August 02, 2023

Aarti Steel International Limited: [ICRA]A+ (Stable) / [ICRA]A1; assigned

Summary of rating action

Instrument*	Current Rated Amount (Rs. crore)	Rating Action
Long term - Fund based – Term Loans	33.91	[ICRA]A+ (Stable); assigned
Long term - Fund based / Cash Credit	130.00	[ICRA]A+ (Stable); assigned
Short term - Non-fund based limits	40.00	[ICRA]A1; assigned
Long term / short term – Unallocated limit	0.09	[ICRA]A+ (Stable) / [ICRA]A1; assigned
Total	**204.00**	

**Instrument details are provided in Annexure-I*

Rationale

The ratings favourably consider the long operational track record of the Aarti Group and experience of the promoter in the steel business. ICRA notes that Aarti Steel International Limited (ASIL) has been formed as a part of the Aarti Group's restructuring exercise for which the regulatory approval has been received from the National Company Law Tribunal (NCLT) in Q4 FY2023. The Group company, Aarti Steels Limited (ASL), had two plants in Cuttack and Ludhiana, out of which the Ludhiana plant has been demerged into ASIL, and the appointed date of the demerger has been fixed on April 1, 2020. The ratings factor in ASIL's status as an approved supplier of steel products to the ancillaries of major automobile original equipment manufacturers (OEMs) and tyre manufacturers and repeat business generated from the clients over the years. ASIL manufactures rolled carbon and alloy steel, spring wire and tyre bead wire, which are value-added products that are used as components of engine, axel, tyre, etc. The company's presence in such specialised downstream steel products and a partially integrated nature of operation positively impact its margins. The ratings also consider ASIL's conservative capital structure and strong debt coverage metrics, supported by healthy profits and limited borrowings compared to its net worth.

The ratings, however, are constrained by the company's exposure to the cyclicality in the automobile sector from which ASIL mainly derives its revenues, and the inherent risks of price fluctuations and cyclicality in the steel industry. ICRA also notes ASIL's highly working capital-intensive nature of operations with significant receivables and stocking requirements and limited creditors, which encumber its liquidity to an extent. The company will remain exposed to the project risks associated with its planned debt-funded capex for increasing the capacity of tyre bead wire. The promoters' previous experience in such capex mitigates the execution risk of the project to an extent, however, the company's ability to conclude the project within the budgeted cost and estimated timeframe will remain important from the credit perspective.

The Stable outlook on the long-term rating reflects ICRA's opinion that the company's financial profile will remain healthy with strong earnings from operations, a conservative capital structure and comfortable debt coverage metrics despite the planned debt-funded capex.

Key rating drivers and their description

Credit strengths

Long operational track record and experience of promoters in the steel business – The Aarti Group has been involved in steel manufacturing for more than four decades, since commissioning of the plant in Ludhiana in 1979. Such a long operational track record of the Group and the promoter's experience in steel business lend operational strength to ASIL.

Established association with reputed players in automotive industry and track record of repeat business – The company's plant in Ludhiana is approved by major automobile OEMs and leading tyre manufacturers in northern India for supplying rolled steel products and wire. The company supplies rolled carbon and alloy steel products, which are used in critical automobile parts like engines, axels etc. and in two-wheeler components. The company also supplies spring wire to automobile ancillaries and tyre bead wire to tyre manufacturers. The Group company, ASL's plant in Cuttack, also caters to the ancillaries of major automobile OEMs in southern and western India. The Group's established association with the reputed clients and product quality have led to repeat business over the years.

Presence of value-added products and partially integrated operation positively impact margins – The rolled products manufactured by ASIL are made of carbon and alloy steels, which are relatively value-added items used in automobile parts. The steel wire manufactured by the company is used as spring wire in automobiles and as tyre bead wire. The value-added products keep the average realisations healthy. The company does not have any captive power plant, however, it has partial backward integration. The ingots/billets manufactured by the company are almost entirely consumed internally to produce rolled products, providing some cost advantage. Healthy realisatons due to value-added products and partial backward integration positively impact ASIL's operating margin, which remained in the range of 12-13% over the last three fiscals.

Healthy financial risk profile characterised by a conservative capital structure and strong debt coverage metrics – ASIL's debt level remained limited compared to its net worth, leading to a low gearing of 0.2 times as on March 31, 2023 (provisional) despite the reduction in net worth due to adjustments on account of the Group restructuring. The conservative capital structure coupled with healthy profits led to strong debt coverage indicators, as reflected by an interest coverage of 14.4 times (19.2 times in FY2022), total debt relative to OPBDITA of 0.9 times (1.0 times in FY2022) and net cash accrual relative to the total debt of 86% (77% in FY2022) in FY2023 (provisional).

Credit challenges

Exposed to cyclicality in the automobile sector, the key contributor to ASIL's revenues – ASIL derives the major portion of its revenue from automobile ancillaries. Hence, the company remains exposed to the cyclicality associated with the automobile sector, as reflected by the volatility in its revenue in the past years. Nevertheless, the company's products find use in various types of automobiles like commercial vehicles, passenger vehicles, tractors, two-wheelers and are also used in tyres, reducing the product concentration risks to an extent.

Vulnerable to price fluctuation risks and cyclicality inherent in the steel industry – The company consumes steel scrap as the main raw material in addition to sponge iron, pig iron, ferro alloys and other metals used to manufacture ingots/billets. It also purchases wire rod to produce wire. The volatility in the raw material prices and cyclicality inherent in the steel industry may impact the company's profits and cash accruals.

