Press Release

Deccan Ferro Alloys Pvt Ltd (DFAPL)

December 11, 2019

Ratings

Instrument / Facility	Amount (Rs. Crore)	Ratings	Rating Action
Long Term Bank Facilities- Cash credit	15.00	IVR BBB /Stable (IVR Triple B with Stable Outlook)	Assigned
Short Term Bank Facilities – Letter of credit	28.00	IVR A3+ (IVR A three plus)	Assigned
Short Term Bank Facilities – Bank Guarantee	2.00	IVR A3+ (IVR A three plus)	Assigned
Total	**45.00**		

Details of Facilities are in Annexure 1

Detailed Rationale

The ratings assigned to the bank facilities of Deccan Ferro Alloys Pvt Ltd (DFAPL) derives comfort from extensive experience of its promoters in the steel and ferro-alloy industry, reputed customer profile, regular infusion of funds by the promoters and strategic location of the plant. The ratings also considers sustained growth in revenues over the years, satisfactory financial risk profile marked by moderate net worth base leading to satisfactory gearing with healthy debt protection metrics, prudent working capital management and comfortable liquidity. However, the rating strengths are partially offset by power intensive nature of its operations, lack of backward integration vis-à-vis volatility in prices, exposure to foreign exchange fluctuation risk, concentrated customer profile and susceptibility to performance of end-user industry.

Key Rating Sensitivities

Upward Factor:

- Growth in scale of operations with improvement in profitability on a sustained basis
- Sustenance of the capital structure
- Manage working capital requirement efficiently

Downward factor:

- Elongation of operating cycle
- Moderation in the capital structure with deterioration in overall gearing to more than 2x

List of Key Rating Drivers with Detailed Description

Key Rating Strengths

- **Extensive experience of the promoters in the steel and ferro-alloy industry**

DFAPL was promoted by Mr. Siva Rama Raju Pericherla (Managing Director) having an experience of around three decades in the steel and ferro alloys. He looks after the overall business operations of the company.

- **Regular infusion of funds by the promoters**

The promoters have supported the business by infusion of funds in the form of unsecured loans sub-ordinated to bank loans to meet the capex and incremental working capital requirements. As per the undertaking provided by the company to bank, unsecured loan aggregating Rs.4.15 crore has been subordinated to the bank facilities; same has been considered as part of net worth. Further, the company has also provided undertaking that additional Rs.3.85 crore infused by the promoters will also remain in the business and they will not withdraw it in coming few years; same has been neither been considered as debt nor equity in projected years.

- **Locational Advantage**

The company's plant is located in Visakhapatnam, Andhra Pradesh which is about 20 km from Vishakhapatnam port. Since, the company does not have any captive mines for its key raw materials such as manganese ore, coke and coal, it imports a significant portion of its raw material requirements (50.46% of its purchases during FY19). Proximity to port enables the company in savings of transportation cost and thus enables them to be competitive in the industry. Further, the proximity of the plant to port is also advantageous for exports, as DFAPL also caters to the export market (~36% of total operating income in FY19).

- **Reputed customer profile albeit concentrated**

DFAPL's customer profile consists of well-known clients. The company has the advantage of local suppliers' status with Rashtriya Ispat Nigam Limited (RINL) which supports the company to have a priority over the other competitors. However, there is a customer concentration risk as its top five customers contribute ~55% of total revenue in FY19. The single customer concentration has come down from ~40% during FY18 to ~25% during FY19.

- **Sustained growth in revenues over the years**

The total operating income of the company registered a CAGR of ~85% during FY17-FY19 with a steady y-o-y growth of ~44% in FY19. The growth is driven by higher demand of ferro

products backed by higher capacity utilization of ~90% in FY19 from ~73% in FY18. However, despite increase in the scale of operations and EBIDTA level, the EBIDTA margin of the company witnessed a declining trend over the last three years; the same declined by 108 bps to 5.59% in FY19 due to higher increase in cost of raw materials vis-à-vis operating income and compromise to attain higher volume sales. However, the same has marginally improved in H1FY20 to 5.63%. The PAT margin of the company though declined by 78 bps y-o-y in FY19 remained satisfactory at 2.28%. However, the EBIDTA margin in FY17 remained relatively high due to receipt of power subsidy from the state government which was discontinued since FY18. Further, the company earned a gross cash accruals of Rs.7.95 crore in FY19 (Rs.7.53 crore in FY18). In H1FY20, the company has earned an EBIDTA and PAT of Rs.6.73 crore and Rs.3.16 crore respectively on net sale of Rs.119.46 crore (Rs.101.72 crore in H1FY19)

