

Ratings

CRISIL Ratings Limited (A subsidiary of CRISIL Limited)



Rating Rationale

August 12, 2021 | Mumbai

Shyam Sel and Power Limited

Rating outlook revised to 'Positive'; Ratings reaffirmed

Rating Action

Total Bank Loan Facilities Rated	Rs.835 Crore (Enhanced from Rs.802.35 Crore)
Long Term Rating	CRISIL AA-/Positive (Outlook revised from 'Stable'; Rating Reaffirmed)
Short Term Rating	CRISIL A1+ (Reaffirmed)
Rs.50 Crore Commercial Paper	CRISIL A1+ (Reaffirmed)

1 crore = 10 million

Refer to Annexure for Details of Instruments & Bank Facilities

Detailed Rationale

CRISIL Ratings has revised its outlook on the long-term bank facilities of Shyam Sel and Power Ltd (SSPL) to 'Positive' from 'Stable' while reaffirming the rating at 'CRISIL AA-'; the rating on the short-term bank facilities and commercial paper programme of the entity has been reaffirmed at 'CRISIL A1+'. The outlook revision reflects the improving business risk profile of SSPL and its parent, Shyam Metalics & Energy Ltd (SMEL; 'CRISIL AA-/Positive/CRISIL A1+'); collectively called as the Shyam Metalics group.

Buoyant demand, increased contribution from recently enhanced capacities, increasing product diversity, favorable sales realizations owing to current upcycle in the steel industry and also driven by higher share of value-added products boosted business performance in fiscal 2021; this is likely to continue over the medium term as well. Revenue and operating profit grew by ~40% and ~110%, respectively, in fiscal 2021 and are likely to further rise in fiscal 2022, as evident from the first-quarter revenue growth of 5% (over the fourth quarter revenue - in fiscal 2021). Capacity addition in value-added products such as thermomechanical treatment (TMT) bars, structural products, ferro alloys and diversification into new business of conversion of aluminum foil will further support healthy double digit revenue growth over the medium term. Operating profitability may remain stable at 18-20% in fiscal 2022, with better integration, increased access to cheaper captive power, close proximity to raw materials, captive railway sidings and focus on higher value-added products, ensuring strong cash generation.

Additionally, the financial risk profile has been strengthened with reduction in overall debt followed by the initial public offering (IPO) completed in June 2021. Improved profitability and low debt levels (Rs 314 crore as on June 30, 2021) led to robust debt protection metrics. The company has utilised the IPO proceeds to reduce working capital debt by Rs 470 crore in June 2021. Thus, ratio of debt to earnings before interest, tax, depreciation and amortisation (EBITDA) improved to 0.46 time in the first quarter of fiscal 2022 from 0.57 time in fiscal 2021, while the interest coverage ratio rose to above 18 times. The group should sustain its healthy financial risk profile, despite pursuing sizeable capital expenditure (capex) plans of ~Rs 2,000 crore over the next 3-4 years, supported by strong cash-generating ability of about Rs 1000 crore per annum and also liquid surplus treasury of over Rs 1,000 crore, which will ensure limited debt. Any material additional, debt-funded capex or acquisition, impacting debt protection metrics, will remain a key monitorable.

In the past five fiscals, the group has seen strong scaling up of operations, aided by capacity additions (overall capacities increased to 5.7 million tonne per annum [MTPA] in fiscal 2021 from 2.1 MTPA in fiscal 2016) with revenue registering a compound annual growth rate (CAGR) of 30%. The group is expected to witness strong revenue growth in fiscal 2022 owing to increased realisation, improving product mix and healthy demand outlook for its products. Over the next 3-4 years, growth will be supported by further addition of capacities of 5.9 MTPA, at a cost of ~Rs 2,000 crore, taking the overall capacity to 11.6 MTPA by fiscal 2025.

