

December 09, 2019

ARS Steels and Alloy International 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/ TL	0.00	35.00	[ICRA]BBB (Stable); reaffirmed
Long Term - Fund Based/ CC	29.00	29.00	[ICRA]BBB (Stable); reaffirmed
Short Term - Non-Fund Based	106.00	106.00	[ICRA]A2; reaffirmed
Long Term - Unallocated	35.00	0.00	-
Total	170.00	170.00	

*Instrument details are provided in Annexure-1

Rationale

The ratings reaffirmation considers the significant improvement in ARS Steels and Alloy International Private Limited's (ARS Steels) sales volume in FY2019 on the back of favourable demand and remunerative steel prices. The company's capital structure and debt protection metrics continue to remain healthy on the back of relatively low fund-based borrowing and strong net worth position. The ratings favourably factor in ARS Steels' power procurement arrangement with its Group concern at a competitive rate, which helps in sustaining profitability. Further, the ratings continue to draw comfort from the considerable experience of ARS Steels' promoters in the steel industry and its partially backward-integrated plant with capabilities to manufacture mild steel (MS) billets and TMT bars.

The ratings, however, remain constrained by the cyclicity in price fluctuation associated with the TMT steel industry. ARS Steels' operating income (OI) and profitability are likely to be under pressure in the near term, given the steep decline in steel prices in H1 FY2020. Nonetheless, declining input costs are expected to mitigate this risk to an extent. The ratings also continue to factor in the company's moderate scale of operations, along with high geographical concentration risk. Further, the TMT steel industry is characterised by intense competition and commoditised nature of the product, which limit the company's pricing flexibility, thereby limiting its operating margins.

The Stable outlook reflects ICRA's expectation that ARS Steels will benefit from its established brand presence in the domestic steel industry and the extensive experience of its promoters.

Key rating drivers and their description

Credit strengths

Significant experience of the promoters, established network of suppliers and customers – ARS Steels was incorporated in 2013 through demerger of the steel division from ARS Metals Private Limited, which was involved in the business of metal and allied products since 1990. The promoters of ARS Steels, Mr. Ashwani Kumar Bhatia and Mr. Rajesh Bhatia, have over three decades of experience in the steel industry. Given the vast experience of the promoters in the industry with an established operational track record, the company has been able to develop a wide network of suppliers and customers.

Strong sales growth in FY2019, expected to remain stagnant in FY2020 – ARS Steels’ operating income (OI) grew at a healthy rate of 38% in FY2019 on the back of favourable demand and realisations. The sales growth was supported by regular off-take from local dealers in Tamil Nadu, Andhra Pradesh, Karnataka and Pondicherry and improved demand from construction and real-estate sectors. Its healthy growth in sales volume was further supported by the established dealership network and reputation of the company’s brands, TRUSTEEL and PIXON.

Partially backward integrated plant – The company’s operating margin are supported by the integrated nature of operations and reduced power cost. ARS Steels has a continuous casting facility to manufacture MS billets from MS scrap and has hot-charging line in its TMT operations. Through the partially backward-integrated facility, ARS Steels has been able to moderately utilise the raw material price differential benefits as it consumed the entire MS billets produced for manufacturing of TMT bars. In FY2019, higher production resulted in higher external billets purchase, which resulted in a marginal decline in operating margins. However, with the proposed capex to increase the induction furnace capacity, the operating margins are expected to improve in the long term.

Reduced power cost due to favourable power situation with procurement arrangement from Group company – During the last two years, ARS Steels procured a major portion of its power requirement (90% of its total power requirement) from its Group company, ARS Energy Private Limited. The company continues to benefit from the power procurement arrangement with its Group company, which supports the cost structure to an extent. ICRA also notes that, going forward, operationalisation of the direct feeder line (after receiving approvals) would result in a considerable cost savings for the company.

Credit challenges

Susceptibility of margins to fluctuation in raw material prices – Being a secondary steel manufacturer, the company’s main raw material is scrap/billet, prices of which remain highly volatile. ARS Steels’ operations are raw material intensive with raw materials and consumables consumption accounting for over 60% of its OI over the last three fiscals. With the company maintaining moderately high inventory levels, the profitability remains exposed to raw material price fluctuation risk. The company’s OI and profitability are likely to be under pressure in the near term, given the steep decline in steel prices in H1 FY2020. Nonetheless, declining input costs are expected to mitigate this risk to an extent.

