

Rating Rationale

Saakha Steel Industries Private Limited

Rating

Facility	Amount (Rs. In Million)	Rating ¹	Rating Action
Long Term Bank Facilities	299.32	CARE-NP B+ [Single B Plus]	Reaffirmed
Short Term Bank Facilities	1,600.00	CARE-NP A4 [A Four]	Reaffirmed
Total Facilities	1,899.32		

Details of Facilities in Annexure 1

CARE Ratings Nepal Ltd. (CRNL) has reaffirmed rating of ‘CARE-NP B+’ assigned to the long term bank facilities and ‘CARE-NP A4’ assigned to the short term bank facilities of Saakha Steel Industries Private Limited (SSIPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of SSIPL is constrained by declining trend in sales and profitability during the last three years ended on FY20 (Audited, refers to 12 months period ended mid-July 2020) leading to negative cash accruals and eroded net-worth of the company followed by highly leveraged capital structure and weak debt service coverage indicators. The rating is also constrained by working capital intensive nature of operations, raw material price volatility, foreign exchange fluctuation risk, exposure to volatile interest rates and presence in highly fragmented and competitive nature of steel industry. The ratings however, derives strength from established business group and experienced promoter in the related field, demand of steel products in the country and locational advantage. The ability of the company to manage the growth in the operations & improve the profitability will be key rating sensitivities.

Impact of COVID-19 on the operations and financials of the company

With the outbreak of Coronavirus disease 2019 (COVID-19) recognized 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. During the lockdown period, sales of the company has been directly impacted in FY20. However, with government easing restriction for various activities recently, operations, revenue and profitability of the company is also expected to improve in FY21.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Declining trend in sales and profitability during the last three years ended mid-July 2020 leading to negative cash accruals

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

SSIPL reported sales of Rs 728 Mn in FY20 recording a decline of 32% as compared to Rs. 1,071 Mn in FY19 on account of reduction in quantity of TMT sold by the company and impact of COVID 19. With decline in sales, SSIPL recorded negative PBILDT margin in FY20 from margin of 6.47x in FY19. Ability of the company to manage the growth in the operations & improve the profitability will be key rating sensitivities.

Eroded net-worth of the company followed by highly leveraged capital structure and weak debt service coverage indicators of the company

The financial risk profile of the company was below average marked by eroded Net-worth in the books of the company at the end of FY20. Net-worth of the company was negative due to loss suffered by the company during FY19 and FY20 resulting negative reserve and surplus. Company has negative debt equity ratio as well as overall gearing ratio at the end of FY20 due to negative net-worth of the company. Interest coverage ratio of the company further declined to negative 0.19x in FY20 from 0.73x in FY19. Due to negative GCA reported by the company, total debt to GCA was negative in FY20.

Working capital intensive nature of operations

The operations of the company are working capital intensive in nature. SSIPL majorly imports its raw materials from India, manufactures various steel products and then sells them in the domestic market. The company purchases raw materials through LC at sight and also fund the inventory and debtors which lead to high reliance on working capital limits. Company has average debtor collection period of 221 days and average inventory holding period of around 282 days during FY20. Accordingly total operating cycle of the company increased and was very high at 448 days during FY20 (300 days in FY19). The average utilisation of fund-based working capital limit against drawing power was around 90-95% during last 12 months for period ending on mid-July, 2020.

Raw material price volatility risk and foreign exchange fluctuation risk

The major raw materials for SSIPL are imported from India and the prices 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 contributed around 75% of the total operating income of the company during FY20, thus, any volatility in prices of the same impacts the profitability of the company. With prices of raw material imported linked to USD, the company is exposed to the foreign exchange fluctuation risk. 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.

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 TMT bars and 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 completion has intensifies which has resulted into substantial decline in profitability margins of the industry players in FY20.

Key Rating Strengths

Established business group and experienced promoter in the related field

SSIPL is part of the Saakha Group which is one of the established business group in Nepal. The group is promoted by Mr. Ganesh B. Saakha, who is the Chairman of the group and founder promoter of Saakha group and has wide experience across different sectors. The Group was involved in manufacturing adhesive, noodles and garments in the past. Group is also involved in manufacturing dyes and wall paints for over 35 years. Mr. Bishwa Prakash Saakha, Managing Director, manages day to day operation of the company and has more than 20 years of experience in manufacturing of paints, chemicals, non-ferrous metals. Senior management team members have wide work experience in the related field.

Demand of steels products in the country

Nepalese economy is developing and growing and is in phase of investment in infrastructure, power sector and tourism sector. In the budget presented by finance minister of Nepal for FY21, government has allocated Rs. 55 Bn for reconstruction with major focus towards development of health sectors, tourism sectors and other infrastructure development. However, with economic activities affected by COVID-19 pandemic, demand for steel may be subdued in short term, but with government focus on infrastructure, demand is likely to grow in long run. Government's high emphasis on infrastructure development and power sector in the budget for FY20-21 is likely to benefit the steel manufacturers like SSIPL.

Locational advantage

The plant site is located within ~20 Kms from Birgunj dry port in Nepal-India Border which makes the location of the plant near to the Indian border and large Indian State Bihar and provides SSIPL an advantage of supply of raw material at lower transportation cost.

About the Company

Saakha Steel Industries Private Limited (SSIPL) is a private limited company established in 1997 in Simara, Bara district of Nepal. The company manufactures TMT Steel Bars of different sizes under the brand name "Saakha TMT". In addition to production line of TMT bars, SSIPL also produces variety of steel wires and rods. The installed capacity of SSIPL is 72,000 Metric Tons Per Annum for TMT.

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

(Rs in Million)

For the year ended Mid July	FY18(A)	FY19(A)	FY20(A)
Income From Operations	1,095	1,071	728
PBILDT Margin (%)	7.93	6.47	(2.48)
Overall Gearing (times)	12.35	14.52	NM*
Interest Coverage (times)	1.17	0.73	(0.19)
Current Ratio (times)	0.78	0.87	0.73

*Not Meaningful

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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	299.32	CARE-NP B+
Short Term Bank Facilities	Working Capital Loan	1,300.00	CARE-NP A4
Short Term Bank Facilities	Non Fund Based Limits	300.00	CARE-NP A4
Total Bank Facilities		1,899.32	