

Rating Rationale
Jagdamba Enterprises Private Limited

Rating

Facility/ Instrument	Amount (Rs. In Million)	Rating ¹	Rating Action
Long Term Bank Facilities	374.15	CARE-NP BB+ [Double B Plus]	Assigned
Short Term Bank Facilities	1,4920.00	CARE-NP A4+ [A Four Plus]	Assigned
Total facilities	15,294.15		

Details of Facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has assigned rating of ‘CARE-NP BB+’ to the long term bank facilities and ‘CARE-NP A4+’ to the short term bank facilities of Jagdamba Enterprises Private Limited (JEPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of JEPL are constrained by highly leveraged capital structure and weak debt service coverage indicators in FY18 (audited, refers to 12 months period ended mid-July 2018) which further deteriorated in FY19 (audited, refers to 12 months period ended mid-July 2019) and raw material price volatility risk along with foreign exchange fluctuation risk. The ratings also factor in working capital intensive nature of operations, exposure to volatile interest rates and presence in highly fragmented and competitive nature of steel industry. The ratings however, derives strength from strong operational and financial performance characterized by healthy growth in sales, profitability, PAT and internal accruals in FY18, however subdued performance in FY19 coupled with established and long track record of operations of the company with experienced management team in the related field. The ratings also factors in established brand with country wide market presence and large scale of operation of the company, diverse product range catering to wide spectrum of industries, established marketing setup and demand of steels products in the country.

Ability of JEPL to manage growth in the operations & improve the profit margins and rationalization of its debt through efficient working capital management would be the key rating sensitivities. Ability of the company to pass through changes in raw material prices to the customers and manage the foreign exchange fluctuation risks related to raw materials will be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Highly leveraged capital structure and weak debt service coverage indicators in FY18 which further deteriorated in FY19

Debt-Equity ratio was low at 0.22x at the end of FY18 which increased to 0.25x at the end of FY19, however total gearing ratio of the company was high at 3.60x at the end of FY18 which deteriorated to 4.79x at the end of

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

FY19 due to increase in working capital loans in FY19. JEPL had comfortable interest coverage ratio of 6.06x in FY18 which deteriorated to 1.09x during FY19 due to increase in interest expenses on account of high utilization of working capital loans coupled with weak financial performance leading to decline in the PBILDT. Total debt/GCA for FY18 was at 5.71x which increased significantly to 59.39x during FY19.

Raw material price volatility risk and foreign exchange fluctuation risk

JEPL does not have any backward integration for its basic raw material (HR/CR Coils & Sheets, MS Billets) for producing MS Black Pipe, GI Pipe, Tubular Pole, HR/CR Sheet/Plates/Profile, TMT bar and majorly imports from India. The prices of billets, HR/CR Coils & Sheets are market linked and determined on a periodic basis, thus exposing the company to the volatility in the prices of raw materials which has a bearing on its profitability margins. The cost of raw material consumed as % of the total operating income of the company was around 86% in FY19, thus, any volatility in prices of the raw materials are expected to impact the profitability of the company. Further, around 99% of its raw material requirements is met through imports and the price of the same are linked to USD, for which it is exposed to the foreign exchange fluctuation risk. JEPL incurred foreign exchange fluctuation loss of Rs. 92.92 Mn during FY18 which increased to Rs. 316.97 Mn during FY19. 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

JEPL is involved in manufacturing wide range of steel products by majorly importing raw materials through Letter of Credit and also has to fund the inventory and debtors which leads to high reliance on working capital limits. JEPL generally allows three months credit period to its customers, debtors turnover days was 100 days during FY19. At the end of FY19, the receivables of the company were high on account of high credit sales made by the company. The company keeps inventory for around two months and the inventory turnover was 49 days for FY19. Further, credit period allowed to the company during FY19 was at 3 days. Total operating cycle of the company was high at 145 days in FY19 which increased from 130 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. Further the working capital limits utilisation have increased due to increase in the business size following capacity enhancement and increase in the working capital cycle.

Exposure to volatile interest rates

Nepalese banking sectors are fixing lending interest rate based on quarterly base rate and interest rate will be changed accordingly on quarterly basis. Due to tight liquidity in the market, the interest rate has been high and volatile during the last 12 months. Therefore, the funding from Bank and Financial Institutions to the company is 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. Furthermore, the value addition in the steel products like M.S. black, galvanized pipes, TMT & related products is low, resulting into low product differentiation in the market. 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.

