March 31, 2022

Seven Star Steels Limited: Ratings upgraded

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Cash Credit	15.00	15.00	[ICRA]BB+(Stable); Upgraded from [ICRA]BB-(Stable)
Bank Guarantee	1.00	1.00	[ICRA]A4+; Upgraded from [ICRA]A4
Total	**16.00**	**16.00**	

**Instrument details are provided in Annexure-1*

Rationale

The rating action factors in Seven Star Steel Limited's (SSSL) favourable operating environment in FY2022 and expected sustenance of the same in FY2023. SSSL posted an operating profit of Rs.11.94 crore in FY2021, increasing from Rs.5.38 crore in FY2020 owing to a strong rebound in steel demand post unlocking of the economy. The healthy financial performance continued in the current fiscal with the company reporting all-time high spreads in 9M FY2022. ICRA expects SSSL's profits to remain at attractive levels in the next 12 months as steel prices continue to remain elevated, supported by the accelerated recovery in steel demand in key global steel consuming hubs outside China. Although raw material prices (mainly thermal coal) have increased consistently in the recent weeks, ICRA believes that the company's profit metrics are likely to remain significantly better than the long-term historical median levels as steel realisations have also maintained an upward trend. A surge in earnings since FY2021 led to an improvement in the credit metrics with the interest coverage increasing to 7.8 times in FY2021 from 3.4 times in FY2020 and Total Debt/OPBDITA declining to 1.5 times in FY2021 from 2.8 times in FY2020. Limited dependence on debt along with healthy cash accruals estimated is expected to keep the credit metrics comfortable, going forward. The ratings continue to derive comfort from the assured supply of iron ore at flexible credit terms from its Group company, Penguin Trading & Agencies Limited (PTAL), which has a healthy credit profile, thus mitigating supply risks and also rendering working capital support. The ratings also consider SSSL's captive power plant which meets its power requirement entirely, reducing its dependence on external power, and leading to savings in production costs.

The ratings, are, however, constrained by SSSL's inability to report profits across business cycles and its small scale of operations, leading to a high operating cost base, making it susceptible to a period of sustained industry downturns. The ratings further remain constrained by the exposure of the company to the cyclicality inherent in the steel industry and susceptibility of SSSL's profitability to the volatility in raw material prices and end-product realisations. The ratings also consider SSSL's lack of adequate vertical integration, which limits value addition and tempers its profit margins.

The Stable outlook on the long-term rating reflects ICRA's expectations that SSSL will continue to benefit from the favourable operating environment for its products while sustaining its credit profile in the near term.

Key rating drivers and their description

Credit strengths

Significant earnings growth likely in FY2022; earnings outlook for FY2023 remains favourable – Supported by a strong rebound in steel demand post unlocking of the economy, SSSL posted an operating profit of Rs.11.94 crore in FY2021, increasing from Rs.5.38 crore in FY2020. The healthy financial performance continued in the current fiscal with the company reporting all-time high spreads in 9M FY2022. ICRA expects SSSL's profits to remain at attractive levels in the next 12 months as steel prices continue to remain elevated, supported by the accelerated recovery in steel demand in key global steel consuming hubs outside China. Although raw material prices (mainly thermal coal) have increased consistently in the recent weeks, ICRA believes that the company's profit metrics are likely to remain significantly better than the long-term historical median levels as steel realisations have also maintained an upward trend. As a significant portion of the company's total thermal coal requirements for manufacturing of sponge iron is met from the linkages obtained through auctions, SSSL remains partially insulated from the rising coal prices in the spot market.

Procurement of iron ore at favourable credit terms from Group company enhances raw material security and supports liquidity to an extent – SSSL faces limited risks related to supply of iron ore as its iron ore requirement is entirely met from its Group company, PTAL, which has a healthy credit profile and is involved in iron ore mining. Moreover, PTAL extends flexible credit terms to SSSL, which reduces the latter's working capital requirement, supporting its liquidity.

Credit metrics expected to remain healthy, going forward – The surge in earnings since FY2021 led to an improvement in the credit metrics with the interest coverage increasing to 7.8 times in FY2021 from 3.4 times in FY2020 and Total Debt/OPBDITA declining to 1.5 times in FY2021 from 2.8 times in FY2020. Limited dependence on debt along with healthy cash accruals estimated is expected to keep the credit metrics comfortable, going forward.

