June 22, 2023

Seven Star Steels 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
Cash Credit	15.00	15.00	[ICRA]BBB-(Stable); upgraded from [ICRA]BB+(Stable)
Bank Guarantee	1.00	1.00	[ICRA]A3; upgraded from [ICRA]A4+
Total	**16.00**	**16.00**	

**Instrument details are provided in Annexure-I*

Rationale

The rating upgrade factors in Seven Star Steel Limited's (SSSL) better-than-expected earnings growth in FY2022 and FY2023 and expectation that the trend would continue in FY2024 as well. SSSL posted an operating profit of Rs. 27.9 crore in FY2023 against Rs.34 crore in FY2022 but it was still significantly better than Rs. 11.9 crore recorded in FY2021. In FY2023, SSSL, like other steel producers, witnessed a steep contraction in steel spreads mainly due to a disproportionate increase in key input costs (like thermal coal). Notwithstanding a sequential moderation in profits in FY2023 from the high levels recorded in FY2022, SSSL still reported a double-digit operating margin of 15.14% in FY2023 against 16.5% in FY2022 and 9.4% in FY2021. The financial risk profile of the company also remains comfortable because of the low debt level of SSSL. The net debt of SSSL stood at Rs. 16.35 crore as on March 31, 2023 and Rs. 15.2 crore as on March 31, 2022 with net debt/OPBDITA at 0.6 times in FY2023 against 0.4 times in FY2022, but still significantly better than 2.8 times witnessed in FY2020. ICRA expects the company's leverage indicators to remain at comfortable levels in FY2024 also, albeit a modest sequential moderation in the current year earnings.

ICRA believes that while steel prices have witnessed moderation in the current fiscal, the company's profit metrics are likely to remain better than the historical median levels due to relief from the expected moderation in input costs, which as per ICRA's opinion, will help in maintaining the current year spreads in line with FY2023 levels. A surge in earnings since FY2021 led to an improvement in the credit metrics with the interest coverage increasing to 23.6 times in FY2023 (based on provisional financial statements) and 29.8 times in FY2022 from 7.8 times in FY2021. Limited dependence on debt along with healthy net cash accruals is expected to keep the credit metrics comfortable, going forward. The ratings continue to derive comfort from the assured supply of iron ore at flexible credit terms from its Group company, Penguin Trading & Agencies Limited (PTAL, rated [ICRA]A (Stable)/ [ICRA]A1), which has a healthy credit profile. This mitigates raw material supply risks and supports the overall liquidity profile of SSSL. The conservative capex plans and the prudent capital allocation policy of the promoters further supports the ratings of SSSL. The ratings also consider SSSL's captive power plant which meets its power requirement entirely, leading to savings in production costs.

The ratings, are, however, constrained by SSSL's small scale of operations leading to suboptimal plant efficiency parameters and a high operating cost base, making it susceptible to a period of sustained industry downturn. The ratings further remain constrained by the exposure of the company to the cyclicality inherent in the steel industry and susceptibility of SSSL's profitability to the volatility in raw material prices and end-product realisations. The volatility in raw material prices is mitigated to some extent by obtaining a certain portion of the overall coal requirement through the coal linkage with Mahanadi Coalfields Limited (MCL). The ratings also consider SSSL's lack of adequate vertical integration, and limited product diversity with a limited level of value addition, in turn tempering its profit margins.

The Stable outlook on the long-term rating reflects ICRA's expectations that SSSL will continue to benefit from the favourable demand outlook for long products emanating from the Government's infrastructure investment plans. This, along with its conservative growth plans is expected to keep its credit metrics at comfortable levels in the near term.

Key rating drivers and their description

Credit strengths

Better-than-expected performance in FY2022 and FY2023; notwithstanding an expected moderation in earnings in FY2024, credit metrics are expected to remain comfortable – SSSL posted an operating profit of Rs. 27.9 crore in FY2023 against Rs.34 crore in FY2022 but is still significantly higher than Rs. 11.9 crore witnessed in FY2021. In FY2023, SSSL, like other steel producers, witnessed a steep contraction in steel spreads that can be attributed mainly to a disproportionate increase in key input costs. Notwithstanding a sequential moderation in profits in FY2023 from the high levels recorded in FY2022, SSSL's operating margin stood at 15.14% in FY2023 as against 16.5% in FY2022 and 9.4% in FY2021. The financial risk profile of the company remains comfortable because of the low debt levels with the current outstanding long-term loan scheduled to be completely repaid by FY2025. Given that raw material prices (mainly thermal coal) have moderated in the recent months, ICRA believes that the company's profit metrics are likely to remain significantly better than the long-term historical median levels. Also, since a certain portion of the company's total thermal coal requirements for manufacturing of sponge iron is met from the linkages obtained through auctions, SSSL remains partially insulated from the rising coal prices in the spot market.

Procurement of iron ore at favourable credit terms from Group company enhances raw material security and supports liquidity to an extent – SSSL faces limited risks related to supply of iron ore as its entire iron ore requirement is met from its Group company, PTAL, which has a healthy credit profile and is involved in iron ore mining, thus mitigating the raw material supply risks. Moreover, PTAL extends flexible credit terms to SSSL which can be extended beyond the normal credit period, thus reducing the latter's working capital requirement and supporting its liquidity.

