August 29, 2023

SAARLOHA Advanced Materials Private Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. Crore)	Current Rated Amount (Rs. Crore)	Rating Action
Long-term Fund-based - Term loan	17.50	-	-
Long-term/Short-term - Fund-based/Non-fund based	535.00	552.50	[ICRA]A+(Stable)/[ICRA]A1+; reaffirmed
Total	**552.50**	**552.50**	

**Instrument details are provided in Annexure-I*

Rationale

The ratings reflect SAARLOHA Advanced Materials Private Limited's (SAARLOHA) robust financial profile and liquidity position, underpinned by low gearing and healthy unencumbered fixed deposits. The ratings derive comfort from SAARLOHA's status as one of the key steel suppliers to the Kalyani Group's flagship entity, Bharat Forge Limited (BFL, rated [ICRA]AA+(Stable)/[ICRA]A1+). At present, SAARLOHA caters to around 50% of BFL's steel requirements. ICRA notes the operational flexibility enjoyed by SAARLOHA in using various types of raw materials, which helps it attain the desired product quality while maintaining its profitability. The ratings also draw comfort from the proximity of SAARLOHA's manufacturing locations to the sources of raw materials/international seaport and key customers as well as favourable long-term prospects arising from BFL's increased focus on non-automotive sectors.

The ratings, however, are constrained by SAARLOHA's continued large, non-core investments/deposits in Group companies, which drag the overall return indicators. Timely monetisation of these investments would remain a key credit monitorable. The ratings are also tempered by SAARLOHA's high dependence on the cyclical automotive sector and BFL, which accounts for the major portion of the company's revenues. The ratings also factor in the susceptibility of its operating profitability to the raw material price increases as well as its exposure to foreign exchange (forex) risks as the company does not hedge its imports. ICRA, however, notes the expected savings in power costs from FY2024 due to the set-up of a captive solar power plant, which should support profitability despite volatility in input costs. The company is also exposed to high single asset concentration risk as any disruption at its manufacturing unit in Pune could impact its cash flows.

The Stable outlook on the [ICRA]A+ rating reflects ICRA's opinion that SAARLOHA will continue to benefit from its status as one of the primary steel suppliers to the Kalyani Group's flagship entity, which should ensure stability to the overall cash flows.

Key rating drivers and their description

Credit strengths

One of the key steel suppliers to BFL – SAARLOHA was incorporated to meet the steel requirements of BFL. The company supplies forging and engineering quality steel for BFL's domestic and exports automotive and non-automotive components. BFL is a major customer for the company, contributing 70-80% to the total revenues each fiscal. Besides, there exists a strong symbiotic relationship between SAARLOHA and BFL, with the latter procuring over 50% of its steel requirements from SAARLOHA. The proximity of both the plants ensures hot charging of material from SAARLOHA to BFL, thereby saving reheating cost for BFL. Favourable long-term prospects arising from BFL's increased focus on non-automotive business augur well for SAARLOHA.

Diversified product portfolio vis-à-vis competitors – SAARLOHA produces and markets a wide range of speciality steel, such as carbon and alloy steel for forging and engineering applications, automotive steel, bearing steel and electro slag re-melted (ESR) steel. The company has set up two re-melting furnaces for manufacturing ESR and vacuum arc remelted (VAR) steel. ESR and VAR are high value-added steel, which involve advanced methods of re-melting and refining, and find applications in critical mission fields like defence and aerospace, among others, which should further aid in product diversification and support the operating profitability.

Competitive cost advantage due to proximity to raw material sources and key customers – SAARLOHA's manufacturing facility is located near the raw material sources/international seaport and key customers, which gives it a competitive cost advantage on the transportation and logistics front. In FY2023, the company set up a 74-MW solar power plant under captive model with equity contribution of approximately Rs. 0.3 crore per MW. As per the management, this is expected to lead to annual power cost savings of Rs. 35-40 crore from FY2024 onwards.

Comfortable capital structure and coverage indicators – SAARLOHA's total debt of Rs. 250.5 crore as on March 31, 2023, comprised primarily working capital borrowings. Given the limited dependence on debt and no major capital expenditure (capex) incurred over the last few years, the capital structure remained comfortable, as reflected by its low gearing of 0.3 times as on March 31, 2023 (previous year [P.Y.] – 0.4 times). SAARLOHA reported all-time high revenues of Rs. 1,943 crore in FY2023 (reflecting a YoY growth of 34%) given the healthy demand from the end-user industries and elevated sales realisations. Coupled with a stable operating profit margin (OPM) of 10.6% (P.Y. - 10.0%) and no major capex, the coverage metrics remained healthy with an interest cover of 8.6 times in FY2023 (P.Y. 7.9 times) and debt-to-operating profit of 1.2 times as on March 31, 2023 (P.Y. 1.8 times). Going forward, despite the huge capex plan of ~Rs. 250 crore in FY2024 and FY2025 combined, the overall financial profile is likely to remain comfortable, supported by continued strong demand from the end-user industries and expectation of improvement in profitability led by focus on value-added products and cost savings from the captive solar plant.

Credit challenges

Continued large non-core investments/deposits in Group companies – As on March 31, 2023, 51% of SAARLOHA's net worth was deployed towards non-core investments/deposits in Group companies. While the share (as a percentage of net worth) has declined in the recent times due to improved net worth (on account of healthy accretion to reserves), the absolute investments/deposits remain at a similar level. ICRA notes that the company has repaid Rs. 135 crore advance to BFL in Q2 FY2024 (the said advance was extended by BFL to SAARLOHA in the past towards part-funding for investment in Group companies). As per the management, these investments are strategic in nature and are not expected to generate any returns over the medium term. This, however, has a bearing on the capital return indicators. In case of any significant diminution in value of the investment portfolio, the credit profile of SAARLOHA could weaken.

