

Bhagawati Steel Industries Private Limited ^(Revised)

Ratings

Instrument / Facilities	Amount (Rs. Million)	Rating ^[1]	Rating Action
Long-term Bank Facilities	107.68 (Reduced from Rs. 140.71 Mn)	CARE-NP BBB- [Triple B Minus]	Reaffirmed
Short-term Bank Facilities	2,980.00	CARE-NP A3 [A Three]	Reaffirmed
Total Facilities	3,087.68 (Rs. Three Billion Eighty-Seven Million Six Hundred and Eighty Thousand Only)		

Details of instrument / facilities in Annexure-1

CARE Ratings Nepal Ltd. (CRNL) has reaffirmed rating of 'CARE-NP BBB-' for the long-term bank facilities and 'CARE-NP A3' for 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 continue to derive strength from established and long track record of operations along with experienced promoters and management team in the related field and moderate and improving profitability margins. The ratings also factor in comfortable gearing levels and healthy 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, locational advantage and demand of steels products in the country.

The ratings are however constrained by declining scale of operations and elongated operating cycle. The ratings also continue to be constrained by raw material price volatility and foreign exchange fluctuation risk, exposure to volatile interest rates and presence in highly competitive nature of steel industry. The ratings also took cognizance of high dividend payouts in FY21 (FY refers to 12 months period ended mid-July).

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. Deterioration in capitalisation structure of the company through further outflow of dividend shall also remain a rating sensitivity.

Detailed description of the key rating drivers

Key Rating Strengths

Established & long track record of operations along with experienced management team

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 the managing director of BSPL and has more than 30 years of experience in various types of business and industries.

Diverse product range, established marketing setup and locational advantage for the company

The company is into manufacturing mild steel (MS) black pipes & galvanized (GI) pipes and their variants along with tubular pole, telescopic pole, structure, shutter profile etc. The company is also involved in selling galvanized plain sheets (GP Sheet), hot rolled coil (HRC) sheet and cold rolled coil (CRC) sheet by cutting it in different sizes. BSPL sells its product all over Nepal through direct marketing network. Most of the sales revenue comes through direct domestic sales, followed by tender based sales. Also, with plant site located in Chhatapipra, Simara, only ~15 Kms from Indo-Nepal

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

borders and Birgunj dry-port, the factory's proximity to the border remains a positive point leading to savings in huge freight cost as majority of raw materials used by BSPL are imported from India.

Established brand with strong customer base

The company sells its products under the brand name of "BST" all over Nepal. The company's established brand presence ensures regular demand and aid in the differentiation of products with the competitors thereby, reducing the impact of competition induced volatility in prices over the years. The company is an approved vendor of various Government Departments and reputed business group.

Moderate financial risk profile

During FY21, the company has moderate financial risk profile marked by moderate and improving profitability margins, despite decline in total operating income and healthy debt service coverage indicators.

For the period FY19-FY21, BSPL's total operating income has been declining on y-o-y basis from Rs. 4,930 Mn to Rs. 3,220 Mn. The ongoing pandemic and resultant lockdowns have impacted demand factor mainly in respect of government tenders ultimately impacting manufacturing operations as well as revenue of the company. Despite the decline in total operating income, PBILDT margin improved during the same period from 8.30% in FY19 to 13.31% in FY21 on account of improved average price realization and change in share of revenue of product mix.

Total debt of the company declined by Rs. 690 Mn to Rs. 1,212 Mn as on mid-July, 2021 compared to previous balance sheet date on account of scheduled repayment of term loan as well as lower utilization of working capital loans. With this, overall gearing ratio of the company improved from 2.58x at the end of FY20 to 1.61x at the end of FY21. Also, total adjusted gearing ratio (net of cash and bank balances) of the company has improved and remained comfortable at 0.68x at the end of FY21. Despite, BSPL regularly paid dividend in last 2 financial years, net-worth has improved as on mid-July, 2021 on account of higher net profit earned. Improved profitability margins and declining debt levels resulted into improvement in debt service coverage indicators of the company for FY21. BSPL had healthy interest coverage ratio and Total debt/ Gross Cash Accruals of 9.83x and 1.74x respectively in FY21.

