

Vijayshri Steel Private Limited

Rating

Facility/Instrument	Amount (Rs. in Million)	Ratings ¹	Rating Action
Long Term Bank Facilities	869.83	CARE-NP BB [Double B]	Reaffirmed
Short Term Bank Facilities- Fund Based Facilities	3,200.00	CARE-NP A4+ [A Four Plus]	Reaffirmed
Total Facilities	4,069.83		

Details of Facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has reaffirmed rating of 'CARE-NP BB' assigned to the long-term bank facilities and 'CARE-NP A4+' assigned to the short-term bank facilities of Vijayshri Steel Private Limited (VSPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of VSPL are constrained by its leveraged capital structure and modest debt service coverage indicators, working capital intensive nature of operations, raw material price volatility and foreign exchange fluctuation risk. The ratings also factor in VSPL's exposure to volatile interest rates, and presence in highly fragmented and competitive nature of steel industry. The ratings, however, derive strength from VSPL's increasing scale of operations, albeit low profitability, in FY21, established business group and promoter's experience in cement manufacturing and trading businesses, demand of steel products in the country and locational advantage of its facilities.

Going forward, the ability of the company to continue to profitably scale up its operations with sustained improvement in capacity utilization will be the key rating sensitivities. Also, VSPL's ability to pass through changes in raw material prices to the customers and manage the foreign exchange fluctuation risks related to raw materials will also remain key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Leveraged capital structure and modest, albeit improving, debt service coverage indicators

Total gearing ratio of the company remained high at 2.81x at the end of FY21, although improved from 4.73x at the end of FY20 majorly on account of lower debt levels as on mid July, 2021. The company's short-term debt decreased to Rs. 1,578 Mn at the end of FY21 from Rs. 2,040 Mn at the end of FY20 backed by improved operating cycle. Also, VSPL's long term debt decreased to Rs. 241 Mn at the end of FY21 from Rs. 447 Mn at the end of FY20. Consequently, VSPL's interest expense lowered to Rs. 27 Mn during FY21 from Rs. 96 Mn during FY20, which led to interest coverage ratio improving to 4.44x during FY21 from 1.89x during FY20. However, total debt/ gross cash accrual (GCA) of the company continued to remain high at 44.62x during FY21, with impact of lower debt levels being offset to some extent by lower gross cash accrual during the year.

Working capital intensive nature of operations

VSPL is involved in the manufacturing of TMT bars by importing raw materials from India through letter of credit at sight. Hence, the operations of the company are working capital intensive marked by low creditor period coupled with high collection period, which was around 70 days at the end of FY2. Consequently, total operating cycle of the company remained high at 96 days during FY21, although improved from 147 days in FY20, aided majorly by relatively lower inventory at the end of

¹Complete definitions of the ratings assigned are available at www.careratingsnepal.com and in other CRNL publications.

FY21. Elongated operating cycle leads to increased reliance of the company on the bank finance for working capital requirements. Consequently, the average monthly utilization of VSPL's fund-based working capital limits against drawing power was around 97% during the twelve-month period ended mid-January 2022.

Raw material price volatility risk and foreign exchange fluctuation risk

VSPL, not having any backward integration, imports its basic raw material (MS Billets) from India, the prices of which are market linked and determined on a periodic basis. This exposes the company to the volatility in the prices of raw materials, which has a bearing on its profitability margins. Raw material costs accounted for around 86% of the total operating income during FY21, thus, any volatility in raw material prices impacts the profitability of the company. Also, the company is exposed to foreign exchange fluctuation risk as the raw prices are linked to USD. VSPL incurred foreign exchange loss of Rs. 53 Mn during FY21. The ability of the company to pass through changes in raw material prices to the finished products 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 in Nepal is intensely competitive and fragmented marked by presence of both larger players and numerous smaller players in the unorganized segment. The demand for iron & steel products is considered cyclical as it depends upon the capital expenditure plans of major players in the end-user industry. Furthermore, the value addition in the TMT bars and other related products is relatively low, resulting in 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 and resulted in lower price realizations and profitability margins.