Exposure to high customer concentration and cyclicality in automobile sector – SAARLOHA primarily caters to the automobile sector, which has a high degree of cyclicality in the business. Moreover, high dependence on BFL also exposes the company to high client concentration risk. BFL accounts for 70-80% of SAARLOHA's total sales each fiscal. The share is likely to remain at a similar level going forward. Nevertheless, SAARLOHA's strong wallet share in BFL's raw material requirement and strong market position of BFL in the Indian forging industry partially mitigate the impact of high client concentration risk.

Exposure to raw material price fluctuations and foreign exchange risks – SAARLOHA follows a cost-plus based pricing mechanism with its customers, which allows passing higher raw material costs, but there is a lag of two to three months due to quarterly fixing of selling prices. As a result, in the interim, the profitability is exposed to raw material price volatility. Nevertheless, the company is focusing on increasing the share of value-added products in its portfolio, which should result in margin expansion over the medium term. The company generally does not hedge its forex exposure, and hence, its profitability is exposed to foreign exchange risk volatility.

Liquidity position: Strong

SAARLOHA's liquidity position is **strong,** supported by healthy cash flow from operations, unutilised working capital limits (with sufficient drawing power) and large liquid investments. As on August 22, 2023, the company had unencumbered fixed deposits of ~Rs. 279 crore. The company's average utilisation of fund-based limits stood at 63% during the twelve months ended in March 2023. While there are no term loan repayment obligations, the company has capex plans of Rs. 250 crore, to be incurred in FY2024 and FY2025 (combined) towards replacement of caster, debottlenecking and upgrading transformer. The capex is expected to be funded from liquid balances and internal accruals. The company prefers supplier's credit facility over cash credit/working capital demand loan limits on account of relatively lower interest costs. Going forward, SAARLOHA's fund flow from operations is likely to remain healthy in the range of Rs. 140-170 crore, given the healthy demand from the end-user industries and expectation of improvement in profitability on account of a better product mix (in favour of remunerative and value-added products) and savings in power costs on account of captive solar power plant.

Rating sensitivities

Positive factors - A rating upgrade could be triggered by monetisation of non-core investments/deposits from Group companies, while maintaining a conservative capital structure and comfortable liquidity position.

Negative factors - The ratings may be downgraded if a sustained slowdown in the key end-user industry exerts pressure on the profitability and coverage indicators. A deterioration in coverage indicators with total debt vis-à-vis the operating profit (Total Debt/OPBIDTA) remaining above 2 times, on a sustained basis, could result in ratings downgrade. Any large debt-funded capacity expansion affecting SAARLOHA's capital structure, or any significant increase in investments/deposits in Group companies exerting pressure on the credit profile would also be negative rating triggers.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Entities in Ferrous Metals Industry
Parent/Group Support	Not Applicable
Consolidation/Standalone	Standalone

About the company

Incorporated in 1999, SAARLOHA (formerly known as Kalyani Carpenter Special Steels Private Limited) commenced as a 74:26 joint venture between the Kalyani Group and Carpenter Technology Corporation, USA. The company was set up to supply specialty steel to Bharat Forge Limited in technical collaboration with its foreign shareholder. The company's manufacturing facilities operated as units of Kalyani Steel Limited till 1999, when the units were de-merged and incorporated into a separate company. In FY2016, the Kalyani Group acquired the entire stake held by the Carpenter Group. The company was renamed to SAARLOHA Advanced Materials Private Limited with effect from March 13, 2018.

SAARLOHA manufactures and supplies specialised steel for the auto, mining, bearings, defence, and engineering sectors. It has a wide product portfolio, which includes forging quality and engineering quality steel, carbon, and alloy steel, ESR steel, tool and die, valve, gearing and stainless steel. SAARLOHA has two plants - one each at Mundhwa (Pune, Maharashtra) and Ranjangaon (Maharashtra). While the Pune facility is a steel producing unit with an installed production capacity of 2,04,000 MTPA, the Ranjangaon facility houses the finishing facility with a manufacturing capacity of 5,000 MTPA.

Key financial indicators (Audited)

Standalone Financials	FY2022	FY2023
Operating Income	1,487.7	1,943.1
PAT	84.0	121.7
OPBDIT/OI	10.0%	10.6%
PAT/OI	5.6%	6.3%
Total Outside Liabilities/Tangible Net Worth (Times)	1.0	0.8
Total Debt/OPBDIT (Times)	1.8	1.2
Interest Coverage (Times)	7.9	8.6

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes, and amortisation; Amount in Rs. Crore
All ratios as per ICRA's calculations

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 (Rs. Crore)	Date & rating in FY2024 Aug 29, 2023	Date & rating in FY2023 May 12, 2022	Date & Rating In FY2022 -	Date & Rating In FY2021 Mar 15, 2021
1	**Term Loans**	Long-term	-	-	-	**[ICRA]A+(Stable)**	-	**[ICRA]A+(Stable)**
2	**Fund-based/Non-fund-based Limits**	Long-term/ Short-term	552.50	-	**[ICRA]A+(Stable) /[ICRA]A1+**	**[ICRA]A+(Stable) /[ICRA]A1+**	-	**[ICRA]A+(Stable) /[ICRA]A1+**

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term/Short -term – Fund based/Non-fund Based Limits	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	Fund Based/Non-Fund Based Facilities	-	-	-	552.50	[ICRA]A+(Stable)/[ICRA]A1+

Source: Company

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

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