

Rating Rationale
Bhagawati Steel Industries Private Limited

Rating

| Facility | Amount (Rs. In Million) | Rating ¹ | Rating Action |
|----------------------------|-------------------------|----------------------------------|---------------|
| Long Term Bank Facilities | 171.48 | CARE-NP BBB- [Triple B Minus] | Assigned |
| Short Term Bank Facilities | 2,980.00 | CARE-NP A3 [A Three] | Assigned |
| Total facilities | 3,151.48 | | |

Details of Facilities in Annexure 1

CARE Ratings Nepal Ltd. (CRNL) has assigned Rating of ‘CARE-NP BBB-’ to the long term bank facilities and ‘CARE-NP A3’ to the short term bank facilities of Bhagawati Steel Industries Private Limited (BSPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of BSPL derive strength from established and long track record of operations along with experienced management team in the related field and moderate operational and financial profile characterized by healthy growth in sales and profitability during FY19 (Audited, refers to 12 months period ended mid-July 2019). The ratings also factor in moderate gearing levels and debt service coverage indicators of the company, diverse product range catering to wide spectrum of industries, established marketing setup and brand with strong customer base and demand of steels products in the country. The ratings are however constrained by raw material price volatility and foreign exchange fluctuation risk, working capital intensive nature of operations, exposure to volatile interest rates and presence in highly fragmented and competitive nature of steel industry. The ability of BSPL to manage growth in the operations, maintaining the profit margins and rationalization of its debt through efficient working capital management would be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Strengths

Established and long track record of operations along with experienced management team in the related field

BSPL has an operational track record of almost three decades in manufacturing pipes, tubes and other allied steel products. The promoters of BSPL have an experience of more than three decades in the steel industry. BSPL is managed under the overall guidance of its three member Board of Directors (BoD) which includes experienced businessmen/industrialist with wide experience in the manufacturing sector. Mr. Sumit Kumar Agrawal is the Chairman and Managing Director of BSPL and has 30 years of experience in various types of business and industries. He is also an executive member of Nepal Chamber of Commerce and Nepal-China Chamber of Commerce & Industry (NCCCI).

¹Complete definitions of the ratings assigned are available at www.careratingsnepal.com

Moderate operational and financial profile characterized by healthy growth in sales and profitability during FY19 (A)

BSPL has been able to maintain moderate capacity utilization of 57% in FY17 and 59% in FY18 with total installed capacity of 59,000 MTPA and with addition of 26,500 MTPA capacity during Mid-January FY19, healthy capacity utilization of 65% was maintained on the enhanced total capacity of 85,500 MTPA. BSPL's total revenue increased by ~25% during FY18 over FY17 which further increased by ~47% during FY19 to Rs. 4,930 Mn as compared to FY18. During FY19, BSPL reported 69.33% of revenue through direct local sales and 30.67% through tender based sales to government offices and departments. PBILDT margins of the company improved to 10.14% in FY18 from 8.63% in FY17 which declined to 8.30% during FY19. The PBIDT margin declined despite increased sales due to growth in trading sales having lower profit margin. The PAT margins declined to 3.84% during FY19 from 4.86% during FY18 on account of higher interest expense on increased working capital utilization. However, there was growth in the PBILDT and PAT in absolute numbers. Further, during Q1FY20 (Unaudited, refers to 3 months period ended mid-October 2019) the company has achieved sales of Rs. 1,349 Mn with PBILDT margin of 7.82%.

Moderate gearing levels and debt service coverage indicators of the company

Debt-equity ratio of the company has been on a declining trend which reduced to 0.19x at the end of FY19 from 0.23x at the end of FY18 and 0.70x at the end of FY17. Total gearing ratio of the company was moderate at 2.11x at the end of FY17 which increased to 3.23x at the end of FY18, however, improved to 2.54x at the end of FY19, despite increase in working capital loan due to accretion of profit to net worth. BSPL had healthy interest coverage ratio of 9.47x in FY18 (FY17: 6.35x) which however reduced during FY19 to 4.95x due to increased interest expenses. Total debt/ Gross cash accruals (GCA) for FY17 was 3.41x which increased to 6.36x in FY18, however improved marginally to 6.17x during FY19 due to higher GCA of Rs. 244 Mn in FY19 as compared to Rs. 208 Mn in FY18.

Diverse product range catering to wide spectrum of industries and established marketing setup

The company is into manufacturing mild steel black pipes & galvanized pipes and their variants along with tubular pole, telescopic pole, structure, shutter profile etc. Company is also involved in selling galvanized plain sheets, hot rolled coil sheet and cold rolled coil sheet by cutting it in different sizes. Also, to diversify its products and cater to varied market, capacity for Bridges and Towers and Penstock Pipes was installed by the company during FY19. BSPL sells its product all over Nepal and the sales are through direct marketing to existing as well as new customers.