High working capital intensity of operations – The company has significant receivables and stocking requirements, and its creditors remain limited. Hence, ASIL's working capital intensity of operations remained high, as reflected by the net working capital relative to the operating income of 30-32% over the last three fiscals. Hence, its incremental working capital requirement to scale up operations would remain high. Nevertheless, the company has a significant cushion in its working capital utilisation.

Project risks associated with the planned capex – The company has planned a capex to increase the tyre bead wire capacity by 30,000 tonnes per annum. The total cost of the capex has been estimated at Rs. 185.5 crore. However, excluding the cost of land (which has already been acquired) and the working capital margin, a total cash outlay of ~Rs. 161 crore has been estimated. The capex will be funded by a term loan of Rs. 112 crore and the balance by internal accruals. The project has been scheduled to be concluded by September 2024. The company's capital structure and debt coverage metrics are likely to remain comfortable despite the planned debt-funded capex. However, any significant time or cost overrun in the project may exert pressure on ASIL's cash flows. Nevertheless, the promoters' previous experience in such capex mitigates the execution risk to an extent.

Liquidity position: Adequate

ASIL's liquidity position is adequate. Its cash flow from operations declined in FY2023 and stood at Rs. 20 crore due to incremental working capital requirement arising from a significant increase in the scale of operation, aided by capacity expansion. However, the company's cash flow from operations is likely to improve significantly to more than Rs. 100 crore in FY2024. Its debt repayment obligation will remain at a moderate level of around Rs. 5 crore annually till FY2025, but would increase subsequently due to the planned debt-funded capex. The capex will entail a cash outlay of around Rs. 161 crore till FY2025, to be funded by a term loan of Rs. 112 crore and the balance through internal accruals. The company's expected healthy cash flow from operations and considerable undrawn working capital (Rs. 38 crore as of March 2023) would ensure adequate fund availability for the capex.

Rating sensitivities

Positive factors – Healthy growth in the company's revenues and profits and an improvement in its liquidity position on a sustained basis may result in an upgrade of the ratings.

Negative factors – The ratings may be downgraded if a sustained decline in revenues or profitability of the company adversely impacts its debt protection metrics and liquidity. The specific credit metrics, which may trigger a rating downgrade include total debt/OPBDITA of more than 1.8 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Ferrous Metals
Parent/Group support	Not applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the standalone financials of the company.

About the company

Incorporated in December 2020, Aarti Steel International Limited (ASIL) is a part of the Aarti Group promoted by the Ludhiana-based Mittal family. ASIL's plant in Ludhiana, Punjab was earlier under Aarti Steels Limited (ASL). However, the same has been demerged to ASIL as a part of the Aarti Group's restructuring. Mr. Shiv Parshad Mittal is the promoter of the Aarti Group. His sons, Mr. Rajeev Mittal and Mr. Mahesh Mittal, are managing ASL and ASIL, respectively, after the Group restructuring. The regulatory approval for the restructuring was received through NCLT's judgment in February 2023 and the formal order in March 2023. ASIL's plant in Ludhiana has the capacity to manufacture billets and ingots of 1,40,000 tonnes per annum (TPA), rolled products of 3,40,000 TPA, and steel wires of 48,000 TPA. The company manufactures carbon and alloy steel, which are mainly sold to automobile ancillaries. The steel wire manufactured by the company is used as spring wire and tyre bead wire.

Key financial indicators

ASIL Standalone	FY2022 (Unaudited)*	FY2023 (Unaudited)*
Operating income	1071.0	1330.8
PAT	90.2	95.5
OPBDIT/OI	12.4%	12.3%
PAT/OI	8.4%	7.2%
Total outside liabilities/Tangible net worth (times)	0.2	0.4
Total debt/OPBDIT (times)	1.0	0.9

ASIL Standalone	FY2022 (Unaudited)*	FY2023 (Unaudited)*
Interest coverage (times)	19.2	14.4

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore
*Source: Company, ICRA Research; *Audited results of ASIL from FY2021 will be prepared as the appointed date of Group restructuring is April 01, 2020*

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
					Aug 02, 2023	-	-	-
1	**Fund based - Term Loans**	Long term	33.91	33.91	**[ICRA]A+ (Stable)**	-	-	-
2	**Fund based/ Cash Credit**	Long term	130.00	-	**[ICRA]A+ (Stable)**	-	-	-
3	**Non-fund based limits**	Short term	40.00	-	**[ICRA]A1**	-	-	-
4	**Unallocated limit**	Long term/ Short term	0.09	-	**[ICRA]A+ (Stable) / [ICRA]A1**	-	-	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long term - Fund based – Term Loans	Simple
Long term - Fund based / Cash Credit	Simple
Short term - Non-fund based limits	Very simple
Long term / Short term – Unallocated limit	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 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
-	**Fund based – Term Loan-1**	Jul-2021	-	Sep-2029	23.20	[ICRA]A+ (Stable)
-	**Fund based – Term Loan-2**	Sep-2021	-	Sep-2029	10.71	[ICRA]A+ (Stable)
-	**Fund based / Cash Credit**	-	-	-	130.00	[ICRA]A+ (Stable)
-	**Non-fund based limits**	-	-	-	40.00	[ICRA]A1
-	**Unallocated limit**	-	-	-	0.09	[ICRA]A+ (Stable) / [ICRA]A1

Source: *Company*

Please click here to view details of lender-wise facilities rated by ICRA

Annexure II: List of entities considered for consolidated analysis: Not applicable

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About ICRA Limited:

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