

January 15, 2020

P. S. Steel Tubes Limited: Ratings downgraded to [ICRA]BB+ (Stable)/[ICRA]A4+

Summary of rating action

| Instrument* | Previous Rated Amount (Rs. crore) | Current Rated Amount (Rs. crore) | Rating Action |
|--|-----------------------------------|----------------------------------|--|
| Fund-based Limits – Term Loan | 30.03 | 24.00 | [ICRA]BB+ (Stable); Downgraded from [ICRA]BBB (Stable) |
| Fund-based Limits – Working Capital Facilities | 78.00 | 108.00 [#] | [ICRA]BB+ (Stable); Downgraded from [ICRA]BBB (Stable) |
| Unallocated Limits | 2.54 | 8.57 | [ICRA]BB+ (Stable); Downgraded from [ICRA]BBB (Stable) |
| Non-Fund based Limits – Working Capital Facilities | 37.00 | 7.00 | [ICRA]A4+; Downgraded from [ICRA]A3+ |
| Total | 147.57 | 147.57 | |

* Instrument details are provided in Annexure-1

[#] Fund-based working capital facilities of Rs. 108.00 crore includes non-fund based working capital facilities of Rs. 25.00 crore as the sub-limit

Rationale

The downward revision in the ratings primarily considers the steady decline in the profitability of P. S. Steel Tubes Limited (PSST), resulting in weakening of the coverage indicators over the past two years. The ratings also take into account muted realisations and weak demand scenario, which are likely to result in a de-growth in the company's turnover in the current fiscal compared to FY2019. ICRA does not expect any major improvement in its profits as well as cash accruals from business and debt protection metrics in the near term, at least.

Meanwhile, the ratings draw comfort from the long experience of the promoters in the steel-tube manufacturing business, and the company's established relationship with its reputed customers and suppliers located in proximity, which mitigates counterparty risk and ensures regular availability of quality raw materials. The company's raw material supply risk is further mitigated due to its operational integration with its associate concerns, which acts as key raw material suppliers to the Chhattisgarh plant.

The ratings, however, remain constrained by the limited value addition in the steel tube manufacturing operation. Besides, intense competition limits the company's pricing flexibility and keeps margins under check. Additionally, the ratings note PSST's susceptibility to volatility in prices of raw materials like steel and zinc as well as finished goods. Such risk is accentuated by the company's significant stocking requirement. ICRA also notes that the company's debt level increased significantly over the past few years on account of increased working capital borrowings to support the enhanced scale of operations, which in turn impacted the capital structure adversely.

The Stable outlook on the [ICRA]BB+ rating reflects ICRA's opinion that PSST will continue to benefit from its recognised track record of operations in the domestic market and established relationships with its clients.

Key rating drivers and their description

Credit strengths

Long track record of the company in the steel-tube manufacturing business – PSST has been involved in steel-tube manufacturing business for around three decades. The promoters are associated with the industry for more than four decades. The company sells its products under the brand name, Sun, in southern India and under the brand name, PSST Kundan, in rest of India. The company is originally based in Chhattisgarh and has a strong market presence in the state. Over the years, it has expanded in other states like Maharashtra, Tamil Nadu, Kerala, Andhra Pradesh, Rajasthan etc. The new plant in Khanav, Maharashtra has supported PSST's operations in southern and western India. Proximity of the new plant to the port also supports export sales of PSST.

Established relationship with reputed customers and suppliers located in proximity – The company derives a major portion of its revenue from institutional clients including government entities and public sector undertakings (PSUs) like Public Health Engineering Department (PHED) of Chhattisgarh, Bharat Heavy Electricals Limited (BHEL), South Eastern Coalfields Limited (SECL) etc. as well as private entities across sectors like engineering, auto ancillaries, telecom, construction etc. The company's established relationship with a reputed clientele mitigates its counterparty risk to a large extent. PSST also has a distribution network spread across a number of states. The company's continuous expansion across geographies and customer segments resulted in a considerable growth in scale of operations in the recent years. ICRA also notes that PSST's established supply linkages with large steel manufacturing companies located in proximity ensure regular availability of good quality raw materials.