Key Rating Strengths

Established business group and experienced promoter in cement manufacturing and trading business

VSPL is promoted by individuals who are associated with Vijaya Group of companies of Nepal which has a presence of more than 30 years in the industry. Currently, the Group is involved in importing and manufacturing cement, manufacturing batteries, trading bitumen, agriculture and education sector. The group also involves in manufacturing of cement (Bijaya Cements Private Limited). Since the group is operating in cement business in the Nepalese market for more than a decade with over 400 dealers, it gives them an advantage of existing distribution channel for marketing of goods manufactured by VSPL. The company is managed under overall guidance of its Board of Directors, led by Mr. Vikash Kedia, who has industrial experience of more than 18 years.

Locational advantage

VSPL's plant is located at Shivaraj, Kapilvastu which is at a distance of around 11km from Barhni border, India and around 98 km from Sunauli border, India, which gives VSPL an advantage of lower transportation cost during raw material procurement. Presently, VSPL is importing raw materials from Barhni border. Furthermore, the plant is situated nearby to the East-West Highway of Nepal which provides road access for supply of finished products to the major markets. Also, most of the steel factories are concentrated in eastern parts of Nepal. Hence, VSPL can exploit opportunities while focusing in the Central and Western parts of Nepal.

Increasing scale of operations, albeit lower profitability during FY21

The total revenue of the company increased by around 35% year on year to Rs. 5,348 Mn in FY21 on account of increase in sales volume and average price realization. However, the increase in price realization was not enough to offset the corresponding increase in raw material prices, which led to the company's PBILDT margin declining to 2.28% in FY21 from 4.59% in FY20. Profitability margins of the company remain on the lower side given the lower value addition to the goods manufactured. VSPL booked net profit of Rs 0.31 Mn in FY21 compared to Rs 0.01 Mn in FY20. During H1FY21 (unaudited,

refers to six-month period ended mid-January 2022), the company has booked total revenue of around Rs. 2,505 Mn.

Demand of steels products in the country

Nepalese economy is developing with growing investments particularly in the construction, power, manufacturing and tourism sector infrastructures. In its annual budget for FY22, the government has allocated Rs. 34 Bn towards post-earthquake reconstruction, Rs. 41 Bn towards urban development, Rs. 163 Bn for physical infrastructure and transport. However, with the pace of economic activities slowed down by the covid-19 pandemic, demand for steel products could remain relatively subdued in the short term. This is likely to grow in medium term. Furthermore, government's high emphasis on infrastructure development and other construction activities in the budget for FY22 augurs well for increased demand for steel products, particularly during H2FY22.

About the Company

VSPL is a private limited company, incorporated on February 23, 2017 to set up a TMT bar manufacturing plant in Kapilvastu district of Nepal. The company is promoted by businessmen engaged in manufacturing and trading business. The company manufactures TMT bars by importing raw materials from India and selling them into Nepal's market with production capacity of 700 MT of TMT bars per day. The plant started commercial operation from November 25, 2018.

Brief financials of VSPL for FY20 and FY21 are given below:

(Rs. Million)

For the year ended Mid-July	FY20 (Audited)	FY21 (Audited)
Income from Operations	3,954	5,349
PBILD Margin (%)	4.59	2.28
Overall Gearing (times)	4.73	2.81
Interest Coverage (times)	1.89	4.44
Current Ratio (times)	0.98	0.93
Total Debt/Gross Cash Accruals (times)	68.52	44.62

Annexure 1: Details of the Facilities rated

Nature of the Facility	Type of the Facility	Amount (Rs. In Million)	Rating
Long Term Bank Facilities	Term Loan	869.83	CARE-NP BB
Short Term Bank Facilities	Fund Based Limit	1,700.00	CARE-NP A4+
Short Term Bank Facilities	Non-Fund Based Limit	1,500.00	CARE-NP A4+
Total		4,069.83	

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The Unified Directives, 2078 issued by NRB has changed the validity of ratings to two years, however, in view of the SEBON regulations stating regular monitoring along with mandate agreement with the client which mentions annual detailed review of the rating assigned, CRNL continues to mention validity of the ratings as one year.