November 06, 2023

Aarti Steels Limited: Ratings downgraded to [ICRA]A (Stable)/[ICRA]A2+ and removed from Watch with Developing Implications

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Fund-based – Cash credit	430.00	300.00	[ICRA]A (Stable); Downgraded from [ICRA]A+ and removed from Rating Watch with Developing Implications
Long-term Fund-based – Term loan	219.37	185.46	[ICRA]A (Stable); Downgraded from [ICRA]A+ and removed from Rating Watch with Developing Implications
Short-term Non-fund based	185.39	145.39	[ICRA]A2+; Downgraded from [ICRA]A1 and removed from Rating Watch with Developing Implications
Long term/ Short term – Unallocated	5.24	-	-
Total	**840.00**	**630.85**	

**Instrument details are provided in Annexure-I*

Rationale

ICRA has removed the ratings of Aarti Steels Limited (ASL) from 'Rating Watch with Developing Implications' following consummation of the Aarti Group's restructuring programme and emergence of clarity on ASL's earnings profile and balance sheet post restructuring. ASL had two plants in Cuttack, Odisha and Ludhiana, Punjab. However, its plant in Ludhiana has been demerged to Aarti Steel International Limited (ASIL) and its Cuttack plant remains with ASL, after restructuring of the Group. The regulatory approval for the restructuring was received through the National Company Law Tribunal's (NCLT) judgment in February 2023 and the formal order in March 2023. The appointed date for the restructuring has been fixed as April 1, 2020.

While arriving at the ratings, ICRA has consolidated the financials of ASL with its associate entity, Aarti Green Tech Limited (AGTL), as ASL has provided a corporate guarantee to the lender of AGTL. Previously, ICRA had also considered another Group company, Creative Infra Limited (CIL), in which ASL had a shareholding of ~38%, for the consolidated rating view. However, CIL has been merged into another Group company, Aarti International Limited, as per the restructuring scheme and hence CIL has not been considered for arriving at the ratings of ASL.

The ratings downgrade primarily considers a higher-than-anticipated debt level and demerger of the Ludhiana plant, negatively impacting the financial profile of ASL. Relatively higher debt in the Cuttack plant than the demerged Ludhiana plant, inclusion of a sizeable amount of unsecured loan payable by ASL to ASIL owing to the restructuring, and moderation in revenue and profits of ASL due to the demerger weakened ASL's credit metrics. A contraction in profitability because of a sharp rise in coal prices in FY2023 also had a bearing on ASL's overall financial performance. The ratings, however, continue to favourably consider the long operational track record of the Aarti Group and experience of the promoters in the steel business. The ratings factor in ASL's status as an approved supplier of steel products to the ancillaries of major automobile original equipment manufacturers (OEMs) and repeat business generated from the clients over the years. ASL manufactures rolled carbon and alloy steel, which are value-added products used as components of engine, axel, etc. The company's presence in such specialised downstream steel products, a vertically integrated nature of operation and availability of power at a cheap rate from the captive power plants are likely to support its earnings, albeit volatility in margins witnessed in the past. The ratings also factor in ASL's conservative capital structure and comfortable debt coverage metrics, notwithstanding a deterioration in FY2023.

The ratings, however, are constrained by the company's exposure to the cyclicality in the automobile sector from which ASL mainly derives its revenues, and the inherent risks of price fluctuations and cyclicality in the steel industry. In FY2023, a sharp increase in the prices of coal, which is a key input for sponge iron production and power generation, adversely impacted ASL's profit margins. However, in the current fiscal, softening of coal prices and an increase in the volume of linkage coal with lower landed cost are likely to positively impact ASL's profitability. ICRA also notes ASL's highly working capital intensive nature of operations with significant receivables and stocking requirements and limited creditors, which encumber its liquidity to an extent. Its debt repayment obligation would also remain high in the near-to-medium term, however, sizeable undrawn working capital limits would support ASL's liquidity.

The Stable outlook on the long-term rating reflects ICRA's opinion that the company's business profile will remain comfortable, aided by healthy demand from its clientele and a likely uptick in margins with a moderation in input costs. Improved earnings and debt reduction with scheduled repayment are also likely to keep the credit metrics comfortable, going forward.

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 (currently under ASIL) in 1979. Such a long operational track record of the Group and the promoter's experience in steel business lend operational strength to ASL.

Established association with reputed players in automotive industry and track record of repeat business – The company's plant in Cuttack is approved by major automobile OEMs in the eastern, western and southern India for supplying rolled steel products. 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 Group company, ASIL's plant in Ludhiana, also caters to the ancillaries of major automobile OEMs in northern India. The Group's established association with reputed clients and product quality have led to repeat business over the years.