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 recent budget presented by finance minister of Nepal for FY22, government has allocated funds towards post-earthquake reconstruction, urban development, physical infrastructure and transport development, water supply and sanitation. 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 previous budgets is likely to benefit the company.

Key Rating Weaknesses

Elongated operating cycle, with high reliance on bank finance for funding

The operations of the company are working capital intensive in nature marked by high working capital cycle of 167 days in FY21. BSPL is involved in manufacturing wide range of steel products by majorly importing raw materials through Letter of Credit. Being a highly competitive business, the company has to extend credit period of around two months. The company is required to maintain adequate inventory of raw material for smooth running of its production processes. Furthermore, being a manufacturer, it is critical for the company to maintain minimum inventory levels to

meet immediate demand of its customers; all this led to high working capital requirements. The average utilisation of fund-based working capital limit against drawing power was around 87.23% during last 12 months period ended mid-August, 2021.

Raw material price volatility risk and foreign exchange fluctuation risk

The prices of major raw materials for BSPL which are mainly imported from India are market linked and determined on a periodic basis, thus exposing the company to the volatility in the prices having bearing on its profitability margins. The raw material consumption cost contributed around 71% of the total operating income of the company in FY21. The general volatility in the iron and steel prices also has an impact on the price of the final products. Any sudden spurt in these raw material prices might not be passed on to the end customers, instantly, on account of competitive nature of the industry, which could lead to decline in profitability margins.

Furthermore, the total raw material requirement is met through imports and the prices of the same are linked to USD, for which the company is exposed to the foreign exchange fluctuation risk. However, same is mitigated to some extent as the company has practice of hedging foreign exchange exposure. 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 is critical for the company to maintain its profitability.

Highly 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 M.S. Black, galvanized pipes & 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.

About the Company

Bhagawati Steel Industries Private Limited (BSPL) is a private limited company incorporated in 1991 and has plant in Chhatapipra, Bara, Nepal. The company is involved in manufacturing of pipes, sheets and has diversified its products to door and window frames, shutter profiles, side channels, truss, poles and towers, suspension and motorable bridge and related products. As on mid-July 2021, the total installed capacity of the plant is 85,500 Metric Tons Per Annum (MTPA).

Financial Performance

For the Period Ended / as at Mid-July,	(Rs. Million)		
	2019 (12m, A)	2020 (12m, A)	2021 (12m, A)
Total Operating Income	4,930	4,101	3,220
PBILDT Margin (%)	8.30	11.04	13.31
Adjusted Overall Gearing Ratio (times)*	1.97	1.64	0.68
Interest Coverage (times)	4.95	7.04	9.83
Current Ratio (times)	1.22	1.28	1.44
Adjusted Total Debt/Gross Cash Accruals (times)*	4.98	6.16	1.74

A: Audited

*BSPL has policy to invest surplus cash in short term fixed deposits which are later used to pay off working capital loans once they mature. Considering the same, CRNL has calculated adjusted gearing ratio and adjusted total Debt/Gross Cash Accruals by netting off working capital loans with such deposits in banks at the year end.

Annexure-1: Details of Instrument / Facilities

Name of the Instrument / Bank Facilities	Type of the Facility	Amount (Rs. in Million)	Rating assigned
Long Term Bank Facilities	Term Loan	107.68	CARE-NP BBB-
Short Term Bank Facilities	Fund Based Limits	1,610.00	CARE-NP A3
Short Term Bank Facilities	Non-Fund Based Limits	1,370.00	CARE-NP A3
Total		3,087.68	

Contact Us**Analyst**

Mr. Utsav Baral

Contact No.: +977-01-4012628

Email: utsav.baral@careratingsnepal.com

Relationship Contact

Name: Achin Nirwani

Contact No.: +977 9818832909

Email: achin.nirwani@careratingsnepal.com

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