The ratings continue to consider the Shyam Metalics group's established market position in the steel sector, well-diversified product profile and customer base. The ratings also factor in healthy operating efficiency, supported by integrated nature of operations and strategic locations of its manufacturing units, and the longstanding experience of promoters in the steel sector. The ratings further factors in the group's comfortable financial risk profile backed by healthy debt protection metrics. These strengths are partially offset by vulnerability to fluctuations in prices of raw material and finished goods, exposure to inherent cyclicity as well as competitive and capital-intensive nature of the steel industry.

Analytical Approach

For arriving at its ratings, CRISIL Ratings has applied its parent notch-up framework to factor in the support from its parent, SMEL. SMEL and SSPL, together referred to as the Shyam Metalics group, are in the same business and under a common

management, and have significant operational and financial linkages as well as 100% shareholding of SSPL is owned by SMEL.

Key Rating Drivers & Detailed Description

Strengths:

- **Established market position**

The Shyam Metalics group is one of the largest players in the steel and steel intermediates industry in Eastern India. Over the years, it has also increased its foothold in export markets with 15-20% revenue derived from exports. Backed by the established market position, revenue reached to about Rs 6,297 crore (on consolidated basis) in fiscal 2021 from Rs 1,697 crore in fiscal 2016, at a CAGR of 30%.

The promoters are associated with the steel industry for over three decades and have established forward as well as backward integrated operations. The group's capacities increased to 5.7 MTPA in fiscal 2021 from 2.1 MTPA in fiscal 2016. Revenue growth will continue over the medium term, given the recent capacity expansion by the group and planned capacity addition of 5.9 MTPA over next few years.

The group has a diversified product mix with multiple points of sale across the value chain including pellets, sponge iron, billets, TMT bars and structural products and ferro alloys contributing 15-30% each to the overall revenue. Over the coming years, contribution from TMT bars, structural products and ferro alloys is expected to increase. Clientele is also fairly diversified, with no single customer contributing more than 5% to revenue.

- **Healthy operating efficiencies driven by integrated operations**

The group has integrated operations with presence in steel value chain right from pellets to long products. It provides the group flexibility to sell intermediate products and use them for captive consumption. The facilities are also supported by captive power plants, waste heat recovery plants, coal washery, and railway sidings, which result in cost efficiencies besides presence across value chain. Over the last few fiscals, the company started manufacturing TMT directly from sponge iron using direct charging methods, which improved the consumption ratio of billets, thereby improving overall operating efficiency. The profitability is supported by low power cost of Rs 2-2.5/unit, improving product mix and healthy proportion of high-margin ferro alloys.

Working capital management has been prudent. The group sells mainly on advance/letter of credit basis and hence the debtors are low at 20-30 days. Inventory is maintained for 60-70 days with majority being the raw materials. In fiscal 2020, the group increased the iron ore inventory sharply ahead of mining auctions in Odisha, which led to inventory increasing to 140 days, and benefitted the operating margin in fiscal 2021 to a certain extent. In the absence of captive iron ore mines, steady-state operating margin should be 18-20% in fiscal 2022.

- **Healthy and improving financial risk profile**

With infusion of fresh capital of Rs 657 crore in June 2021 and continuing healthy cash generation, overall networth of the group is projected at over Rs 5,000 crore as on March 31, 2022. Comparatively, debt remains modest at Rs 314 crore as on June, 30 2021, also supported by reduction of working capital debt by Rs 470 crore, which along with sizeable cash surplus, has increased financial flexibility, besides strengthening the debt protection metrics. The debt /EBITDA and gearing stood at 0.57 time and 0.22 time, respectively, in fiscal 2021, compared with 1.95 time and 0.47 time in fiscal 2020.

The financial risk profile will remain healthy, despite high capex intensity over the medium term. Capex of ~Rs 2,000 crore is expected over the next 3-4 years, expected to be funded largely from annual cash accrual of ~Rs 1,000 crore. This should continue to strengthen the debt protection metrics. Furthermore, as per the management, gearing is likely to remain below 0.5 time and debt/EBITDA below 1 time even in the event of any sizeable capex. Higher-than-expected, debt-funded capex or acquisition will remain a key rating sensitivity factor.

