November 30, 2022

Suraj Products Limited: Ratings upgraded to [ICRA]BBB (Stable) / [ICRA]A3+

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term Loans	31.00	31.00	[ICRA]BBB (Stable); upgraded from [ICRA]BBB- (Stable)
Cash Credit	25.00	25.00	[ICRA]BBB (Stable); upgraded from [ICRA]BBB- (Stable)
Non Fund-Based Facilities	1.50	1.50	[ICRA]A3+; upgraded from [ICRA]A3
Total	**57.50**	**57.50**	

**Instrument details are provided in Annexure-1*

Rationale

The ratings upgrade factors in the better-than-expected financial performance of Suraj Products Limited (SPL) in H1 FY2023 and expected sustenance of the same going forward, leading to a healthy profitability, net cash accruals and debt coverage indicators. While the broader industry had reported a sequential decline in earnings in the first half of the current fiscal amid falling steel prices and elevated coal prices (for secondary steel players), SPL bucked the trend as its earnings remained unscathed. The company reported an OPBITDA[1] of Rs.22.63 crore in H1 FY2023 vis-a-vis Rs.20.86 crore in H2 FY2022 and Rs.22.77 crore in H1 FY2022. The healthy financial performance of the company was primarily driven by the benefits accruing from the coal linkages, which meet almost ~50% of the company's total thermal coal requirements for manufacturing of sponge iron at a significant discount to the prevailing market price. Besides, the smaller kiln size of the company permits using domestic thermal coal having lower calorific value, thus insulating spreads at a time when international coal prices remain elevated. ICRA expects SPL's financial performance to remain healthy for the remainder of FY2023 as well with input costs largely reaching the peak and steel demand increasing in the second half of the fiscal. The ratings also consider the comfortable financial risk profile of the company, which has witnessed a steady improvement over the years. The ratings continue to derive comfort from SPL's vertically integrated nature of operations, characterised by the presence of DRI[2] kiln (used to manufacture sponge iron), mini blast furnace (used to manufacture pig iron), induction furnace and continuous caster to produce billets using captive sponge iron and pig iron. The manufactured billets are then subjected to rolling to produce TMT bars of desired profile. The ratings also derive comfort from the presence of the company's captive power plant (CPP), leading to availability of power at a competitive rate that positively impacts its cost structure owing to a highly power intensive nature of operation. The ratings also derive strength from the favourable location of SPL's plant in terms of proximity to major raw material sources. ICRA has noted the company's cost improvement initiatives, which include setting up of a washing and attrition system for iron ore, enabling the company to process inferior grade of iron ore. With the jigging facility expected to be operational by the next fiscal, which would allow higher recovery rates of lower Fe content iron ore, SPL's cost competitiveness is expected to increase further.

The ratings are, however, constrained by the intensely competitive nature of the secondary steel industry, which leads to pricing pressure, keeping margins under check. The ratings also remain constrained by the exposure of the company to the cyclicality inherent in the steel industry and susceptibility of SPL's profitability to the volatility in raw material prices and end-product realisations, although the vertically integrated nature of operations reduces the vulnerability to an extent. The ratings also factor in SPL's small scale of operations relative to other established players in the secondary steel industry, which constrains its ability to benefit from the economies of scale and limits its pricing flexibility.

[1] Operating Profit before Interest, Tax, Depreciation and Amortisation

[2] Direct reduced iron

The Stable outlook on the long-term rating reflects ICRA's opinion that the company's credit metrics would continue to remain at comfortable levels, going forward, aided by steady accruals and moderate dependence on debt.

Key rating drivers and their description

Credit strengths

Healthy financial performance in FY2022 and H1FY2023; expected to sustain for the rest of FY2023 – Notwithstanding a revenue growth of only ~9% in FY2022 due a change in the sales mix, the operating profits grew by a healthy ~42% year-on-year (YoY), aided by a favourable operating environment for steel manufacturers. The healthy financial performance continued in H1 FY2023, which was much better than ICRA's earlier estimates. While the broader industry had reported a sequential decline in earnings in the first half of the current fiscal amid falling steel prices and elevated coal prices (for secondary steel players) both in the domestic and international market, SPL's earnings remained unscathed. The company reported an OPBITDA of Rs.22.63 crore in H1FY2023 vis-a-vis Rs.20.86 crore in H2FY2022 and Rs.22.77 crore in H1FY2022. The healthy financial performance of the company was primarily driven by the benefits accruing from the coal linkages, which meet almost ~50% of the company's total thermal coal requirements for manufacturing of sponge iron at a significant discount to the prevailing market price. Besides, the smaller kiln size of the company permits using domestic thermal coal having lower calorific value, thus insulating spreads at a time when international coal prices remain elevated. ICRA expects SPL's financial performance to remain healthy for the remainder of FY2023 as well with input costs largely reaching the peak and steel demand increasing in the second half of the fiscal