- **Satisfactory financial risk profile marked by moderate net worth base leading to satisfactory gearing with healthy debt protection metrics**

The company has a satisfactory financial risk profile marked by its moderate net worth base of Rs.37.77 crore as on March 31, 2019 (considering subordinated unsecured loans from the promoters aggregating to Rs.4.15 crore as quasi-equity) and a strong DSCR over the past three years. The debt profile of the company comprise term loan, unsecured loan from others and working capital borrowings. The overall gearing ratio of the company remained comfortable at 0.67x as on March 31, 2019 (0.62x as on March 31, 2018). The debt protection parameters, though deteriorated, due to increase in total debt from Rs.20.19 crore in FY18 to Rs.25.47 crore in FY19 mainly due to increase in bank borrowings to fund incremental scale of operations remained comfortable marked by interest coverage ratio at 3.74x in FY19 (4.03x n FY18) and total debt to GCA of 3.20 years in FY19 (2.68 years in FY18). Moreover, Total indebtedness of the company as reflected by TOL/TNW, improved marginally and remained stagnant at 1.30x as on March 31, 2019 (1.29x as on March 31, 2018). Further, the interest coverage ratio also improved and remained healthy at 6.80x in H1FY20.

- **Prudent working capital management**

The operations of the company are working capital intensive as the company has to maintain inventory of around 30-45 days to cover the time lag between placing and importing the raw materials. The collection period stood stable at 15 days as on March 31, 2019 (6 days as on March 31, 2018) attributable to improvement in the industry demand scenario. The creditors are mainly import creditors against LC. The company is managing its working capital effectively and the operating cycle remained comfortable at 29 days in FY19. Further, the

company's reliance on working capital is satisfactory having average working-capital utilization remained low at ~27% for the trailing 12 months period ended September 2019. However, the utilization of non-fund based limits stood at ~88% on account of increased raw materials imports. The liquidity position of the company remained comfortable with adequate cash accrual generation and low debt repayment obligations, the company had free cash of Rs.2.02 crore as on March 31, 2019.

Key Rating Weaknesses

- **Lack of backward integration vis-à-vis volatility in prices**

Raw material consumption is the single largest cost component for DFAPL. The company does not have any backward integration for its basic raw materials and has to purchase the same from import and open market. Since, the raw material is the major cost driver (constituting about 65% of total cost of sales in FY19) and with raw material prices being volatile in nature, the profit margins of the company remain susceptible to fluctuation in raw material prices.

- **Power Intensive Industry**

DFAPL's production and profitability will be adversely affected by any change in power tariffs as Ferro alloy is a power intensive industry and it is one of the major cost component for DFAPL after raw material. Power and fuel contribute around ~27% of the total cost in FY19. DFAPL is entirely dependent on AP State Electricity Board for supply of power.

- **Foreign exchange fluctuation risk**

DFAPL imports around ~50% of its manganese ore requirement in FY19 mainly from African countries mainly South Africa, Gabbon. However, due to its presence in export market, export revenues, which contributes around ~36% of total revenue in FY19, act as a natural hedge to an extent. The company does not have any forex policy in place. Hence the company is exposed to foreign exchange risk due to time difference in realization of sales against the purchase payments towards material.

- **Susceptible to performance of end-user industry**

The prospects of the alloy industry are strongly correlated and linked to the performance of the steel industry, since Ferro alloys are intermediaries for the steel industry. Demand for steel products is sensitive to trends of particular industries, such as automotive, construction, infrastructure and consumer durables, which are the key consumers of steel products. These key user industries in turn depend on various macroeconomic factors, such as consumer confidence, employment rates, interest rates and inflation rates, etc. in the economies in which

they sell their products. When downturns occur in these economies or sectors, steel industry generally witness steep decline in demand, leading to decrease in demand of ferro alloys.

