Press Release

Gagan Ferrotech Limited

December 31, 2019

Ratings

Instrument / Facility	Amount (Rs. crore)	Ratings	Rating Action
Long Term Bank Facilities- Cash Credit	155.00	IVR A/Stable (IVR Single A with Stable Outlook)	Assigned
Long Term Bank Facilities- Term Loan	116.00	IVR A/Stable (IVR Single A with Stable Outlook)	Assigned
Short Term Bank Facilities- Letter of Credit/Bank Guarantee	88.75	IVR A1 (IVR Single A One)	Assigned
Total	**359.75**		

Details of Facilities are in Annexure 1

Detailed Rationale

The aforesaid ratings assigned to the bank facilities of Gagan Ferrotech Limited (GFL) favourably factor in its long track record, long standing experience of the promoters in iron and steel industry and its comfortable financial risk profile marked by healthy liquidity, satisfactory gearing with healthy debt protection metrics and prudent working capital management. Moreover, the ratings also factor in semi-integrated nature of its operations with presence of captive power plant which reduces the vulnerability of the company’s cash flows to fluctuation in input prices, established brand with a strong market presence in the Eastern India and its healthy capacity utilisation. However, the rating strengths are partially offset by vulnerability of the operating margins to fluctuating raw material prices, given the commoditised nature of the business, intense competition in the operating spectrum and cyclicality in the steel industry.

Key Rating Sensitivities

- Upward Rating Factor- Significant improvement in revenue and profitability coupled with rise in net cash accruals while maintaining its operating efficiency and financial risk profile. Further, expected benefit in the form of overall improvement in top-line going forward arising from the sizeable capex which is in the verge of completion could also entail a positive outlook.
- Downward Rating Factor- Dip in operating income or profitability impacting the debt coverage indicators, subdued industry scenario, deterioration in working capital management and moderation in overall gearing to more than 1.5 times could lead to a negative rating action.

List of Key Rating Drivers with detailed description

Key Rating Strengths

Extensive experience of the promoter in the steel industry

GFL ventured into manufacturing process in 2006 by setting up a sponge iron plant and over the years has expanded into billet, TMT with a captive power plant. The long track record and the extensive experience of the promoters have helped the company to build an established relationship with the distributers and suppliers thereby resulting in stable business risk profile.

Healthy capacity utilisation with operational efficiency by virtue of having partially integrated manufacturing facility

The capacity utilisation of GFL remained healthy over the last few years which translated into better absorption of fixed overhead and resulted in healthy operating profitability. With capacity utilisation of sponge iron unit and rolling mill unit surpassing 100% in the last three fiscal (FY17-19) - leading to better economies of scale. The billet manufacturing unit is also running at its full capacity. Further, to support its operations the company also has a 12MW captive power plant utilising waste heat recovered from the sponge iron kilns, for meeting majority of the electricity requirement. Profitability improved, as indicated by EBIDTA margin of 5.89% in fiscal 2019 from 3.73% in fiscal 2018 and 3.91% in fiscal 2017. Semi-integrated nature of operations coupled with proximity to the source of raw materials & end user market provides a competitive edge to the company.

Established brand with a strong market presence in Eastern India

The company has a long track record of over a decade in the iron and steel industry. Over the years, the company forayed into sponge iron and thereafter as a part of forward integration initiative set up facility for billets & rolling mill in 2010. The long track record has helped the company to position itself among the established players in the eastern market. Currently, GFL is selling its TMT Bars in the eastern parts of India mainly in West Bengal, Jharkhand and Assam. GFL is selling its TMT bars under the brand name "Gagan".

Sustained growth in revenues over the years with improvement in profitability

The total operating income of the company registered a CAGR of ~10.3% during FY17-FY19 with a y-o-y growth of ~10% in FY19. The growth is driven by higher brand penetration leading to increase in volume sale and increase in sales realisations. Also, with increase in the scale of operations, the EBIDTA margin of the company improved from 3.73% in FY18 to 5.89 % in FY19. The improvement in profitability is majorly due to better cost management and lower electricity and power cost. Electricity and power cost as a percentage of sales reduced to ~9% in FY19 from ~12 % in FY18 resulted in better operating margins. Further, the PAT margin of the company improved from 1.09 % in FY18 to 2.48 % in FY19. The company has earned healthy gross cash accruals of Rs.42.52 crore in FY19 (Rs.24.82 crore in FY18). During H1FY20 (provisional), the company has clocked a PBT of Rs.13.05 crore on revenue of ~Rs.447 crore. Going forward, Infomerics expects improvement in the topline with GFL increasing its capacity in all the product lines from sponge iron, billets and rolling products which is in the verge of completion.

Comfortable financial risk profile marked by satisfactory gearing with healthy debt protection metrics

The financial risk profile of GFL is marked by its healthy net worth, comfortable gearing and healthy debt protection metrics. The tangible net worth stood healthy at of Rs.390.69 crore as on March 31, 2019 as against Rs.280.10 crore in the previous year. To arrive at the net worth, Infomerics has considered Rs.42.92 crore of unsecured loans from promoters/ directors as quasi equity as the same is subordinated to the bank facilities. GFL's promoters have infused funds at regular intervals to support the business operations of the company. During FY19, the promoters have infused equity ~Rs.68.0 crore for its on-going capex. Long term debt equity stood comfortable at 0.06 times as on March 31, 2019 as compared to 0.09 times as on March 31, 2018. The overall gearing ratio has remained at less than unity in the past three years ended March 31, 2019. The interest coverage ratio stood healthy at 5.91 times in FY2019 as compared to 4.39 times in FY2018. Going forward, Infomerics believes the financial risk profile to remain healthy as GFL has lower reliance on external debt and maintained a conservative capital structure.

