past, ICRA notes that coal/ coke consumers in Meghalaya have encountered operational challenges associated with the banning of coal mining and restrictions on coal movement in the state. SCFL sources coke locally from Meghalaya based suppliers, and any adverse ruling which adversely impacts coke availability in Meghalaya could lead to input cost pressures for Meghalaya-based coke consumers, including SCFL. Moreover, it is seen that SCFL's specific consumption of coke has been steadily increasing in the last few years, which indicates deteriorating quality. With coke accounting for ~29% of the overall cost of producing ferrosilicon, this deterioration in coke quality has led to an overall escalation in input costs for SCFL.

Small scale of operations– The company's scale of operations is modest, evident from a turnover in the range of Rs 87 crore to Rs 133 crore between FY2017 and FY2021. A small scale makes SCFL vulnerable to a period of sustained industry downturn. The turnover improved to Rs. 207.4 crores, backed by the hike in the prices on the back of rising global steel prices. SCFL's modest scale is also a function of its moderate capacity utilisation over the last five years, ranging between 51% and 70%, but the same is expected to improve to 75% with the operationalization of third furnace from July 2022.

Captive power plant remains unutilized from FY2020 due to bottlenecks in coal availability in Meghalaya – The company is unable to utilize its 14-MW captive power plant under Meghalaya Power Limited(MPL) due constraints faced in respect of availability of coal in the Meghalaya region after the ban of coal movement in Meghalaya from FY2020. However, if adeqaute coal at a competitive rate is made available, then the company would be able to operate the plant and will become largely self-sufficient in its power requirements at current capacity utilization levels.

Customer concentration risk - SCFL is exposed to customer concentration risk as ~78% of its total sale in FY2022 was contributed by its top ten customers. Therefore, any disruption in the operations of the key clientele will adversely impact the company's revenues. Nevertheless, its established and reputed customer base, and policy of supplying against payment security mitigates counterparty credit risks to a large extent.

Significant volatility in earnings given the cyclical nature of steel industry, the key end-user for ferrosilicon– The steel industry is cyclical in nature, which is likely to result in volatile cash flows for ferroalloy players, including SCFL. Nevertheless, the company's efficient cost structure emanating from its access to power at an attractive tariff partly reduces the susceptibility of its profitability to downturns in the steel industry.

Liquidity position: Strong

SCFL's liquidity position is **strong** with healthy cash flows and sufficient undrawn limits. The average monthly utilisation of the fund-based working capital limits stood moderate at 0.34% of its sanctioned limits during April 2021 to May 2022. The free cash flows were positive in FY2022, and ICRA expects free cash flows to remain positive in FY2023 as well. The company has minimal debt service obligations going forward, which strengthens the liquidity position. In addition, the free cash balance and liquid investments stood at Rs. 86.6 crores as on March 31, 2022, which can comfortably take care of the ongoing buyback accumulating to Rs. 28 crore.

Rating sensitivities

Positive Factors – The company's ability to gradually ramp up the operations of the third furnace while maintaining healthy profit margins and liquidity profile will be a positive rating trigger.

Negative Factors – Any adverse regulatory development constraining the availability of key input materials or a sharp rise in power costs would be negative for the ratings. Moreover, a significant debt-funded capex or drop in earnings leading to a deterioration in the debt protection metrics, or any deterioration in the liquidity position will exert negative rating pressure. A specific credit metric that would put pressure on the ratings would be a net debt/OPBITDA of more than 2.0x on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Ferrous Metals Industry
Parent/Group support	Not Applicable
Consolidation/Standalone	The rating is based on the standalone financials of SCFL. The company does not have any subsidiary or joint venture as on March 31, 2021.

About the company

Shyam Century Ferrous Limited (SCFL) was incorporated in 2011. It was a dormant company till April 01, 2014 before the transfer of the ferro alloy business, including a 48.8% shareholding in Meghalaya Power Ltd. (MPL, operating a 43 MW thermal power plant) from Star Ferro and Cement Limited (which earlier used to house the ferro alloy, power, and cement businesses), as per the scheme of demerger approved by the High Court of Meghalaya in Shillong on March 31, 2015, effective from Apr 01, 2014. SCFL manufactures ferrosilicon with a total capacity of 21,600 metric tonnes per annum (MTPA) and has a captive power plant of 14 MW (currently non-operational) at Meghalaya.

Key financial indicators (audited)

SCFL Standalone	FY2021	FY2022	Q1 FY2023
Operating income	127.6	207.4	31.99
PAT	2.8	56.9	7.06
OPBDIT/OI	10.3%	35.7%	25.8%
PAT/OI	2.2%	27.4%	22.1%
Total outside liabilities/Tangible net worth (times)	0.1	0.1	-
Total debt/OPBDIT (times)	0.4	0.01	-
Interest coverage (times)	16.5	117.1	118

Source: *Company; PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

<table>
<tr><th rowspan="3"></th><th rowspan="3">Instrument</th><th colspan="4">Current rating (FY2023)</th><th colspan="3">Chronology of rating history for the past 3 years</th></tr>
<tr><th rowspan="2">Type</th><th rowspan="2">Amount rated (Rs. crore)</th><th rowspan="2">Amount outstanding as on March 31, 2022 (Rs. crore)</th><th>Date & rating in FY2023</th><th>Date & rating in FY2022</th><th>Date & rating in FY2021</th><th>Date & rating in FY2020</th></tr>
<tr><th>31-October -2022</th><th>08-July -2021</th><th></th><th></th></tr>
<tr><td>1</td><td>Working capital</td><td>Long-term</td><td>28.00</td><td>-</td><td>[ICRA]BBB+ (Stable)</td><td>[ICRA]BBB+ (Stable)</td><td></td><td></td></tr>
<tr><td>2</td><td>Bank guarantee</td><td>Short-term</td><td>6.00</td><td>-</td><td>[ICRA]A2+</td><td>[ICRA]A2+</td><td></td><td></td></tr>
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Complexity level of the rated instruments

Instrument	Complexity Indicator
Working Capital	Simple
Bank Guarantee	Very 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 analysing 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 are available on ICRA's website: www.icra.in

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	**Working capital**	NA	NA	NA	**28.00**	**[ICRA]BBB+ (Stable)**
NA	**Bank guarantee**	NA	NA	NA	**6.00**	**[ICRA]A2+**

Source: Company.

Annexure II: List of entities considered for consolidated analysis

Company Name	Standalone Approach
	Not Applicable

Source: Company

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