Value-added products and vertically integrated operation with presence of captive power plants likely to support earnings – The rolled products manufactured by ASL are made of carbon and alloy steels, which are relatively value-added items used in automobile parts. The value-added products keep the average realisations healthy. A portion of the sponge iron produced by the company is internally consumed for production of ingots/billets, and the same are almost entirely consumed internally to produce rolled products. ASL is involved in conversion of chrome ore into ferro chrome for Tata Steel Limited (TSL), which is highly power intensive. However, presence of captive power plants (out of which ~25% is based on waste heat recovery technology), which ensures availability of power at a cheap rate, and favourable realisation keep the contribution for ferro chrome conversion at a healthy level, supporting ASL's profitability. The vertically integrated nature of operation and presence of captive power plants provide cost advantage over non-integrated players and are likely to support ASL's earnings, notwithstanding the volatility in its margins witnessed in the past due to fluctuations of input costs.

Softening of coal prices likely to positively impact margins – A sharp increase in the prices of coal, which is a key input for sponge iron production and power generation in the Cuttack plant, adversely impacted ASL's profit margins in FY2023. Nevertheless, softening of coal prices and an increase in the volume of linkage coal with lower landed cost are likely to positively impact ASL's profitability in the current fiscal.

Conservative capital structure and comfortable debt coverage metrics, notwithstanding a deterioration in FY2023 – The Group restructuring had a negative impact on ASL's capital structure and debt coverage metrics as the demerged Ludhiana plant (currently under ASIL) has relatively lower debt. Nevertheless, ASL's consolidated gearing remained conservative at 0.7 times as on March 31, 2023. The debt coverage metrics also remained comfortable, as reflected by an interest coverage of 3.8 times and DSCR of 1.7 times. However, the interest coverage and DSCR deteriorated from 7.3 times and 3.3 times, respectively in FY2022, led by margin contraction on the back of a sharp rise in coal prices. Nevertheless, a likely uptick in profit margins with softening of coal prices and gradual repayment of debt are likely to strengthen the credit metrics, going forward.

Credit challenges

Higher-than-anticipated debt level and demerger of the Ludhiana plant, negatively impacting the financial profile of ASL – The Ludhiana plant, which has been demerged to ASIL, is relatively old and less integrated. However, the level of debt in the Ludhiana plant is also lower than the Cuttack plant. Moreover, during the restructuring, it was settled between the promoter family that ASL will pay Rs. 77.5 crore to ASIL as the valuation of ASL's plant is higher than that of ASIL. The amount has been included as an interest-bearing unsecured loan (~Rs. 71 crore outstanding as on March 31, 2023) from ASIL to ASL, increasing the latter's debt level. The overall turnover and profits of ASL have also declined significantly due to demerger of the Ludhiana plant. Deterioration in profits and higher-than-anticipated debt level adversely impacted ASL's credit metrics in FY2023.

Exposed to cyclicality in the automobile sector, the key contributor to ASL's revenues – ASL 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 presence of ferro chrome conversion operation, sales of excess sponge iron and power reduce the product concentration risks to an extent.

Vulnerable to price fluctuation risks and cyclicality inherent in the steel industry – The company requires iron ore and coal as the main raw materials for sponge iron production. Coal is also required for power generation. In addition, the company requires scrap, pig iron, ferro alloys and other metals used to manufacture ingots/billets. The volatility in the raw material prices and cyclicality inherent in the steel industry may impact the company's profits and cash accruals. In FY2023, its profit margins were adversely impacted by a sharp increase in coal prices.

High working capital intensity of operations – The company has significant receivables and stocking requirements, and its creditors remain limited. Hence, ASL's working capital intensity of operations remained high, as reflected by the net working capital relative to the operating income of ~35% over the last two fiscals. Consequently, its incremental working capital requirement to scale up operations would remain high. Nevertheless, the company has a significant cushion in its working capital utilisation.

Liquidity position: Adequate

ASL's liquidity profile remains adequate. The total cost of the ongoing capex for installing a wagon tippler facility in its railway siding for automated unloading of raw materials has been estimated at Rs. 70-75 crore, being partly funded by a term loan (Rs. 45 crore) and the balance from internal accruals. In addition, the company is incurring capex for construction of a new office building, which is likely to cost Rs. 55-57 crore, and some smaller capex for an oxygen plant and modification of furnaces, which are being funded internally. The major portion (~Rs. 91 crore) of the capex was already incurred till March 31, 2023. In the current fiscal, a capex of Rs. 50-55 crore is likely to be incurred, out of which ~Rs. 21 crore would be funded by debt. The consolidated entity has sizeable debt repayment obligation of ~Rs. 50 crore in FY2024 and ~Rs. 61 crore in FY2025. However, the undrawn limit in ASL's working capital facility stood at ~Rs. 144 crore on an average in H1 FY2024. This coupled with a likely improvement in cash flow from operations are likely to keep the liquidity position adequate.