- **Strong support from parent, SMEL**

SMEL holds a 100% stake in SSPL and extends strong operational, managerial and financial support. Both companies are in the same business and under a common management, and have significant operational and financial linkages. CRISIL expects SMEL to extend support to the company in case required.

Weaknesses

- **Vulnerability to fluctuations in prices of raw material and finished goods**

Operating margin is vulnerable to fluctuations in the prices of inputs (iron ore and coal) as well as realisation from finished goods. The prices and supply of the main raw material, iron ore, directly impacts the realisations of finished goods. Further, the steel sector remains exposed to steel prices globally, which declined significantly in fiscal 2016 impacting realisations and operating profitability (the group's operating margin declined to 9.4%). Any significant change in the demand and pricing scenario should result in moderation in operating margins below 12-14% on sustained basis will remain a key monitorable.

- **Exposure to inherent cyclicality in and competitive & capital intensive nature of steel sector**

The group's performance remains vulnerable to cyclicality in the steel sector given the close linkage between the demand for steel products and the domestic and global economy. The end-user segments such as real estate, civil construction and engineering also display cyclicality. While there has been a significant push by the government on steel-intensive sectors such as railways and infrastructure, any sustained downturn in demand will adversely impact performance of steel companies. For instance, operating margin for the group was constrained in fiscal 2016 due to down cycle.

The competitive intensity in the Indian steel sector is significant owing to presence of large steel companies such as Tata Steel Ltd, JSW Steel Ltd, Jindal Steel and Power Ltd ('CRISIL A-/Stable/CRISIL A2+'). Also, steel imports from other countries, mainly China, add to the competition. Additionally the domestic steel sector is fairly capital intensive. To maintain/improve market share, the industry participants have been observed to routinely carry out capacity expansion and debottlenecking activities.

Liquidity: Strong

Liquidity should remain supported by healthy annual cash accrual (~ Rs 1,000 crore per annum), cash surpluses treasury of over Rs 1,000 crore as on August 10, 2021, and only moderate utilisation of working capital bank lines (about 55% in the past six months through June 2021 and presently at 25-30% level). The group has low long-term debt on its balance sheet and hence repayment obligation is just Rs 5 crore in fiscal 2022. Bank limit utilisation is expected to remain moderate going forward. Also, annual cash accrual should suffice for capex requirement and debt repayment. Besides, in the event of material need, the group has access to funds from the holding company of the promoters that has sizeable cash surpluses available.

Outlook: Positive

The Shyam Metalics group will continue to benefit from established market position in key long steel products, diversified revenue streams, healthy demand for its steel products and its integrated nature of operations, ensuring healthy cash generation. The financial risk profile is likely to remain healthy, driven by prudently funded capex plans and strong liquidity.

Rating Sensitivity Factors

Upward Factors

- * Healthy operating performance, supported by high capacity utilisation and improvement in product diversity, resulting in cash accrual remaining at Rs 1,100-1,200 crore on sustained basis
- * Sustenance of healthy financial risk profile, with debt to EBIDTA not exceeding 0.8-1.0 time even in the event of any additional capex
- * Maintenance of healthy liquid surpluses
- * Positive bias in credit rating of parent, SMEL

Downward Factors

- * Deterioration of operating performance due to weakened demand, and intense competition, leading to a sharp decline in operating profitability and cash accrual dropping below Rs 700 crore
- Large, debt-funded capex/acquisition deteriorating debt metrics; debt to EBIDTA increasing above 2.25-2.50 times.
- * Sharp reduction in liquid surpluses, due to additional capex or share buy-back, or material dividend payout
- * Negative bias in credit rating of parent, SMEL

About the Group

The Shyam Metalics group has diversified businesses, comprising production of iron and steel, ferroalloys, and power. SMEL was established in 2002 as Shyam DRI Power Ltd, when the group expanded its operations to Odisha. The company got its present name in January 2010. It manufactures sponge iron, billets, TMT steel bars, and ferroalloys, and has a power plant.

SSPL was incorporated in 1991 and started commercial production in 1996 with steel-melting shops. Over the years, it added rolling mills, ferroalloy furnaces, sponge iron kilns, billet and ingot capacities, and a captive power plant to ensure operational and business integration. Its manufacturing units are at Raniganj and Jamuria in West Bengal.

