

August 12, 2021

Suraj Products 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
Fund-based term loans	31.00	31.00	[ICRA]BBB-(Stable); Upgraded from [ICRA]BB+(Stable)
Fund-based cash credit	25.00	25.00	[ICRA]BBB-(Stable); Upgraded from [ICRA]BB+(Stable)
Non-fund-based limits	1.50	1.50	[ICRA]A3; Upgraded from [ICRA]A4+
Total	57.50	57.50	

*Instrument details are provided in Annexure-1

Rationale

The rating upgrade factors in the improvement in Suraj Products Limited's (SPL) financial risk profile in FY2021. The improvement was aided by factors including revenue growth, a rise in operating profits resulting in higher accruals, and a reduction in debt levels. The revenues grew 85% year-on-year (YoY) to ~Rs.218 crore and the operating profits grew 86% YoY to ~Rs.31 crore in FY2021. Revenues and operating profits got support on the back of increased sales volume and higher realisations owing to a change in the product mix with the company benefitting from the first full year of operations of its rolling mill, allowing it to sell more TMT bars, a value-added product. Improved accruals along with a reduction in its working capital intensity aided SPL to channelise its free cash flows for debt reduction, strengthening its capitalisation and coverage metrics in FY2021. Additionally, ICRA believes that SPL's business outlook remains favourable in FY2022 with resilient demand for steel and realisations inching towards all-time high levels in Q1 FY2022, notwithstanding the impact of the second wave of the pandemic. Although raw material prices (mainly iron ore) have increased consistently in the recent months, ICRA does not expect any significant deterioration in SPL's operating margins as steel realisations have also maintained an upward trend. The ratings continue to derive comfort from SPL's vertically integrated nature of operations, characterised by the presence of DRI¹ kiln (used to manufacture sponge iron), mini blast furnace (used to manufacture pig iron), induction furnace and continuous caster to produce billets using captive sponge iron and pig iron. The manufactured billets are then subjected to rolling to produce TMT bars of desired profile. The ratings also derive comfort from the presence of the company's captive power plant (CPP), leading to availability of power at a cheap rate that positively impacts its cost structure owing to a highly power intensive nature of the operation. In addition, a significant portion of the company's total thermal coal requirements for manufacturing of sponge iron is met from the linkages obtained through auctions, keeping the landed cost of coal competitive and enhancing raw material security. The ratings also derive strength from the favourable location of SPL's plant in terms of proximity to major raw material sources. The company has capex plans over the next one year towards cost improvement initiatives, which include installation of a 3,00,000 metric tonnes per annum (MTPA) beneficiation plant and expansion of its captive power generation capacity by 3 MW. Once operational, the same will further strengthen the operating profile of the company and enable sizeable cost savings.

The ratings are, however, constrained by the intensely competitive nature of the secondary steel industry, which leads to pricing pressure, keeping margins under check. The ratings also remain constrained by the exposure of the company to the cyclical nature inherent in the steel industry and susceptibility of SPL's profitability to the volatility in raw material prices and end-product realisations, although the vertically integrated nature of operations reduces the vulnerability to an extent. The ratings

¹ Direct reduced iron

also factor in SPL's small scale of operations relative to other established players in the secondary steel industry, which constrains its ability to benefit from the economies of scale and limits its pricing flexibility.

The Stable outlook on the long-term rating reflects the favourable operating environment for the steel industry, which is expected to lead to yet another year of healthy earnings growth for SPL in FY2022. The company's planned capital allocation on efficiency improvement capex has attractive payback periods, which ICRA expects would support the company's earnings in periods when the steel spreads move towards more sustainable levels from the prevailing highs.