Analytical Approach: Standalone

Applicable Criteria:

Rating Methodology for Manufacturing Companies

Financial Ratios & Interpretation (Non-financial Sector)

Liquidity: Strong

The liquidity position of the company is expected to remain strong in the near to medium term marked by its strong accruals against negligible repayment obligations and cash balance of Rs. 2.02 crore as on September 2019. Further, the company has above unity current ratio which stood at 1.26x as on March 31, 2019. With a gearing of 0.67 times as of March 31, 2019, the company has sufficient gearing headroom, to raise additional debt for its capex. However, the company has no major near term capex plan. Further, its unutilized bank lines are more than adequate with about ~27% over the last 12 months ended on September 2019 to meet its incremental working capital needs over the next one year. The Company projected to earn a GCA of ~Rs.10.93 crore vis-à-vis its negligible debt repayment obligation of ~Rs.1.54 crore in FY20.

About the Company

Incorporated in the year 2000, Deccan Ferro Alloys Private Limited (DFAPL), is engaged in the manufacturing of ferromanganese and silico manganese by Mr. Siva Rama Raju Pericherla and his family, who has an experience of 30 years in the alloys industry.

Financials (Standalone):

(Rs. crore)

For the year ended* / As On	31-03-2018	31-03-2019
	Audited	Audited
Total Operating Income	153.44	221.26
EBITDA	10.24	12.37
PAT	4.73	5.07
Total Debt	20.19	25.47
Tangible Net worth	32.71	37.77
EBITDA Margin (%)	6.67	5.59
PAT Margin (%)	3.06	2.28
Overall Gearing Ratio (x)	0.62	0.67

*Classification as per Infomerics' standards.

Status of non-cooperation with previous CRA: CRISIL has moved the rating of DFAPL into the Issuer Non-Cooperating category as the company did not co-operate in the rating procedure despite repeated follow ups as per the Press Release dated August 2, 2019.

Any other information: Nil

Rating History for last three years:

Sr. No.	Name of Instrument/Facilities	Current Rating (Year 2019-20)			Rating History for the past 3 years		
		Type	Amount outstanding (Rs. Crore)	Rating	Date(s) & Rating(s) assigned in 2018-19	Date(s) & Rating(s) assigned in 2017-18	Date(s) & Rating(s) assigned in 2016-17
1.	Long Term Fund Based Limits – Cash Credit	Long Term	15.00	IVR BBB/ Stable Outlook	-	-	-
2.	Short Term Non Fund Based Limits- Letter of Credit	Short Term	28.00	IVR A3+	-	-	-
2.	Short Term Non Fund Based Limits- Bank Guarantee	Short Term	2.00	IVR A3+	-	-	-

Note on complexity levels of the rated instrument: Infomerics has classified instruments rated by it on the basis of complexity and a note thereon is available at www.infomerics.com.

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About Infomerics:

Infomerics commenced rating & grading operations in April 2015 after having spent over 25 years in various segments of financial services. Infomerics is registered with the Securities and Exchange Board of India (SEBI) and accredited by Reserve Bank of India. It is gradually gaining prominence in domestic rating and/or grading space. Infomerics is striving for positioning itself as the most trusted & credible rating agency in the country and is gradually widening its product portfolio. Company's long experience in varied spectrum of financial services is helping it to fine tune its product offerings to best suit the market.

Annexure 1: Details of Facilities

Name of Facility	Date of Issuance	Coupon Rate/ IRR	Maturity Date	Size of Facility (Rs. Crore)	Ratings Assigned/ Outlook
Long Term Facilities- Cash Credit	-	-	-	15.00	IVR BBB / Stable Outlook
Short Term Facilities- Letter of Credit	-	-	-	28.00	IVR A3+
Short Term Facilities- Bank Guarantee	-	-	-	2.00	IVR A3+
Total				**45.00**	