Comfortable financial risk profile – SPL's financial risk profile remains comfortable and has witnessed a steady improvement over the years. The capital structure, as reflected by the gearing, improved to 0.77 times as on March 31, 2022 from 1.88 times as on March 31, 2020 aided by debt reduction and accretion to reserves. The coverage metrics, as reflected by interest coverage and debt service coverage ratio (DSCR) improved to 9.74 times and 2.68 times, respectively in FY2022 from 2.64 times and 1.41 times, respectively in FY2020 aided by higher operating profits. The company has an expansion plan worth around Rs. 45 crore over the next 2-3 years to increase the captive power generation capacity by 3 MW and setting up a jigging facility along with a new ferro alloy plant. However, SPL is expected to maintain its comfortable financial risk profile, aided by steady accruals and moderate dependence on debt to fund its growth plans.

Vertically integrated nature of operations with capacity to manufacture sponge iron, pig iron, billets and TMT bars – The company has a vertically integrated continuous casting steel manufacturing facility with a capacity of 36,000 MTPA of sponge iron, 24,000 MTPA of pig iron, 72,600 MTPA of billets and 72,600 MTPA of TMT bars. Billets are manufactured using captive sponge iron and pig iron. The manufactured billets are then subjected to rolling to produce TMT bars of desired profile.

Presence of captive power plant, coal linkage and ability to process inferior grade input materials for steel-making strengthen the operating profile of the company – The company's steel melting operation is highly power intensive. However, power generated through SPL's captive power plant at a competitive rate meets the major part of its overall power requirement, which positively impacts the cost structure. In addition, a significant portion (~50%) of the company's total thermal coal requirements for manufacturing of sponge iron is met from the linkages obtained through auctions, keeping the landed cost of coal competitive and enhancing raw material security. ICRA has noted the company's cost improvement initiatives, which include setting up of a washing and attrition system for iron ore, thus enabling the company to process inferior grade of iron ore. With the jigging facility expected to be operational by the next fiscal, which would allow for higher recovery rates of lower Fe content iron ore, SPL's cost competitiveness is expected to increase further.

Credit challenges

Competitive nature of the industry likely to keep margins under check – SPL is a secondary steel producer and derives the major portion of its revenue from semi-urban and rural areas. The fragmented nature of the long product/semis industry and intense competition from other organised as well as unorganised players are likely to keep its margins under check.

Exposed to cyclicality inherent in the steel industry – SPL is exposed to cyclicality inherent in the steel industry, which leads to volatility in revenue and cash flows for the industry players, including SPL. The cash flows and profitability of the company would remain volatile largely because of the fluctuation in steel spreads emanating from the mismatch in price movement of raw materials and end products. However, the vertically integrated nature of SPL's operations reduces the earnings volatility to an extent.

Relatively smaller scale of operations – Notwithstanding the increase in scale of operations of SPL in recent years, the same remained small compared to other established players in the secondary steel industry. This constrains its ability to benefit from the economies of scale and limits its pricing flexibility vis-à-vis that of the bigger entities operating in the industry.

Environmental and Social Risks

Environmental considerations – Steel manufacturing is an energy intensive process and requires substantial use of fossil fuels, which results in greenhouse gas emissions, industrial waste generation, and environmental pollution. Increasing regulatory requirements to reduce greenhouse gas emissions and stricter air pollution standards may lead to higher costs for steel manufacturers in the medium term. This is in turn leads to a greater focus on reducing the carbon footprint through various technological interventions, like increasing share of renewables in the energy mix, increasing the share of steelmaking through the electrical route, transition to green hydrogen technologies, decrease in fuel rate in furnaces, and setting up carbon capture utilisation and storage units, to name a few. With many of these emerging low-carbon technologies yet to achieve commercial viability, this transition could entail a significant investment for metal manufacturers. Further, SPL faces risk of physical climate change from floods and drought in the form of disruption in raw material availability due to extreme weather events and impact on water availability due to drought.