Key rating drivers and their description

Credit strengths

Significant growth in revenues and operating profits in FY2021, expected to sustain in FY2022 – SPL posted an 85% YoY growth in its revenues and 86% YoY growth in its operating profits in FY2021 on the back of increased sales volume and higher realisations owing to a change in the product mix. The company benefitted from the first full year of operations of its rolling mill, which allowed it to sell more TMT bars, a value-added product. The sale of TMT bars accounted for a predominant share of SPL's revenues in FY2021 unlike previous years, when the entire sales were contributed by semis. Additionally, ICRA believes that SPL's business outlook remains favourable in FY2022 with resilient demand for steel and realisations inching towards all-time high levels in Q1 FY2022, notwithstanding the impact of the second wave of the pandemic. Although raw material prices (mainly iron ore) have increased consistently in the recent months, ICRA does not expect any significant deterioration in SPL's operating margins as steel realisations have also maintained an upward trend.

Improvement in the financial risk profile – Growth in operating profits in FY2021 resulted in higher accruals. Improved accruals along with a reduction in its working capital intensity aided SPL to channelise its free cash flows for debt reduction, strengthening its capitalisation and coverage metrics in FY2021. The capital structure, as reflected by the gearing, improved to 1.2 times as on March 31, 2021 from 1.9 times as on March 31, 2020. The coverage metrics, as reflected by interest coverage and TD/OPBDITA, improved to 4.4 times and 2.1 times, respectively in FY2021 from 2.6 times and 5.2 times, respectively in FY2020.

Vertically integrated nature of operations with capacity to manufacture sponge iron, pig iron, billets and TMT bars – The company has a vertically integrated continuous casting steel manufacturing facility with a capacity of 36,000 MTPA of sponge iron, 24,000 MTPA of pig iron, 72,600 MTPA of billets and 72,600 MTPA of TMT bars. Billets are manufactured using captive sponge iron and pig iron. The manufactured billets are then subjected to rolling to produce TMT bars of desired profile. In addition, a significant portion of the company's total thermal coal requirements for manufacturing of sponge iron is met from the linkages obtained through auctions, keeping the landed cost of coal competitive and enhancing raw material security.

Presence of captive power plant ensures availability of power at a cheap rate – The company's steel melting operation is highly power intensive. However, power generated through SPL's captive power plant at a cheap rate meets the major part of its overall power requirement, which positively impacts the cost structure.

Planned capex likely to further strengthen the operating profile of the company, going forward – The company has capex plans over the next one year towards cost improvement initiatives, which include installation of a 3,00,000-MTPA beneficiation plant and expansion of its captive power generation capacity by 3 MW. With the price differential between high-grade and low-grade iron ore remaining substantially high in the current environment of a domestic iron ore deficit for high-grade ore, the beneficiation plant, once operational will enable significant cost savings. Once operational, the additional power generation capacity, equipment orders for which has already been placed at a competitive capital cost, will meet most of the incremental power demand arising out of the increased scale of operations. The entire portion of the planned capex will be funded through internal accruals, given the healthy cash generation expected in the current fiscal.

Credit challenges

Competitive nature of the industry likely to keep margins under check – SPL is a secondary steel producer and derives the major portion of its revenue from semi-urban and rural areas. The fragmented nature of the long product/semis industry and intense competition from other organised as well as unorganised players are likely to keep its margins under check.

Exposed to cyclical nature inherent in the steel industry – SPL is exposed to cyclical nature inherent in the steel industry, which leads to volatility in revenue and cash flows for the industry players, including SPL. The cash flows and profitability of the company would remain volatile largely because of the fluctuation in steel spreads emanating from the mismatch in price movement of raw materials and end products. However, the vertically integrated nature of SPL’s operations reduces the earnings volatility to an extent.

Relatively smaller scale of operations – Notwithstanding the increase in scale of operations of SPL in FY2021, the same remained small compared to other established players in the secondary steel industry. This constrains its ability to benefit from the economies of scale and limits its pricing flexibility vis-à-vis that of the bigger entities operating in the industry.