Credit metrics expected to remain healthy, going forward – The financial risk profile of the company remains comfortable because of SSSL's low debt levels. The net debt of SSSL stood at Rs. 16.35 crore as on March 31, 2023 against Rs. 15.2 crore as on March 31, 2022 with net debt/OPBDITA at 0.6 times in FY2023 against 0.4 times in FY2022. However, the same was still significantly better than 2.8 times witnessed in FY2020. A surge in earnings since FY2021 led to an improvement in the credit metrics with the interest coverage increasing to 23.6 times in FY2023 (based on provisional financial statements) and 29.8 times in FY2022 from 7.8 times in FY2021. Limited dependence on debt, along with healthy net cash accruals estimated, is expected to keep the credit metrics comfortable, going forward.

Conservative capex plans along with prudent capital allocation policy – The promoters of the company follow conservative capex plans and their prudent capital allocation policy further supports SSSL's liquidity profile. Apart from the nominal annual maintenance capex, the company has no other major capex plan in the pipeline.

Presence of captive power plant reduces cost of production to some extent – The company has a captive power plant (CPP) of 8 MW, out of which 4 MW is based on waste heat recovery (WHR) technology and the balance 4 MW is based on atmospheric fluidised bed combustion (AFBC) process. The cost structure of the steel melting operation, which is highly power intensive in nature, is positively impacted by the power available from CPP at a competitive rate

Credit challenges

Small scale of operations leads to a high operating cost base and makes it susceptible to a period of sustained industry downturns – SSSL's absolute scale of operations remains quite small, which leads to a comparatively higher operating cost base emanating from lower plant efficiency parameters compared to larger integrated steel mills. Given the commoditised nature of the steel business, a structurally higher operating cost base makes the performance of smaller steel companies, like SSSL, susceptible to a period of sustained industry downturns.

Lack of adequate vertical integration, limited product diversification/value addition tempers margins – The company manufactures intermediate products like sponge iron and billets, which are low value added compared to finished steel products, where margins are higher. The competition in the semis segment remain very elevated, leading to low pricing flexibility.

Exposed to cyclicality inherent in the steel industry – SSSL is exposed to cyclicality inherent in the steel industry, which leads to volatility in revenue and cash flows for the industry players, including SSSL. The company's cash flows and profitability would remain volatile mainly because of the fluctuation in steel spreads emanating from the mismatch in price movement of raw materials and end products.

Liquidity position: Adequate

The company has **adequate** liquidity with free cash flow of Rs. 37.62 crore as on March 31, 2023 and is expected to be in the range of Rs. 8-20 crore annually from FY2024 to FY2025. Against these sources of cash, the company has negligible capex commitments and nominal debt repayment obligations. Therefore, the company's liquidity profile has been assessed as adequate. Also, flexible payment arrangements with PTAL further support the liquidity of the company as the credit period for payment (for the supply of iron ore, the key raw material) can be extended beyond normal terms, supporting SSSL's working capital requirements.

Rating sensitivities

Positive factors – ICRA may upgrade SSSL's ratings if there is a substantial improvement in the company's profitability and cash accruals, leading to a further improvement in liquidity, credit metrics, and strengthening of the net worth.

Negative factors – Pressure on SSSL's ratings may arise if there is a significant decline in its profits and/or if the company undertakes any sizeable debt-funded capex, which may adversely impact its capital structure and liquidity. Specific credit metrics, which may lead to ratings downgrade, include an interest coverage 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 Entities in the Ferrous Metals Industry
Parent/Group support	Not applicable
Consolidation/Standalone	Standalone

About the company

Incorporated in November 2004, Seven Star Steels Limited (SSSL) commenced commercial operations in June 2007. The company's manufacturing facility is located at Kalendamal, Gudigaon, in the Jharsuguda district of Odisha. It has sponge iron and mild steel (MS) billet manufacturing facilities with installed capacity of 60,000 tonnes per annum (TPA) and 28,800 TPA, respectively, along with an 8-MW captive power plant (4 MW through waste-heat recovery, and 4 MW through atmospheric-fluidised bed combustion). The present promoters (Kolkata-based Bathwal family) took over SSSL's management in 2007. The sponge iron manufacturing capacity of the plant was expanded from 30,000 TPA to 60,000 TPA in February 2008. The captive power plant and the steel-melting facility were commissioned in April 2013 and April 2014, respectively.

Key financial indicators (audited/provisional)

	FY2020	FY2021	FY2022	FY2023 Provisional
Operating income	123.95	126.44	206.6	184.0
PAT	-51.74	2.63	17.6	18.5
OPBDIT/OI	4.34%	9.4%	16.5%	15.14%
PAT/OI	-41.74%	2.1%	8.5%	10.05%
Total outside liabilities/Tangible net worth (times)	5.16	4.35	2.0	0.9
Total debt/OPBDIT (times)	2.82	1.48	0.5	0.6
Interest coverage (times)	3.42	7.76	29.8	23.6

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

	Instrument	Current rating (FY2024)				Chronology of rating history for the past 3 years		
		Type	Amount rated (Rs. crore)	Amount outstanding as of Mar 31, 2023 (Rs. crore)	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021
					Jun 22, 2023	-	Mar 31, 2022	Jan 08, 2021
1	**Cash Credit**	Long term	15.0	14.8	**[ICRA]BBB-(Stable)**	-	**[ICRA]BB+ (Stable)**	**[ICRA]BB-(Stable)**
2	**Bank Guarantee**	short term	1.0	--	**[ICRA]A3**	-	**[ICRA]A4+**	**[ICRA]A4**

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term fund-based – Cash Credit	Simple
Short -term – 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: 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	15.00	[ICRA]BBB- (Stable)
NA	**Bank Guarantee**	NA	NA	NA	1.00	[ICRA]A3

Source: Company

Annexure II: List of entities considered for consolidated analysis – Not Applicable

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