In the first quarter of fiscal 2022, the group posted profit after tax (PAT) of Rs 458 crore on revenue of Rs 2,465 crore against Rs 80 crore and Rs 912 crore, respectively, in the corresponding period last fiscal.

Key Financial Indicators (Consolidated)

As on/for the period ended March 31	Units	2021	2020
Revenue	Rs crore	6,297	4363
PAT	Rs crore	843	340
PAT margin	%	13.4	7.8
Adjusted debt/adjusted networkth	Times	0.22	0.47
Interest coverage	Times	18.0	4.55

Any other information: Not applicable

Note on complexity levels of the rated instrument:

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Annexure - Details of Instrument(s)

ISIN	Name of instrument	Date of allotment	Coupon rate (%)	Maturity date	Issue (Rs.Cr)	Complexity Level	Rating outstanding with outlook
NA	Bank Guarantee	NA	NA	NA	75.00	NA	CRISIL A1+
NA	Letter of Credit	NA	NA	NA	470.00	NA	CRISIL A1+
NA	Cash Credit	NA	NA	NA	290.00	NA	CRISIL AA-/Positive
NA	Commercial paper	NA	NA	7-365 days	50.00	Simple	CRISIL A1+

Annexure - Rating History for last 3 Years

Instrument	Current			2021 (History)		2020		2019		2018		Start of 2018
	Type	Outstanding Amount	Rating	Date	Rating	Date	Rating	Date	Rating	Date	Rating	Rating
Fund Based Facilities	LT	290.0	CRISIL AA-/Positive		--	16-10-20	CRISIL AA-/Stable	31-10-19	Withdrawn	24-10-18	CRISIL A/Positive	CRISIL A-/Positive
			--		--	06-10-20	CRISIL AA-/Watch Negative		--	27-02-18	CRISIL A-/Positive	--
			--		--	10-08-20	CRISIL AA-/Stable		--		--	--
Non-Fund Based Facilities	ST	545.0	CRISIL A1+		--	16-10-20	CRISIL A1+	31-10-19	Withdrawn	24-10-18	CRISIL A1	CRISIL A2+
			--		--	06-10-20	CRISIL A1+/Watch Negative		--	27-02-18	CRISIL A2+	--
			--		--	10-08-20	CRISIL A1+		--		--	--
Commercial Paper	ST	50.0	CRISIL A1+		--	16-10-20	CRISIL A1+	31-10-19	Withdrawn	24-10-18	CRISIL A1	CRISIL A2+
			--		--	06-10-20	CRISIL A1+/Watch Negative		--	27-02-18	CRISIL A2+	--
			--		--	10-08-20	CRISIL A1+		--		--	--

All amounts are in Rs.Cr.

Annexure - Details of various bank facilities

Current facilities			Previous facilities		
Facility	Amount (Rs.Crore)	Rating	Facility	Amount (Rs.Crore)	Rating
Bank Guarantee	75	CRISIL A1+	Bank Guarantee	49	CRISIL A1+
Cash Credit	290	CRISIL AA-/Positive	Cash Credit	265	CRISIL AA-/Stable
Letter of Credit	470	CRISIL A1+	Letter of Credit	405	CRISIL A1+
-	-	-	Proposed Bank Guarantee	26	CRISIL A1+
-	-	-	Proposed Letter of Credit	45	CRISIL A1+
-	-	-	Proposed Long Term Bank Loan Facility	5	CRISIL AA-/Stable
-	-	-	Term Loan [^]	7.35	CRISIL AA-/Stable
Total	835	-	Total	802.35	-

[^]INR equivalent of USD 1.50 million

Criteria Details

Links to related criteria
CRISILs Approach to Financial Ratios
Rating criteria for manufacturing and service sector companies
CRISILs Bank Loan Ratings - process, scale and default recognition
Rating Criteria for Steel Industry
CRISILs Criteria for rating short term debt
Criteria for Notching up Stand Alone Ratings of Companies based on Parent Support

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