Presence of captive power plant reduces cost of production to some extent – The company has a captive power plant (CPP) of 8 MW, out of which 4 MW is based on waste-heat-recovery (WHR) technology and the balance 4 MW is based on atmospheric fluidised bed combustion (AFBC) process. The cost structure of the steel melting operation, which is highly power intensive in nature, is positively impacted by the power available from the CPP at a competitive rate.

Credit challenges

Inability to report profits across business cycles – SSSL's performance has been volatile over the years. Between FY2015 and FY2021, the company reported operating losses in FY2015, FY2016, and FY2017, and net losses in FY2017, FY2018, and FY2020. The ability of the company to come back in the black on a sustained basis would remain a key credit rating driver.

Small scale of operations leads to high operating cost base and makes it susceptible to a period of sustained industry downturns – SSSL's absolute scale of operations remains quite small, which leads to a comparatively higher operating cost base emanating from lower plant efficiency parameters compared to larger integrated steel mills. Given the commoditized nature of the steel business, a structurally higher operating cost base makes the performance of smaller steel companies, like SSSL, susceptible to a period of sustained industry downturns.

Lack of adequate vertical integration restricts value addition – The company manufactures intermediate products like sponge iron and billets, which are low value added compared to finished steel products, where margins remain higher. The competition in the semis segment remain very elevated, leading to low pricing flexibility.

Exposed to cyclicality inherent in the steel industry – SSSL is exposed to cyclicality inherent in the steel industry, which leads to volatility in revenue and cash flows for the industry players, including SSSL. 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.

Liquidity position: Adequate

Healthy underlying earnings following the steel upcycle would aid in generating positive free cash flows in the range of Rs.10 -18 crore annually in FY2022 and FY2023. Against these sources of cash, the company has negligible capex commitments and nominal debt repayment obligations. Therefore, the company's liquidity profile has been assessed as **adequate.**

Rating sensitivities

Positive factors – ICRA may upgrade SSSL's ratings if there is a substantial improvement in the company's profitability and cash accruals.

Negative factors – Pressure on SSSL's ratings may arise if there is a significant decline in its profits and/or if the company undertakes any sizeable debt-funded capex, which may adversely impact its capital structure and liquidity. Specific metrics which may lead to ratings downgrade include interest coverage of less than 2.5 times on a sustained basis.

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	The ratings are based on the standalone financial statements of SSSL.

About the company

Incorporated in November 2004, Seven Star Steels Limited (SSSL) commenced commercial operations in June 2007. The company's manufacturing facility is located at Kalendamal, Gudigaon, in the Jharsuguda district of Odisha. It has sponge iron and mild steel (MS) billet manufacturing facilities with installed capacity of 60,000 tonnes per annum (TPA) and 28,800 TPA, respectively, along with an 8-MW captive power plant (4 MW through waste-heat recovery, and 4 MW through atmospheric-fluidised bed combustion). The present promoters (Kolkata-based Bathwal family) took over SSSL's management in 2007. The sponge iron manufacturing capacity of the plant was expanded from 30,000 TPA to 60,000 TPA in February 2008. The captive power plant and the steel-melting facility were commissioned in April 2013 and April 2014, respectively.

Key financial indicators (Audited)

SSSL Standalone	FY2020	FY2021
Operating Income (Rs. crore)	123.9	126.4
PAT (Rs. crore)	-51.7	2.6
OPBDIT/OI (%)	4.3%	9.4%
PAT/OI (%)	-41.7%	2.1%
Total Outside Liabilities/Tangible Net Worth (times)	5.2	4.4
Total Debt/OPBDIT (times)	2.8	1.5
Interest Coverage (times)	3.4	7.8

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

Status of non-cooperation with previous CRA: Not applicable

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 Jan 31, 2022 (Rs. crore)	Date & Rating in FY2022	Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2019
					Mar 31, 2022	Jan 8, 2021	Feb 11, 2020	Feb 05, 2019
1	Cash Credit	Long Term	15.00	-	[ICRA]BB+ (Stable)	[ICRA]BB- (Stable)	[ICRA]BB- (Stable)	[ICRA]B+(Stable)
2	Bank Guarantee	Short Term	1.00	-	[ICRA]A4+	[ICRA]A4	[ICRA]A4	[ICRA]A4

Complexity level of the rated instruments

Instrument	Complexity Indicator
Cash Credit	Simple
Bank Guarantee	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	Cash Credit	NA	NA	NA	15.00	[ICRA]BB+ (Stable)
NA	Bank Guarantee	NA	NA	NA	1.00	[ICRA]A4+

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.

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