Rating sensitivities

Positive factors – A 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 the company's revenues or profitability adversely impacts its debt protection metrics and liquidity. The specific credit metrics, which may trigger a rating downgrade, include consolidated interest coverage below 4.0 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 consolidated the financials of ASL with an associate entity enlisted in Annexure-II

About the company

Incorporated in 1979, Aarti Steels Limited (ASL) is a part of the Aarti Group, promoted by the Ludhiana-based Mittal family led by Mr. Shiva Prasad Mittal. ASL is a vertically integrated manufacturer of carbon and alloy steel, mainly for the automobile sector. ASL had two plants in Cuttack, Odisha and Ludhiana, Punjab. However, its plant in Ludhiana has been demerged to Aarti Steel International Limited (ASIL; rated at [ICRA]A+ (Stable)/[ICRA]A1), and the Cuttack plant remains with ASL, after restructuring of the Group. 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. The appointed date for the restructuring has been fixed as April 1, 2020. ASL's plant in Cuttack has the capacity to manufacture sponge iron of 3,20,000 tonnes per annum (TPA), ingots/billets of 1,20,000 TPA, rolled products of 2,00,000 TPA along with ferro alloys manufacturing capacity of 36 MVA and captive power plants of 90 MW. The ferro alloys manufacturing facility is used to carry out conversion of ferro chrome for Tata Steel Limited.

ASL has provided a corporate guarantee to the lender of Aarti Green Tech Limited (AGTL), which is involved in shredding of metal scraps for Tata Steel Limited. The plant, which has an installed capacity of 5,00,000 TPA, commenced operations from November 2020. Earlier, ASL had a shareholding of ~52% in AGTL. However, after the recent Group restructuring, ASL's shareholding in AGTL has been reduced to ~26%, and the balance ~26% has been transferred to ASIL.

Key financial indicators (audited)

ASL	Standalone		Consolidated*	
	FY2022	FY2023	FY2022	FY2023
Operating income	1,453.7	1,681.6	1,483.2	1,726.5
PAT	83.2	25.1	85.2	28.7
OPBDIT/OI	12.6%	7.0%	13.2%	7.7%
PAT/OI	5.7%	1.5%	5.7%	1.7%
Total outside liabilities/Tangible net worth (times)	0.8	1.0	0.9	1.0
Total debt/OPBDIT (times)	2.3	4.0	2.5	4.0
Interest coverage (times)	8.4	4.0	7.3	3.8

*PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore; *Estimated*

Note: ASL has prepared the FY2023 results as per the restructuring and has also restated FY2021 and FY2022 results accordingly, as the appointed date of the restructuring scheme has been fixed as April 1, 2020; hence, the standalone/ consolidated results do not include the Ludhiana unit (demerged to ASIL)

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
					Nov 06, 2023*	Mar 27, 2023	May 12, 2022	Feb 14, 2022	May 10, 2021	-
1	Cash credit	Long term	300.00	-	[ICRA]A (Stable)	[ICRA]A+&	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	-
2	Term loan	Long term	185.46	156.92	[ICRA]A (Stable)	[ICRA]A+&	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	-
3	Non-fund based limit	Short term	145.39	-	[ICRA]A2+	[ICRA]A1&	[ICRA]A1	[ICRA]A1	[ICRA]A1	-
4	Working capital demand loan	Short term	-	-	-	-	[ICRA]A1	-	-	-
5	Unallocated	Long term/ Short term	-	-	-	[ICRA]A+& / [ICRA]A1&	-	-	-	-
6	Unallocated	Long term	-	-	-	-	-	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	-

*&: Rating Watch with Developing Implications; *Ratings removed from Rating Watch with Developing Implications*

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

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	300.00	[ICRA]A (Stable)
NA	Term Loan-I	26-Mar-21	NA	30-Apr-25	13.31	[ICRA]A (Stable)
NA	Term Loan-II	31-Mar-22	NA	31-Mar-28	12.70	[ICRA]A (Stable)
NA	Term Loan-III	27-Jun-17	NA	30-Sep-29	38.00	[ICRA]A (Stable)
NA	Term Loan-IV	31-Mar-21	NA	31-Mar-26	8.65	[ICRA]A (Stable)
NA	Term Loan-V	31-Mar-22	NA	28-Feb-27	7.08	[ICRA]A (Stable)
NA	Term Loan-VI	1-Feb-18	NA	28-Feb-26	40.72	[ICRA]A (Stable)
NA	Term Loan-VII	7-Jun-22	NA	31-Mar-29	45.00	[ICRA]A (Stable)
NA	Term Loan-VIII	7-May-21	NA	31-Mar-26	20.00	[ICRA]A (Stable)
NA	Non-fund based facilities	NA	NA	NA	145.39	[ICRA]A2+

Source: Company

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

Annexure II: List of entities considered for consolidated analysis

Company Name	ASL Ownership	Consolidation Approach
Aarti Green Tech Limited (AGTL)	~26%	Full Consolidation

Source: ASL
Note: ICRA has taken a consolidated view of ASL and AGTL while assigning the ratings

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