

Rating Rationale
Real Steels Private Limited

Rating

Facilities	Amount (Rs. In Million)	Rating ¹	Rating Action
Long Term Bank Facilities	390.00	CARE-NP B+ [Single B Plus]	Reaffirmed
Short Term Bank Facilities	550.00	CARE-NP A4[A Four]	Reaffirmed
Total Facilities	940.00		

Details of Facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has reaffirmed rating of ‘CARE-NP B+’ assigned to the long-term bank facilities and rating of ‘CARE-NP A4’ assigned to the short-term bank facilities of Real Steels Private Limited (RSPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to bank facilities of RSPL continues to be constrained by subdued financial performance of the company during the first year of operation in FY20 with net loss (Provisional, refers to 12 months period ended mid-July 2020) coupled with highly leveraged capital structure and weak debt service coverage indicators of the company. The ratings are further constrained by financial closure not achieved for the total project cost, working capital intensive nature of operations, raw material price volatility risk, foreign exchange fluctuation risk, exposure to volatile interest rates and presence in highly fragmented and competitive nature of steel industry. The ratings, however, derive strength from experienced promoters and management in the related field, demand of steels products in the country, locational advantage and product diversification. Ability of RSPL to achieve revenue growth, improvement in the profitability margins and improve its overall solvency position would be the key rating sensitivities.

Impact of Covid-19 on the business of the company

With the outbreak of Coronavirus disease 2019 (COVID-19) recognised as Pandemic by World Health Organization on March 11, 2020, which has affected Nepal as well, the Government of Nepal (GoN) had imposed travel restrictions and countrywide lockdown since March 24, 2020 till June 14, 2020. Considering the same, business operation of RSPL have been interrupted and sales of RSPL has slowed down which has directly impacted the revenue and profitability of the company.

Detailed Description of the Key Rating Drivers

Key Rating Weakness

Subdued financial performance of the company during the first year of operation in FY20 with net loss
RSPL’s capacity utilization has been low at 9.35% (annualized) during FY20 mainly due to its first year of operation which was also impacted by COVID-19 immediately after the commercial operation of the plant. RSPL’s total revenue was Rs. 43 Mn during FY20 from sale of 626 MT of steel products. PBILDT

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

of the company was negative Rs. 14 Mn in FY20. Further, the company incurred loss of Rs. 53 Mn during FY20. RSPL generated negative Gross Cash Accruals (GCA) in FY20 as a result of loss incurred during the year. The capacity utilization during 3MFY21 has improved to 25.37% on account of increased production and normalized operations after the opening up of lockdown due to Covid-19. The company has achieved sales of Rs. 221 Mn during 3MFY20.

Highly leveraged capital structure and weak debt service coverage indicators

RSPL has highly leveraged capital structure as reflected by overall gearing ratio of 3.82x. RSPL had negative interest coverage ratio of 0.74x in FY20 along with negative total debt/ GCA ratio due to losses generated during FY20. The gearing ratios of the company is expected to improve in future with stabilization of operations and generation of profit. Further, the project cost was estimated at Rs.597.50 Mn as per the last estimates provided by the company in September 2019. However, project has been completed at cost of Rs. 578.84 Mn. which has been financed through Rs. 243.32 Mn. term loan from bank, Rs. 216.50 Mn. through capital from promoters and Rs. 119.02 Mn from retention money/credit from suppliers. Further, the company is planning to take additional term loan of Rs. 156 Mn from bank to repay its capital creditors. Additional loan is expected to further impact the capital structure of the company which will be partially offset by additional equity infusion by the promoters in the company.

Working capital intensive nature of operations

RSPL purchases raw materials through Letter of Credit and also has to fund the inventory and debtors which lead to high reliance on working capital limits. Total operating cycle of the company was 372 days in FY20 with average collection period from customers of 145 days and average inventory holding period of 607 days for FY20. As FY20 is the first year of operation which has been impacted by Covid-19, sales achieved by the company was low which led to high inventory at year end. The average utilisation of fund-based working capital limit against drawing power was around 90-95% during last 9 months as on period ending mid-November, 2020.