Social considerations – Social risks for steel manufacturers manifest from health and safety of employees involved in the manufacturing activity. Casualties/ accidents at operating units due to gaps in safety practices could not only lead to production outages for steel manufacturers like SPL, but also invite penal actions from regulatory bodies. The sector is exposed to labour related risks and risks of protests/social issues with local communities, which might impact expansion/modernisation plans. Also, the adverse impact of environmental pollution in nearby localities could trigger local criticism.

Liquidity position: Adequate

SPL's liquidity position has been assessed as **adequate** with free cash/bank balances of around Rs. 15 crore as on September end, 2022 and healthy retained cash flow of ~Rs. 45 crore expected in the current fiscal. Against these sources of cash, the company has a total capex commitment of around ~Rs.22-23 crore and debt repayment obligations of ~Rs.8 crore in FY2023. Overall, ICRA expects SPL to be able to comfortably meet its capex commitments and service its debt obligations through internal sources of cash.

Rating sensitivities

Positive factors – ICRA may upgrade SPL's ratings if there is a significant increase in its scale of operations while maintaining healthy business returns and credit metrics.

Negative factors – Pressure on SPL's ratings may arise in case of weaker-than-expected financial performance due to adverse demand scenario. A specific trigger for downgrade would be DSCR lower than 1.8 times on a sustained basis. Additionally, any major debt-funded capex, leading to weakening of capital structure would put pressure on SPL's ratings.

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	For arriving at the ratings, ICRA has considered the standalone financials of SPL.

About the company

Established in 1991, Champion Cement Industries Limited was involved in production of cement. The company took its present name, Suraj Products Limited (SPL), in 2000. Since 2002, the company discontinued the cement manufacturing plant and diversified into manufacturing of sponge iron and pig iron. The manufacturing facility is in Sundargarh district, Odisha. The company commissioned its 3-MW waste heat recovery based captive power plant (CPP) and an induction furnace of 25,000 tonnes per annum (TPA) capacity in FY2018. In FY2019, SPL installed its second CPP of 3 MW (AFBC based) and doubled its steel melting capacity to 50,000 TPA. In FY2020, SPL added a rolling mill facility of 72,600 TPA for production of TMT bars and an induction furnace of 22,600 TPA. At present, the company has an installed capacity to produce 36,000 TPA of sponge iron, 24,000 TPA of pig iron, 72,600 TPA of billets and TMT bars, each.

Key financial indicators

SPL	Standalone		
	FY2021 (Audited)	FY2022 (Audited)	H1FY2023 (Provisional)
Operating Income (Rs. crore)	217.7	236.9	135.8
PAT (Rs. crore)	9.2	23.6	12.8
OPBDIT/OI (%)	14.1%	18.4%	16.7%
PAT/OI (%)	4.2%	10.0%	9.5%
Total Outside Liabilities/Tangible Net Worth (times)	1.4	0.9	0.8
Total Debt/OPBDIT (times)	2.1	1.4	1.2
Interest Coverage (times)	4.4	9.7	12.1

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation;

Status of non-cooperation with previous CRA:

CRA	Status	Date of Release
CRISIL	CRISIL B+/Stable/A4; ISSUER NOT COOPERATING	July 30, 2022

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 in	Date & Rating in FY2022	Date & Rating in FY2021	Date & Rating in FY2020
					Nov 30, 2022	Aug 12, 2021	Jun 23, 2020	Feb 28, 2019
1	**Term Loans**	Long Term	31.00	15.74	[ICRA]BBB (Stable)	[ICRA]BBB- (Stable)	[ICRA]BB+ (Stable)	[ICRA]BB+ (Stable)
2	**Cash Credit**	Long Term	25.00	-	[ICRA]BBB (Stable)	[ICRA]BBB- (Stable)	[ICRA]BB+ (Stable)	[ICRA]BB+ (Stable)
3	**Non Fund-Based Facilities**	Short Term	1.50	-	[ICRA]A3+	[ICRA]A3	[ICRA]A4+	[ICRA]A4+

Amount in Rs. crore

Complexity level of the rated instruments

Instrument	Complexity Indicator
Term Loans	Simple
Cash Credit	Simple
Non Fund-Based Facilities	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: Click Here

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs Crore)	Current Rating and Outlook
NA	**Term Loans**	FY2017	NA	FY2027	31.00	[ICRA]BBB (Stable)
NA	**Cash Credit**	NA	NA	NA	25.00	[ICRA]BBB (Stable)
NA	**Non Fund-Based Facilities**	NA	NA	NA	1.50	[ICRA]A3+

Source: *Company*

Annexure-2: List of entities considered for consolidated analysis – Not applicable

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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