November 30, 2022

Vinayak Steels Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long Term –Fund Based- Cash Credit	27.00	27.00	[ICRA]BB+ (Stable); reaffirmed
Long Term - Fund Based TL	10.11	10.11	[ICRA]BB+ (Stable); reaffirmed
Short Term- Non Fund Based	7.00	7.00	[ICRA]A4+; reaffirmed
Long Term -Unallocated	4.17	4.17	[ICRA]BB+ (Stable); reaffirmed
Total	**48.28**	**48.28**	

**Instrument details are provided in Annexure-I*

Rationale

The ratings reaffirmation factors in the extensive experience of Vinayak Steels Limited's (VSL) promotors in the steel manufacturing industry coupled with the company's integrated nature of operations with presence across iron pellets, sponge iron, billets and TMT bars. The ratings also consider VSL's consistent growth in revenue over the last five years on the back of increased sales volumes. VSL's revenue grew significantly in FY2022 on the back of an improvement in sales realisation, largely towards H2 FY2022 amid an increase in steel prices. The ratings further consider VSL's moderate working capital intensity with low debtors, leading to lower short-term borrowing and in turn comfortable gearing and coverage indicators. ICRA notes that VSL's capital cost for operating upstream and downstream steelmaking assets remains very competitive, leading to low capital charges, supporting its net profit margins.

The ratings, however, remain constrained by VSL's moderate operating profitability owing to high power cost and elevated cost for input materials. Moreover, the margins remain susceptible to volatility in raw material prices and end-product realisations owing to cyclicity inherent in the steel industry, although the vertically integrated nature of operations reduces the vulnerability to an extent. The ratings are also tempered by the highly commoditised and fragmented nature of the secondary steel industry, resulting in intense competition, limiting the company's pricing flexibility.

The ratings are further constrained by increased investments in sister companies and corporate guarantee extended by VSL to its associate company, Genext Steel Private Limited (GSPL) on external borrowings taken for setting up a 0.33-million-tonnes-per-annum (mtpa) integrated steel manufacturing plant in Gujarat. ICRA notes that given the high operating risks associated with setting up greenfield steel projects, timely stabilisation of operations of GSPL's steel plant would remain key monitorable. Nonetheless, co-investment in GSPL in equal proportion by three other Groups restricts the potential financial burden on VSL to one-fourth[1] of the capital invested.

The Stable outlook on the [ICRA]BB+ rating reflects ICRA's opinion that VSL will continue to benefit from the favourable operating environment for the steel spinning industry in the near term.

[1] Corporate guarantee for GSPL's borrowings has been extended by other groups as well, along with VSL

Key rating drivers and their description

Credit strengths

Vertically integrated operations with capacity to manufacture pellet, sponge iron, billets and TMT bars – The company has a vertically integrated continuous casting steel manufacturing facility with a capacity of 90,000 metric tonnes per annum (MTPA) of pellet, 33,000 MTPA of sponge iron, 99,000 MTPA of billets and 86,000 MTPA of TMT bars. It uses mill scale as a feedstock for manufacturing of pellet, which is then captively consumed to produce sponge iron. Along with the in-house sponge iron, the company purchases MS scrap and additional sponge iron, which are used for manufacturing of MS ingots, which are further processed to produce TMT bars. VSL sells TMT bars under the Vinayak brand to traders and real estate players and sells ingots to steel processors.

Extensive experience of promoters in steel industry – VSL is promoted by Mr. Vinod Kedia and Mr. Vineet Kedia, who have more than 25 years of experience in the steel manufacturing business. Apart from VSL, the promotors have other companies in the steel industry, which include Vinayak Metal and Power Private Limited, Hilton Vyapar Limited, Balganapathi Steels India Private Limited and the recently incorporated GSPL. Vast experience and long track record of the promotors have enabled the company to forge strong relationships with its customers, though its sales are mainly limited to Telangana.

Consistent growth in revenue despite market volatility – VSL's revenue rose at a healthy CAGR of 26.0% in the last five years on the back of healthy volume growth, though the realisations remained volatile as inherent in the steel industry. The revenue grew by 36.5% to Rs. 497 crore in FY2022 from Rs. 364 crore in FY2021, supported by an increase in realisation by 32% and that of volume by 4% in FY2022. The company booked revenue of Rs. 240 crore in H1 FY2023, supported by healthy demand outlook for the sector. ICRA believes that VSL's business outlook remains favourable in FY2023 with resilient demand for steel. Besides, realisations are likely to remain at attractive levels. With reduction in raw material prices (mainly mill scale and scraps) in the recent months, ICRA does not expect any significant upside in VSL's operating margins as steel realisations have also witnessed a downtrend.

