

June 11, 2019

## SRC Chemicals Private Limited: Rating reaffirmed and removed from Issuer Not-cooperating category; outlook changed to positive; rated amount enhanced

### Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long term Fund Based – Cash Credit	8.00	20.00	[ICRA]BBB- reaffirmed; outlook revised to positive from stable; removed from Issuer Not-cooperating category
Long term/Short term unallocated	3.00	0.00	[ICRA]BBB-/ [ICRA]A3; reaffirmed; outlook revised to positive from stable, removed from Issuer Not-cooperating category
Short term fund based	5.00	15.00	[ICRA]A3; reaffirmed and removed from Issuer Not-cooperating category
Short term non-fund based	23.35	60.00	[ICRA]A3; reaffirmed and removed from Issuer Not-cooperating category
Short term – Interchangeable*	0.00	(59.00)	[ICRA]A3; reaffirmed and removed from Issuer Not-cooperating category
<b>Total</b>	<b>39.35</b>	<b>95.00</b>	

\*Instrument details are provided in Annexure-1; \*interchangeable with short term non fund based limits

### Rationale

The rating reaffirmation continues to factor in the extensive experience of the promoters of SRC Chemicals Private Limited (SRCC) in the ferro-alloys industry as well as its reputed customer profile. ICRA also notes the significant revenue growth reported by the company in the past two fiscals, mainly contributed by increase in ferro-molybdenum and ferrochrome sales. The positive outlook factors in ICRA's expectation that the company would be able to sustain the revenue growth and improved profit margins in the near-term on the back of stable demand conditions for ferroalloys.

The rating, however, is constrained by the cyclicity of the ferro-alloy industry, which is exposed to the cyclicity of the steel industry. ICRA notes SRCC's modest profit margins, given the limited value-added nature of its operations, and its moderate capitalisation and debt coverage indicators. The ratings also factor in the vulnerability of SRCC's profitability to fluctuations in input as well as finished goods prices, which have exhibited significant volatility in the past, and high supplier concentration risk. The rating also considers SRCC's exposure to foreign exchange risks, given the sizeable import purchases vis-à-vis export sales, in the absence of a firm hedging mechanism. ICRA notes that the low import duty differential between the import of ore and finished goods results in import substitution risk, thereby exerting pressure on the company's overall profitability.

### Outlook: Positive

The positive outlook reflects ICRA's anticipation with regards to the company sustaining its revenue growth and improved profitability in the near term, especially given its presence in the cyclical steel industry. ICRA also expects SRCC to continue to benefit from the extensive experience of its promoters in the ferro-alloys industry; the established relationships with its customers leading to stable order inflow as also suppliers vital in maintaining the raw material supply linkages. The outlook may be revised to stable if growth in revenues and profitability does not witness the expected improvement. The outlook may be revised to Negative if cash accrual is significantly lower than expected, or if any major debt-funded capital expenditure, or stretch in the working capital cycle, weakens liquidity.

## Key rating drivers

### Credit strengths

**Extensive experience of the promoters in the ferro-alloys industry** – SRCC is promoted by the Lakhotia family. The key promoter, Mr. Suresh Lakhotia, has an extensive experience in the ferro-alloys industry spanning over two decades. The Lakhotia family has also promoted Shree Ram Lime Products Private Limited and Shree Ram Cargo Private Limited among other entities, which cumulatively form the SR Group.

**Significant revenue growth over the past two fiscals** – Over the past two fiscals, SRCC has registered a significant revenue growth driven mainly by ferro-molybdenum sales and ferrochrome sales, given the buoyancy in the cyclical steel industry. The operating income stood at Rs. 447.27 crore in 11M FY2019, up from Rs. 291.53 crore in FY2018 and Rs. 182.66 crore in FY2017. Ferro-chrome sales have increased significantly to Rs. 55.19 crore in 11M FY2019 from Rs. 1.33 crore in FY2018 and Rs. 0.48 crore in FY2017, post commissioning of its manufacturing operations at Pune. Ferro-molybdenum sales increased to Rs. 204.13 crore in 11M FY2019 as compared to Rs. 151.82 crore in FY2018.

**Reputed customer profile** – The company's customer profile comprises reputed entities like JSW Steel Limited, AIA Engineering Limited and Gerdau Steel India P. Ltd., among others. JSW Steel Limited has been the key client accounting for 55% and 34% of SRCC's total sales in FY2018 and FY2019, respectively.

### Credit challenges

**Cyclical nature of ferro-alloy industry** – The ferro-alloy industry is cyclical in nature, which is exposed to the cyclicity in the steel industry affecting sales realisations and profit margins during downturns, as witnessed in FY2016 and FY2017.

**Moderate capital structure and debt coverage indicators, modest profit margins** – SRCC's operations are working capital intensive in nature, resulting in high reliance on external borrowings. Its total debt has increased in the last couple of fiscals, mainly due to higher working capital borrowings required to support the growing scale of operations. As of February 28, 2019, the gearing stood at 1.37 times while the debt coverage indicators, although improved over previous fiscals, remained moderate with TD/OPBIDTA of 2.53 times, TOL/TNW of 1.86 times and NCA/TD of 22%. The profit margins of the company have historically remained modest, given the limited value addition, and have fluctuated in the range of 3-5%, depending upon movements in steel prices.

**Vulnerability of profitability to price fluctuation risks, significant imports entailing forex fluctuation risks** – SRCC sources its major raw materials like molybdenum oxide and aluminum cans through imports, which have driven ~80% of its total purchases in the last two fiscals. With limited export sales and the absence of any hedging mechanism, the company's profitability remains vulnerable to foreign exchange fluctuation risks. Nonetheless, the company tries to negotiate pricing terms with suppliers in a manner that averages out the impact of forex fluctuation arising out of different transit times involved in imports from different countries. The prices of raw materials, especially molybdenum, have demonstrated a high degree of volatility in the past. SRCC's operating profit margins thus remain susceptible to such price variations, which might not be fully passed on to customers due to competitive pricing pressures. The company is, however, protected to an extent as its production is order-backed, resulting in low inventory build-up.