Key Rating Strengths***Established and long track record of operations with experienced management team in the related field***

JEPL has an operational track record of around two decades in manufacturing of MS black pipes, galvanized pipes, tubular poles and other allied steel products. JEPL is promoted by industrialists and traders of Nepal, who are involved in manufacturing of cement, trading of construction materials and hospitality business. The company is managed under the overall guidance of its three member Board of Directors (BoD) which includes eminent businessmen/industrialists with wide experience in the manufacturing sectors. The day to day operations of the company is looked after by Mr. Anil Kumar Rungta and Mr. Vishal Patwari, Director, who have an experience of two decades in the steel industry and handle marketing, purchase of material and production planning of the company.

Strong operational and financial performance characterized by healthy growth in sales, profitability, PAT and internal accruals in FY18 however subdued performance in FY19

JEPL's total revenue increased by 18% during FY19 to Rs. 19,661 Mn as compared to growth of 45% in FY18. This high growth in revenue was majorly because of increase in sales quantity due to capacity enhancement coupled with higher per unit sales realization of both TMT bars and MS Black Pipes. However, PBILDT of the company decreased to Rs. 769 Mn in FY19 from Rs. 2,018 Mn in FY18, with reduced PBILDT margin of 3.91% from 12.08% in FY18. Despite growth in revenue in FY19, PBILDT of the company suffered on account of higher proportionate increase in cost of raw material prices than increase in sales realizations. Also, with addition of the new capacities in the market and increase in the intensity of the competition, the company was not able to pass on the increased cost to its customers fully. PBILDT in FY19 was also impacted by foreign exchange loss of Rs. 317 Mn which increased from Rs. 93 Mn in FY18. PAT of the company reduced significantly in FY19 to Rs. 20 Mn with PAT margin of 0.10% on back of decline in PBILDT and increase in the interest cost. During 5

months period ended FY20, the company has achieved sales of Rs. 7,136 Mn and generated PBILDT of Rs. 333 Mn and PAT of Rs. 47 Mn.

Established brand with country wide market presence and large scale of operation

The company sells MS Pipes & Tubes along with shutter items and different kind of flat products under the brand name “Jagdamba” and TMT bars under the brand name “JAG SHAKTI” which is an established brand in the Nepal market on account of its long-standing presence in the construction industry. The company is into the business for two decades and is one of the leading player in the country with significant turnover. Further, JEPL has a customer base of around 400 customers across all major cities in the country which provides a ready market for its products.

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

JEPL manufactures variety of steel products of different sizes which have application in a number of industries which enables company to expand its consumer base. Till the end of FY19, JEPL had six number of tube mills which produces MS Black Pipe which are Indian Standards and Nepal Standards certified. MS Black Pipes find usage in construction, automobile, chemical and oil industries. Company has further diversified with manufacturing of TMT bars which are used for various construction and engineering projects. JEPL is also one of the reputed manufacturer of GI Pipes of various sizes. JEPL also manufactures and supplies varied sizes of shutter items like shutter profiles, shutter guide, shutter spring, lock plate along with fabrication and steel tubular pole.

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.

Locational advantage and scope to increase export

The plant site is located in Parsa, around 15 Kms from Indo-Nepal borders and Birgunj dry-port. Since majority of raw materials used by JEPL are imported from India, the factory’s proximity to the border remains a positive point leading to saving in freight cost. Further, JEPL has also been exporting its products to India and Bhutan which accounted for ~1.20% of total sales in FY19. Upon favorable market conditions in future the company can exploit the opportunity of increasing the export sales.

About the Company

Jagdamba Enterprises Private Limited (JEPL) is a private limited company which was incorporated on March 29, 2001 for setting up M.S. Black & Galvanized pipe manufacturing plant in Jeetpur, Parsa district of Nepal. The company is operating from more than 15 years, manufacturing wide range of steel products with total installed plant capacity of 300,360 Metric Tons Per Annum (MTPA) in FY19 and is the leading player in the industry. JEPL had six tube mills with total tube manufacturing capacity of 118,800 MTPA and the seventh tube with capacity of 57,600 MTPA commenced operations in the beginning of FY20.

Brief Financial Performance during the last 3 years is as follows:

(Rs. In Million)

For the year ended Mid July	FY17 (A)	FY18 (A)	FY19 (A)*
Income from Operations	11,552	16,708	19,661
PBILDT	1,355	2,018	769
PAT	716	1,144	20
Overall Gearing (times)	3.30	3.60	4.79
Interest coverage (times)	4.21	6.06	1.09

*Audited

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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	374.15	CARE-NP BB+
Short Term Bank Facilities	Working Capital Loan	3,475.00	CARE-NP A4+
Short Term Bank Facilities	Non-fund based limits	11,445.00	CARE-NP A4+
Total		15,294.15	