Backward integration with associate concerns mitigates supply risk – The company procures a portion (~30% in FY2019) of its hot-rolled (HR) strips required for smaller diameter tubes from its associate concerns (Orient Ispat Private Limited and Orient Steel Rerolling Mill), located adjacent to the company's plant. This mitigates PSST's supply risk as HR strips account for a significant portion of the raw material requirement of its Chhattisgarh plant.

Credit challenges

Declining profitability and weakening of coverage indicators – The operating margin of the company has witnessed a declining trend over the past two years. The net margin was further impacted by high interest expenses and stood at a low level of 0.51% in FY2019. Although operating profit and cash accruals from the business increased in FY2018 over the previous fiscal, the same declined drastically in FY2019. The coverage indicators deteriorated in FY2019 over the previous fiscal because of a decline in profits as well as cash accruals from the business, and rise in interest expenses. In view of muted realisations and weak macro-economic scenario, the top line of the company is estimated to register a de-growth in the current fiscal. The overall profits and cash accruals from the business are likely to remain almost at a similar level with that of FY2019.

Fragmented nature of the industry and limited value addition keep margins under pressure – The extent of value addition in PSST's business remains low, as reflected by raw material consumption accounting for around 90% of the output in the recent years. Moreover, the steel-tube industry is characterised by the presence of a large number of unorganised players in addition to a few large companies. Intense price-based competition due to the fragmented nature of the industry along with limited value addition keep margins under pressure.

High working capital borrowings, leading to a highly leveraged capital structure – PSST's debt level increased significantly over the past few years primarily due to increased working capital borrowing to support the enhanced scale of operations. The total debt of the company increased to Rs. 131.96 crore as on March 31, 2019 from Rs. 81.85 crore as on March 31, 2016. The capital structure of the company continues to remain highly leveraged with a gearing of 2.02 times (2.02 times as on March 31, 2018) as on March 31, 2019.

Vulnerability of profitability and cash flows to volatility in steel prices – The company receives orders from the government entities by participating in tenders, which are awarded to the company which quotes the lowest price (L-1),

whereas orders from private clients are mainly received directly. Given the raw material intensive nature of operations, PSST's profitability and cash flows remain exposed to the volatility in the prices of steel (the main raw material) as well as zinc (used for galvanised products only), notwithstanding the presence of price variation clauses in contracts with some of the clients. ICRA notes that the company's significant inventory holding period (around 60 days) accentuates the risk associated with price fluctuation, as inherent in the steel industry.

Liquidity position: Stretched

The company generated positive fund flow from operations (FFO) over the past few years, however, the same declined significantly in FY2019. The average fund-based working capital utilisation of the company stood at a high level during the last twelve months, which restricts its financial flexibility. ICRA notes that the company has sizeable long-term debt repayment obligations over the next few years. In view of moderate cash accruals from the business and normal capital expenditure plan, the cash flow position is likely to remain tight relative to its debt servicing obligations. ICRA expects the overall liquidity position of PSST to remain stretched in the near term at least.

Rating sensitivities

Positive triggers – ICRA may upgrade PSST's ratings if the entity demonstrates a significant improvement in its scale of operations and profitability on a sustained basis. Specific credit metrics that may lead to an upgrade of the entity's ratings include interest coverage above 2.8 times on a sustained basis.

Negative triggers – Pressure on PSST's ratings may arise if there is an increase in working capital intensity of operations, adversely impacting the liquidity position. Specific credit metrics that may lead to a downgrade of ratings include interest coverage less than 2.0 times.