Comfortable financial risk profile supported by low working capital intensity – The net working capital intensity continues to remain low with net working capital divided by operating income standing at 6.83% in FY2022. The year-end debt levels for the company increased in FY2022, however, the same remained at comfortable levels, which mainly comprise working capital borrowings and unsecured loan from promotors. The capital structure remained healthy with a gearing of 0.66 times as on March 31, 2022 (0.46 times as on March 31, 2021) due to higher short-term borrowings and lower accretion to reserves. Total Debt/OPBITDA weakened to 2.77 times due to deterioration in margins, however, other coverage metrics remained at healthy levels with an interest coverage of 7.58 times and DSCR of 1.66 times as on March 31, 2022. ICRA expects the same to remain comfortable in FY2023, supported by better operating environment in the steel industry.

Credit challenges

Margins susceptible to fluctuation in raw material prices – Being a secondary steel manufacturer, VSL's major costs are raw material and power, which contribute more than 85% to the operating income (OI). Thus, the profitability remains susceptible to volatility in major raw material prices such as mill scale, DRI fines and scrap. The company has increased investments in Andhra Pradesh Gas Power Corporation Limited (APGPCL) in FY2022 to procure additional power at a relatively lower cost. However, owing to the Andhra Pradesh discom's treatment of APGPCL as an open access source (against group captive), they filed for higher tariff in the form of cross-subsidy surcharge and additional surcharge. This, in addition to the steep escalation in gas costs, led to discontinuation of procurement from APGPCL in FY2023 and increased the power cost for VSL.

Increased investment and corporate guarantee extended to sister company – The promotors of VSL along with Meenakshi Group, Yash Group and Ravindra Pipes incorporated GSPL to start an integrated steel plant in Gujarat. All the four Groups have invested equally in this greenfield project, led by the promotors of VSL. As of May 2022, the commissioned production capacity for GSPL stood at 300 tonnes per day (TPD) for sponge iron and 400 TPD for induction furnace. The project cost till May 2022 stood at Rs. 130 crore with funding mix including term loan from banks and investment by the four sponsors in equal proportion. The term loan has been availed against the corporate guarantee of all four Groups, exposing VSL to the operating and financing risks associated with a greenfield project. VSL has invested Rs. 9.1 crore in GSPL till the conclusion of the second phase of the expansion in May 2022. ICRA takes comfort from the co-investments in GSPL in equal proportion by three other Groups, which restricts the possible financial burden on VSL to one-fourth of the capital invested. However, timely stabilisation of the project within a reasonable timeframe will remain key monitorable as the same may impact the cash flows of VSL.

Intense competition and exposure to cyclicality in steel industry – The steel industry is highly commoditised, characterised by intense competition and low product differentiation, limiting the pricing flexibility of the players, including VSL. The domestic steel industry is cyclical in nature and is likely to impact the cash flows of steel players, including VSL. Nevertheless, VSL's cost competitiveness and a high level of integration reduce the susceptibility of its profitability to downturns in the steel industry, as evident from its modest profit even during the peak of the slowdown in the metal industry. This also demonstrates the resilience of VSL's performance during the period of stress.

Liquidity position: Adequate

VSL's liquidity position is expected to remain **adequate** with modest cash accruals and moderate utilisation of working capital limits. Cash flow from operations weakened in FY2022 due to contraction in margins and an increase in the working capital intensity. VSL has cash credit (CC) limit of Rs. 27.00 crore with 33% average utilisation of the limit during November 2021 to October 2022. The company has availed vehicle loans from various banks and NBFCs with a tenure ranging from two to three years, entailing high repayment obligation in the near term. Nonetheless, healthy cash accruals and moderate CC utilisation are expected to support the liquidity.

Rating sensitivities

Positive factors – ICRA could upgrade VSL's ratings if VSL maintains healthy profit margins and a comfortable liquidity position while maintaining healthy credit metrics on a sustained basis. Further, stabilisation of operations in the new greenfield plant of GSPL might trigger ratings upgrade.

Negative factors – Negative pressure on VSL's ratings could arise if there is a decline in revenues or profitability, resulting in an increase in Total Debt/OPBDITA to above 3.0 times on a sustained basis. Significantly higher investment in Group company, resulting in a deterioration in liquidity and business risks will put a negative pressure on VSL'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	Standalone

About the company

VSL was incorporated in 1985 by Mr. Gulzari Lal Kedia. The company manufacturers TMT bars with an installed capacity of 86,000 MTPA. The company has integrated continuous casting facility to manufacture ingots (99,000 TPA), sponge iron (33,000 TPA) and pellets (90,000 TPA). Its manufacturing facility is in Kothur, near Hyderabad. VSL is managed by Mr. Vinod Kedia and his family. The company procures power from Andhra Pradesh Central Power Company Limited, APGCPL and the rest through open access.