Established brand with strong customer base

The company sells pipes, sheets and other allied products under the brand name of "BST" which is an established brand in the Nepal market on account of its long-standing presence in the construction industry.

This provides leverage to the company in front of new players entering the industry. The company has a strong customer base with majority of the customers being Government Departments, NGOs, Local government authorities and renowned business houses.

Demand of steels products in the country

Nepalese economy is developing and growing and is in phase of investment in infrastructure sectors, power sector and tourism sector. It is highly probable that the national economy will be in need of construction materials in developing public as well as private infrastructures, road, bridges and other public facilities. Further, followed by devastating earthquake of April 2015, Government commitment towards infrastructure and rebuilding the housing sector has increased demand of iron and steel products in Nepal. As a result of increased development works demand for iron and steel is expected to grow by 10% annually.

Key Rating Weaknesses

Raw material price volatility risk and foreign exchange fluctuation risk

HR/CR Coils and Ingots are the major raw materials for BSPL and are imported from India and China. The prices of these raw materials are market linked and determined on a periodic basis. The raw material consumption cost contributed around 76% of the total operating income of the company in FY19, thus, any volatility in prices of the same is expected to impact the profitability of the company. Also the company is exposed to the foreign exchange fluctuation risk as the prices are linked to USD. The ability of the company to pass through changes in raw material prices to the customers and managing the foreign exchange fluctuation risks related to raw materials will be the key rating sensitivities.

Working capital intensive nature of operations

BSPL is involved in manufacturing wide range of steel products by majorly importing raw materials which are procured through Letter of Credit. BSPL generally allows two months credit period to its customers, debtor turnover days was 60 days during FY19 and inventory turnover was 64 days. Further, credit period allowed to the company during FY19 was at 16 days. Total operating cycle of the company was 108 days in FY19 which increased from 98 days in FY18 due to increase in collection period. This leads to high reliance of the company on the bank finance for working capital needs.

Exposure to volatile interest rates

Nepalese banking sector fix interest rates on lending, based on quarterly published base rate by the banks. Due to tight liquidity in the market, the interest rate has been high and volatile during the last 12 months. Therefore, funding from Banks and Financial Institutions are exposed to volatile interest rate.

Presence in highly fragmented and competitive nature of steel industry

The iron and steel industry is intensely competitive and fragmented marked by the presence of both larger players and numerous smaller players in the unorganized segment. Given the fact that the entry barriers to the industry are low, the players in the industry do not have pricing power and are exposed to

competition-induced pressures on profitability. The demand of iron & steel products is considered cyclical as it depends upon the capital expenditure plan of major players in the end-user industry. Further, with increase in the capacities of the existing plants and new capacities coming into operation competition has intensified which has resulted into substantial decline in profitability margins of the industry players in the current year. The producers of steel construction materials are essentially price-takers in the market, which directly expose their cash flows and profitability to volatility in the steel prices.

About the Company

Bhagawati Steel Industries Private Limited (BSPL) is a private limited company incorporated on January 10, 1991 for manufacturing Pipes and Sheets, having plant in Chhatapipra, Bara, Nepal. Currently, the total installed capacity of the plant is 85,500 Metric Tons Per Annum (MTPA) which was increased from 59,000 MTPA during January, 2019.

Brief financial performance during the last 3 years ending FY19 is as follows:

(Rs. In Million)

| For the year ended Mid July | FY17 (A) | FY18 (A) | FY19 (A) |
|-----------------------------|----------|----------|----------|
| Income from Operations | 2,678 | 3,350 | 4,930 |
| PBILDT | 231 | 340 | 409 |
| PAT | 109 | 163 | 189 |
| Overall Gearing (times) | 2.11 | 3.23 | 2.54 |
| Interest coverage (times) | 6.35 | 9.47 | 4.95 |

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Annexure 1: Details of the Facilities rated

| Nature of the Facility | Type of the Facility | Amount (Rs. Million) | Rating |
|----------------------------|----------------------|----------------------|--------------|
| Long Term Bank Facilities | Term Loan | 171.48 | CARE-NP BBB- |
| Short Term Bank Facilities | Working Capital Loan | 1,610.00 | CARE-NP A3 |
| Short Term Bank Facilities | Letter of Credit | 1,280.00 | CARE-NP A3 |
| Short Term Bank Facilities | Bank Guarantee | 90.00 | CARE-NP A3 |
| Total | | 3,151.48 | |