Analytical approach

| Analytical Approach | Comments |
|---------------------------------|--|
| Applicable Rating Methodologies | Corporate Credit Rating Methodology Entities in the Ferrous Metals Industry |
| Parent/Group Support | Not Applicable |
| Consolidation/Standalone | The ratings are based on the standalone financial statements of the company |

About the company

Incorporated in 1989, P. S. Steel Tubes Limited (PSST) mainly manufactures electric resistance welded (ERW) steel tubes like mild steel black pipes and poles, galvanised iron pipes and sections, fabricated structures, metal road crash barriers etc. The company started commercial production of steel tubes in 1992 at its manufacturing facility at Rajnandgaon, Chhattisgarh, which has eight tube mills with a total installed capacity of 58,000 metric tonnes per annum (MTPA). In 2016, PSST commissioned a new tube plant at Khanav in the Raigad district of Maharashtra, which has four tube mills with a total installed capacity of 70,000 MTPA. Since December 2016, PSST has started manufacturing metal crash-road barrier and fabricated steel structure at its plant in Rajnandgaon. The installed capacity for crash-road barrier is around 8,000 TPA. The company has recently started manufacturing of powder coated pipes required for various oil/gas marketing/ distributing companies and pedestrian guard rail required for road construction companies.

Key financial indicators (audited)

| | FY2018 | FY2019 |
|--|--------|--------|
| Operating Income (Rs. crore) | 484.69 | 531.33 |
| PAT (Rs. crore) | 5.62 | 2.72 |
| OPBDIT/ OI (%) | 5.04% | 3.69% |
| RoCE (%) | 11.04% | 9.31% |
| Total Outside Liabilities/Tangible Net Worth (times) | 2.68 | 2.68 |
| Total Debt/ OPBDIT (times) | 5.17 | 6.74 |
| Interest Coverage (times) | 2.09 | 1.40 |
| DSCR | 1.32 | 1.04 |

Source: P. S. Steel Tubes Limited

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

| Instrument | Rating (FY2020) | | | Chronology of Rating History for the past 3 years | | | |
|--|-----------------|--------------|-----------------------------------|---|-----------------------|-----------------------|-----------------------|
| | Type | Amount Rated | Amount Outstanding 31-Mar-2019 | Rating 15-Jan-2020 | FY2019 20-Nov-2018 | FY2018 20-Jul-2017 | FY2017 01-Sep-2016 |
| 1 Term Loan | Long Term | 24.00 | 27.61 | [ICRA]BB+ (Stable) | [ICRA]BBB (Stable) | [ICRA]BBB (Stable) | [ICRA]BBB (Stable) |
| 2 Fund-based Working Capital Facilities [#] | Long Term | 108.00 | 103.24 | [ICRA]BB+ (Stable) | [ICRA]BBB (Stable) | [ICRA]BBB (Stable) | [ICRA]BBB (Stable) |
| 3 Unallocated Limits | Long Term | 8.57 | NA | [ICRA]BB+ (Stable) | [ICRA]BBB (Stable) | [ICRA]BBB (Stable) | [ICRA]BBB (Stable) |
| 4 Non-Fund based Working Capital Facilities | Short Term | 7.00 | - | [ICRA]A4+ | [ICRA]A3+ | [ICRA]A3+ | [ICRA]A3+ |

Amount in Rs. crore

Source: P. S. Steel Tubes Limited

[#] Fund-based working capital facilities of Rs. 108.00 crore includes non-fund based working capital facilities of Rs. 25.00 crore as the sub-limit

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 No | Instrument Name | Date of Issuance/ Sanction | Coupon Rate | Maturity Date | Amount Rated (Rs. crore) | Current Rating and Outlook |
|---------|---|-------------------------------|-------------|---------------|--------------------------|----------------------------|
| NA | Term Loan | Jun-2014 | - | Mar-2024 | 12.50 | [ICRA]BB+ (Stable) |
| NA | Term Loan | Jun-2014 | - | Mar-2024 | 11.50 | [ICRA]BB+ (Stable) |
| NA | Fund-based Working Capital Facilities (CC/ WCDL/ EPC/ FBP/EBR)# | - | - | - | 108.00 | [ICRA]BB+ (Stable) |
| NA | Unallocated Limits | - | - | - | 8.57 | [ICRA]BB+ (Stable) |
| NA | Non-Fund based Working Capital Facilities (LC/ BG/ CEL) | - | - | - | 7.00 | [ICRA]A4+ |

Source: P. S. Steel Tubes Limited

Fund-based working capital facilities of Rs. 108.00 crore includes non-fund based working capital facilities of Rs. 25.00 crore as the sub-limit

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

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