Key financial indicators

VSL (Standalone)	FY2021 (Audited)	FY2022 (Provisional)
Operating Income (Rs. crore)	363.91	496.62
PAT (Rs. crore)	10.95	4.95
OPBDIT/OI (%)	5.94%	2.54%
PAT/OI (%)	3.01%	1.00%
Total Outside Liabilities/Tangible Net Worth (times)	0.46	0.66
Total Debt/OPBDIT (times)	1.02	2.77
Interest Coverage (times)	7.62	7.58

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 of Mar 31, 2022 (Rs. crore)	Date & Rating as on	Date & Rating in FY2022	Date & Rating in FY2021	Date & Rating in FY2020
					30-Nov-2022	30-Aug-2021		06-Feb-2020
1	Cash Credit	Long Term	27.00	-	[ICRA]BB+ (Stable)	[ICRA]BB+ (Stable)		[ICRA]BB+ (Stable)
2	Term Loan	Long Term	10.11	5.33	[ICRA]BB+ (Stable)	[ICRA]BB+ (Stable)		[ICRA]BB+ (Stable)
3	Non Fund based	Short Term	7.00	-	[ICRA]A4+	[ICRA]A4+		[ICRA]A4+
4	Unallocated	Long Term	4.17	-	[ICRA]BB+ (Stable)	[ICRA]BB+ (Stable)		[ICRA]BB+ (Stable)

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term Fund-based – Cash Credit	Simple
Long-term – Fund based - Term Loan	Simple
Short Term – Non Fund based	Very Simple
Long Term – Unallocated	Not Applicable

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: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (RS Crore)	Current Rating and Outlook
NA	Cash Credit	NA	NA	NA	27.00	[ICRA]BB+ (Stable)
NA	Term Loan	FY2019	NA	FY2023	10.11	[ICRA]BB+ (Stable)
NA	Non Fund based	NA	NA	NA	7.00	[ICRA]A4+
NA	Unallocated	Mar 2018	NA	NA	4.17	[ICRA]BB+ (Stable)

Source: *Company*

Annexure II: 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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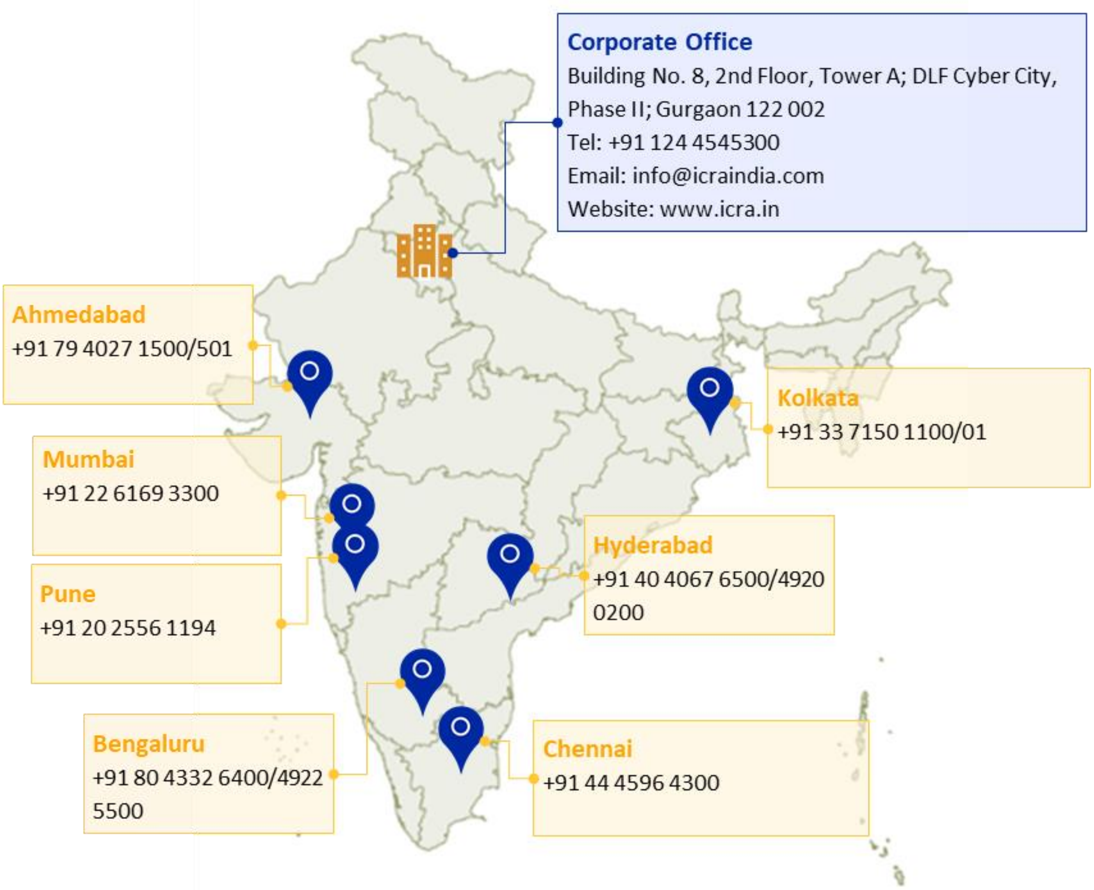

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