Raw material price volatility risk and foreign exchange fluctuation risk

HR/CR Coils are the major raw materials for RSPL and would majorly import from India. The prices of the RSPL's raw materials 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 raw material cost contribute around 80% of the total operating income of the company, thus, any volatility in prices of the same impacts the profitability of the company. Further, the majority of its raw material requirements is imported, prices of which is linked to USD, for which it is exposed to the foreign exchange fluctuation risk. To prevent the impact of foreign exchange fluctuation on profitability, RSPL does forward contract for all forex transactions on regular basis. The 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.

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. 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 MS pipes, shutter patti, shutter guide, construction material etc. is low, resulting into low product differentiation in the market. 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 Strength***Experienced promoters and management in the related field***

RSPL is promoted by traders and businessmen from Birgunj City of Nepal. RSPL is managed under the overall guidance of the Company's Board of Directors (BoD) who possesses wide experience in the industry and trading. Mr. Prem Kumar Jatiya is the Chairman and Managing Director of the Company. Mr. Jatiya, has been involved in different business for more than 19 years. Mr. Dipal Khanna, Executive Director, holds Chartered Accountancy degree from India and is also engaged in the trading of TMT bars, MS Pipes and other hardware items.

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. In the budget of Nepal for FY21, government has allocated Rs. 55 Bn for reconstruction and Rs. 36 Bn for construction of various transmission line and substations. However, with economic activities affected by COVID-19 pandemic, demand for steel may be subdued in short term. Government's high emphasis on infrastructure development and power sector in the budget for FY20-21 is likely to benefit the flat products manufacturers like RSPL.

Locational advantage

The plant site is located around 15 Kms from Birgunj dry-port, that makes the location of the plant in proximity to the Indian Border and big Indian State Bihar and provides RSPL an advantage of procuring raw material at lower transportation cost.

Product diversification

RSPL manufactures MS Pipe that has great usage in construction, automobile, chemical and oil industries including residential housing, shed construction. Shutter patti and shutter guide to be manufactured will be used at several places for safety purposes. The company offer its customers these shutters in varied sizes. Further, RSPL sells Hot Rolled Coil (HRC) and Cold Rolled Coil (CRC) by cutting it in different sizes.

About the Company

RSPL is a private limited company promoted by traders and businessmen from Birgunj mainly engaged in trading businesses for setting up of MS Steel Pipe plant in Parsa district of Nepal. The plant is located at Bagahi-28, Birgunj of Nepal and started its commercial operation since January, 2020. The company manufactures MS Pipes, Shutter Patti, Shutter Guide and other related products with annual production capacity of 18,000 MT of MS Pipes, 3,000 MT of Shutter Patti, 1,800 MT of Shutter Guide and 24,000 MT of Hot Rolled Coil (HRC) and Cold Rolled Coil (CRC) per year. Promoters of RSPL had infused Rs.203.49 Mn equity capital till July 15, 2020 towards the project execution.

Brief Financial Performance during last year

(Rs in Million)

Particulars	FY20
	Provisional
Income from operations	43
PBILDT	(14)
PAT	(53)
Interest Coverage ratio (times)	NM*
Overall gearing (times)	3.82

*NM- Not meaningful

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Annexure 1: Details of the Facilities rated

Nature of Facility	Type of Facility	Amount (Rs. Million)	Rating
Long Term Bank Facilities	Term Loan	233.90	CARE-NP B+
Long Term Bank Facilities (Proposed)	Term Loan	156.10	CARE-NP B+
Short Term Bank Facilities	Working Capital	500.00	CARE-NP A4
Short Term Bank Facilities (Proposed)	Working Capital	50.00	CARE-NP A4
Total		940.00	