**High supplier concentration risk** - Limited availability of raw material, especially for ferro-molybdenum, has resulted in increased reliance of the company on a few suppliers though long-term relationships with them has resulted in the company maintaining stable supply linkages. In FY2019, SRCC's top five suppliers accounted for 93% of its total purchases, indicating a high supplier concentration risk. However, SRCC's established relationship with these suppliers mitigates the risk to an extent.

**Threat of import substitution** – Given the import dependence on raw materials (ores), some end-users also import the finished goods (ferro-alloys) directly, implying high substitution risk. The low import duty differential between import of ore and finished goods further exacerbates the risk.

### Liquidity position

SRCC's cash flows from operations as well as free cash flows stood negative in FY2018 and declined further in 11M FY2019 owing to increased incremental working capital requirements to support the growing scale of operations. SRCC had external term loans of Rs. 2.18 crore on its books as on March 31, 2018, for which it has annual repayments of close to Rs. 0.49 crore in FY2019, followed by Rs. 0.72 crore in FY2020 and FY2021. The average fund-based working capital utilisation as a percentage of sanctioned limits during the 14-month period ending April 2019 stood moderate at 57% while the peak utilisation remained at 86%. The average non-fund based working capital utilisation as a percentage of sanctioned limits during the 14-month period ending April 2019 stood high at 91% while the peak utilisation remained at 100%. As on March 31, 2018, the company had free cash and bank balance of Rs. 1.99 crore on its books.

### Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	<a href="#">Corporate Credit Rating Methodology</a> <a href="#">Rating Methodology for Entities in the Ferrous Metals Industry</a>
Parent/Group Support	Not applicable
Consolidation/Standalone	Standalone

### About the company

SRC Chemicals Private Limited was established in Pune (Maharashtra) as a proprietary concern in 1998 and was later converted into a private limited company in 2002. It is a part of the Rajasthan-based SR Group with interests in limestone mining, manufacturing of lime, dolomite and ferro-alloys along with trading interests in sponge iron, coal and fluorspar. SRCC manufactures calcined lime (quick lime), ferro-molybdenum and ferro-manganese from its three plants at Pune, Visakhapatnam (Andhra Pradesh) and Koppal (Karnataka). SRCC has a lime manufacturing capacity of 120,000 TPA (tonne per annum) in Hosapete (Karnataka). It also has ferro-alloys and fluorspar plants with capacities of 12,000 TPA and 42,000 TPA at Pune and Visakhapatnam, respectively.

In FY2018, the company reported a net profit of Rs. 5.09 crore on an OI of Rs. 291.53 crore, as compared to a net profit of Rs. 1.56 crore on an OI of Rs. 182.66 crore in the previous year. As per the provisional financials for 11M FY2019, the company reported a net profit of Rs.8.72 crore on an OI of Rs.447.27 crore.

## Key financial indicators

	FY2017	FY2018	FY2019 (11M)
	Audited	Audited	Provisional
Operating Income (Rs. crore)	182.66	291.53	447.27
PAT (Rs. crore)	1.56	5.09	8.72
OPBDIT/OI (%)	3.87%	4.50%	4.57%
RoCE (%)	7.89%	14.58%	22.15%
Total Debt/TNW (times)	1.36	1.39	1.37
Total Debt/OPBDIT (times)	5.34	3.48	2.53
Interest Coverage (times)	3.90	4.71	4.61

## Status of non-cooperation with previous CRA: Not applicable

## Any other information: None

## Rating history for last three years

Instrument	Type	Current Rating (FY2020)			Chronology of Rating History for the Past 3 Years		
		Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating	Date & Rating in FY2019	Date & Rating in FY2018	Date & Rating in FY2017
1 Long term Fund Based - CC	Long Term	20.00	-	[ICRA]BBB- (positive) removed from issuer non-cooperating category	[ICRA]BBB- (stable); ISSUER NOT COOPERATING	[ICRA]BBB- (Stable)	-
2 Long term/ Short term unallocated	Long Term/ Short Term	0.00	-	[ICRA]BBB- (positive)/ [ICRA]A3; removed from issuer non-cooperating category	[ICRA]BBB- (stable)/ [ICRA]A3; ISSUER NOT COOPERATING	[ICRA]BBB- (Stable)/ [ICRA]A3	-
3 Short term fund based	Short Term	15.00	-	[ICRA]A3; removed from issuer non-cooperating category	[ICRA]A3; ISSUER NOT COOPERATING	[ICRA]A3	-
4 Short term non fund based	Short Term	60.00	-	[ICRA]A3; removed from issuer non-cooperating category	[ICRA]A3; ISSUER NOT COOPERATING	[ICRA]A3	-
5 Short term - Interchange able	Short Term	59.00*	-	[ICRA]A3; removed from issuer non-cooperating category	-	-	-

## 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](http://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
-	Cash Credit	NA	-	-	20.00	[ICRA]BBB- (positive)
-	Long term/Short term unallocated	NA	-	-	0.00	[ICRA]BBB- (positive)/ [ICRA]A3
-	Short term fund based	NA	-	-	15.00	[ICRA]A3
-	Short term non fund based	NA	-	-	60.00	[ICRA]A3
-	Short term - Interchangeable	NA	-	-	59.00*	[ICRA]A3

\*Interchangeable with short term non fund based limits

Source: SRC Chemicals Private Limited

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

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