Prudent Working Management

The working capital cycle is well managed on account of better debtor and inventory management by the company. GFL's operating cycle stood at 73 days during FY18-19. The debtor days on an average, stood between 45-65 days during the period under review (FY2017-2019). GFL on an average, provides credit period of 30-75 days to its customers. The inventory is generally maintained between 40-48 days for its raw materials such as coal, while ~ 30 days for iron ore and 10 days for its finished products in the form of sponge iron, billet and TMT bars. The raw materials are majorly procured on advance terms from the suppliers. Further, the moderate working capital intensity is reflected from the low utilisation of ~ 65 percent of its working capital facilities of Rs.155 crore during the trailing 12 month ended October 2019.

Key Rating Weaknesses

Susceptibility of profitability to volatility in raw material prices and finished goods

The degree of backward integration defines the ability of the company to withstand cyclical downturns generally witnessed in the steel industry. The major raw materials required for manufacturing billets are coal, iron ore and sponge iron while billets are the main raw material for producing TMT bars. However, it does not have any backward integration for its basic raw materials (iron ore & coal) and has to purchase the same from open market. Since the raw material is the major cost driver (constituting about 85% of total cost of sales in FY19) and raw material prices are volatile in nature, the profitability of the company is susceptible to fluctuation in raw material prices (though the prices of finished goods move in tandem with raw material prices, there is a time lag). Further, finished steel prices are also highly volatile and prone to fluctuations based on global demand supply situations and other macro-economic factors.

Intense competition

The steel manufacturing businesses is characterised by intense competition across the value chain due to low product differentiation, and consequent intense competition, which limits the pricing flexibility of the players, including GFL.

Cyclicality in the steel industry

The domestic steel industry is cyclical in nature and is likely to impact the cash flows of the steel players, including GFL. The steel industry is cyclical in nature and witnessed prolonged periods where it faced a downturn due to excess capacity leading to a downtrend in the prices. Further, the company’s operations are vulnerable to any adverse change in the demand-supply dynamics in the real estate sector.

Analytical Approach: Standalone

Applicable Criteria

Liquidity: Strong

The liquidity profile of GFL is expected to remain strong marked by its expected healthy cash accruals vis a- vis its debt repayment obligations. In FY19, GFL earned cash accruals of ~ Rs.42.5 Cr. as against minimal loan obligations of Rs.0.03 crore in the same period. Further, the average cash credit utilisation of the company remained comfortable at ~65% during the past 12 months ended October, 2019 indicating a sufficient liquidity cushion. The company has sufficient gearing headroom due to its comfortable capital structure. Infomerics expects the liquidity position of the company to be sustained at strong levels as majority of the capex has been completed.

About the Company

Incorporated in 1993, Gagan Ferrotech Limited (formerly, Gagan Commodities Private Limited) is a Kolkata based company promoted by Mr. Vinay Kumar Agarwal and Mr. Deepak Agarwal. Post incorporation, the company was trading in coal and since 2006, the company started its operations with setting up of 66,000 metric tonne per annum (MTPA) sponge iron plant at Asansol (West Bengal). Over the years, GFL expanded its sponge iron capacity and as a part of forward integration initiative set up facility for billets & rolling mill in 2010. Moreover, in order to strengthen the entire value chain, GFL has also set up captive power plant 2011. The present capacity of GFL stands at 1,38,600 MTPA for sponge iron, 2,64,000 MTPA for billets and 1,50,000 MTPA for rolling mill (TMT bars and wire rods). In addition, the company has a captive power plant of 12 MW. The company is further in process of expanding its installed capacities. The TMT bars and wire rods are sold under the brand name 'Gagan'.

In 2016, the entire stake of Mr. Deepak Agarwal in GFL was taken over by Mr. Vinay Kumar & family after a mutual agreement. Currently, the day to day affairs of GFL are managed by Mr. Vinay Kumar Agarwal.

Financials (Standalone):

(Rs. crore)

For the year ended* / As On	31-03-2018	31-03-2019
	Audited	Audited
Total Operating Income	841.78	924.47

For the year ended* / As On	31-03-2018	31-03-2019
EBITDA	31.37	54.47
PAT	9.21	23.03
Total Debt	129.48	127.33
Tangible Net worth	280.10	390.69
EBITDA Margin (%)	3.73	5.89
PAT Margin (%)	1.09	2.48
Overall Gearing Ratio (x)	0.40	0.31

*Classification as per Infomerics' standards.

Status of non-cooperation with previous CRA: Acuité has moved the rating of GFL 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 December 05, 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 Bank Facilities –Term Loan	Long Term	116.00	IVR A/ Stable Outlook	-	-	-
2.	Long Term Bank Facilities –Cash Credit	Long Term	155.00	IVR A / Stable Outlook	-	-	-
3.	Short Term Bank Facilities –Letter of Credit/Bank Guarantee	Short Term	88.75	IVR A1	-	-	-

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.

Name and Contact Details of the Rating Analyst:

Name: Mr. Aniruddha Dhar	Name: Mr. Avik Podder
Tel: (033) 46022266	Tel: (033) 46022266
Email: adhar@infomerics.com	Email: apodder@infomerics.com

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. 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)	Rating Assigned/ Outlook
Long Term Bank Facilities –Term Loan	-	-	Dec'2025	116.00	IVR A/ Stable Outlook
Long Term Bank Facilities –Cash Credit	-	-	-	155.00	IVR A / Stable Outlook
Short Term Bank Facilities –Letter of Credit/Bank Guarantee	-	-	-	88.75	IVR A1