Exposure to cyclicality and intense competition inherent in the steel industry – The domestic steel industry is cyclical in nature and is likely to impact the cash flows of TMT manufacturers, including ARS Steels. The company’s operations are vulnerable to any adverse change in the demand-supply dynamics in the real estate and construction sectors, especially in Tamil Nadu, Andhra Pradesh, Karnataka and Pondicherry regions. Also, given the commoditised nature of the product, the TMT business is characterised by intense competition across the value chain because of low product differentiation, which consequentially limits the pricing flexibility of the players, including ARS Steel. Nonetheless, ARS Steels is trying to significantly distinguish itself by launching new premium products and by targeted marketing efforts.

Moderate scale of operation – Despite a strong growth in FY2019, ARS Steels’ scale of operation continues to remain moderate, with its manufacturing plant located at a single location. Even though the company caters to most of the South Indian states, a major portion of sales is contributed by the Tamil Nadu market.

Liquidity position: Adequate

The company has a robust liquidity position on the back of healthy cash balance and a comfortable buffer in working capital limits in FY2019. Also, ARS’ monthly working capital utilisation was moderate, averaging at 21% of the drawing power and 26% of the sanctioned limits in the 17-month period from April 2018 to August 2019. While the company has planned a debt-funded capex of Rs. 40-47 crore, to be incurred in the medium term, the company’s liquidity position is expected to remain adequate, going forward as well.

Rating sensitivities

Positive triggers – ICRA may upgrade ARS Steels’ ratings if the company is able to sustain the profitability metrics in FY2020 while sustaining its capital structure and liquidity profile.

Negative triggers – Negative pressure on ARS Steels’ ratings may arise if adverse market condition results in a decline in profitability and results in RocE below 13% on a sustained basis. The ratings may also be downgraded if its liquidity profile deteriorates on account of any higher-than-expected capex (capex of Rs.40-47 crore expected in the near term for capacity expansion of induction furnace and rolling mill) or any further large incremental support extended to Group entities (the company extended loan of Rs. 20 crore to ARS Energy in FY2019).

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Ferrous Metals Industry
Parent/Group Support	NA
Consolidation/Standalone	The ratings are based on standalone financial profile of the company

About the company

Incorporated in 2013, ARS Steels manufactures TMT bars, with a capacity to produce 128,000 tonnes per annum (tpa). It also has facilities to produce billets (158,400 tpa), which are used for captive consumption. The company’s manufacturing units are located near Gummidipoondi, Tamil Nadu. Promoted by Mr. Ashwani Kumar Bhatia and Mr. Rajesh Bhatia, ARS Steels sells its products to the housing segment of the construction industry through its dealer network under the brands, TRUSTEEL and PIXON. The company has proposed to increase the induction furnace and rolling mill capacity to 250,000 tonnes each at a cost of Rs.40-47 crore in the near future.

ARS Steels procures power from its Group company – ARS Energy Private Limited – through group captive scheme. ARS Energy Private Limited operates a 60-MW coal-based group captive power plant in Gummidipoondi, near Chennai.

Key financial indicators (audited)

	FY2018	FY2019
Operating Income (Rs. crore)	379.0	521.3
PAT (Rs. crore)	14.2	14.6
OPBDIT/OI (%)	6.1%	4.7%
RoCE (%)	14.6%	14.9%
Total Outside Liabilities/Tangible Net Worth (times)	0.6	0.7
Total Debt/OPBDIT (times)	0.9	1.0
Interest Coverage (times)	4.3	5.4
DSCR	4.6	5.3

Source: ARS Steels

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2020)				Rating History for the Past 3 Years		
		Type	Amount Rated	Amount Outstanding	Rating	FY2019	FY2018	FY2017
					9-Dec-2019	9-Nov-2018	28-Sep-2017	-
1	Term Loan	Long Term	35.00	35.00	[ICRA]BBB (Stable)	-	-	-
2	Cash Credit	Long Term	29.00	-	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB-(Stable)	-
3	Letter of Credit	Short Term	106.00	-	[ICRA]A2	[ICRA]A2	[ICRA]A3	-
4	Unallocated	Long Term	0.00	-	-	[ICRA]BBB (Stable)	-	-

Amount in Rs. crore

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loan	Jan-2019	NA	Sep-2027	35.00	[ICRA]BBB (Stable)
NA	Cash Credit	NA	NA	NA	29.00	[ICRA]BBB (Stable)
NA	Letter of Credit	NA	NA	NA	106.00	[ICRA]A2

Source: ARS Steels

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