Liquidity position: Adequate

SPL’s liquidity position has been assessed as **adequate** with undrawn working capital lines of Rs.25 crore as on May 31, 2021 and healthy fund flow from operations expected over the medium term. Against these sources of cash, the company has a total capex commitment of around ~Rs.9-10 crore and debt repayment obligations of ~Rs.10 crore in FY2022. Overall, ICRA expects SPL to be able to comfortably meet its capex commitments and service its debt obligations through internal as well as external sources of cash.

Rating sensitivities

Positive factors – ICRA may upgrade SPL’s ratings if there is a significant increase in its scale of operations while maintaining healthy business returns and credit metrics.

Negative factors – Pressure on SPL’s ratings may arise in case of weaker-than-expected financial performance due to adverse demand scenario. A specific trigger for downgrade would be DSCR lower than 1.6 times on a sustained basis. Additionally, any major debt-funded capex, leading to weakening of capital structure would put pressure on SPL’s ratings.

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	For arriving at the ratings, ICRA has considered the standalone financials of SPL.

About the company

Established in 1991, Champion Cement Industries Limited was involved in production of cement. The company took its present name, Suraj Products Limited (SPL), in 2000. Since 2002, the company discontinued the cement manufacturing plant and diversified into manufacturing of sponge iron and pig iron. The manufacturing facility is in Sundargarh district, Odisha. The company commissioned its 3-MW waste heat recovery based captive power plant (CPP) and an induction furnace of 25,000 tonnes per annum (TPA) capacity in FY2018. In FY2019, SPL installed its second CPP of 3 MW (AFBC based) and doubled its steel melting capacity to 50,000 TPA. In FY2020, SPL added a rolling mill facility of 72,600 TPA for production of TMT bars and an induction furnace of 22,600 TPA. At present, the company has an installed capacity to produce 36,000 TPA of sponge iron, 24,000 TPA of pig iron, 72,600 TPA of billets and TMT bars, each.

Key financial indicators (Audited)

SPL Standalone	FY2020	FY2021
Operating Income (Rs. crore)	118.0	217.7
PAT (Rs. crore)	5.4	9.2
OPBDIT/OI (%)	14.0%	14.1%
PAT/OI (%)	4.6%	4.2%
Total Outside Liabilities/Tangible Net Worth (times)	2.2	1.3
Total Debt/OPBDIT (times)	5.2	2.1
Interest Coverage (times)	2.6	4.4

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation

Status of non-cooperation with previous CRA:

CRA	Status	Date of Release
CRISIL	CRISIL B+/Stable/A4; ISSUER NOT COOPERATING	May 31, 2021

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2022)				Chronology of Rating History for the past 3 years			
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of Mar 31, 2021 (Rs. crore)	Date & Rating in FY2022 Aug 12, 2021	Date & Rating in FY2021 Jun 23, 2020	Date & Rating in FY2020 Feb 28, 2019	Date & Rating in FY2019 -	
1	Fund-based term loans	Long-term	31.00	27.62	[ICRA]BBB-(Stable)	[ICRA]BB+(Stable)	[ICRA]BB+(Stable)	-	
2	Fund-based cash credit	Long-term	25.00	-	[ICRA]BBB-(Stable)	[ICRA]BB+(Stable)	[ICRA]BB+(Stable)	-	
3	Non-fund-based limits	Short-term	1.50	-	[ICRA]A3	[ICRA]A4+	[ICRA]A4+	-	

Complexity level of the rated instruments

Instrument	Complexity Indicator
Fund-based term loans	Simple
Fund-based cash credit	Simple
Non-fund-based limits	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, is available on ICRA's website: www.icra.in

Annexure-1: Instrument details

ISIN No.	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. Crore)	Current Rating and Outlook
NA	Fund-based term loans	FY2017	NA	FY2024	31.00	[ICRA]BBB- (Stable)
NA	Fund-based cash credit	NA	NA	NA	25.00	[ICRA]BBB- (Stable)
NA	Non-fund-based limits	NA	NA	NA	1.50	[ICRA]A3

Source: Company

Annexure-2: List of entities considered for consolidated analysis – Not applicable

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

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