

## Bhagawati Steel Industries Private Limited

### Ratings

Facility	Amount (Rs. in Million)	Ratings <sup>1</sup>	Rating Action
Long Term Bank Facilities	77.64	CARE-NP BBB- [Triple B Minus]	Reaffirmed
Short Term Bank Facilities	2,980.00	CARE-NP A3 [A Three]	Reaffirmed
Total Facilities	3,057.64 (Three Billion Fifty-Seven Million and Six Hundred Forty Thousand Only)		

*Details of Facilities in Annexure 1*

CARE Ratings Nepal Limited (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 its established track record of operations along with experienced promoters and management team in the related field, low gearing levels with moderate debt service coverage indicators, diverse product range catering to wide spectrum of industries, established marketing setup and brand with strong customer base, locational advantage and demand of steel products in the country. The ratings also take comfort from the moderate confirmed order-book at hand of the company which provides near term revenue visibility.

The ratings are however constrained by the company's declining operating performance in FY22 (Unaudited, refers to the twelve-month period ended mid-July 2022) amid sluggish demand coupled with increased cost pressures, elongated operating cycle, 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 take cognizance of relatively high dividend payout in FY22, particularly amid muted operational cash flow generation.

*Going forward, the ability of BSPL to manage growth in the operations, maintaining the profit margins and rationalization of its debt through efficient working capital management will be the key rating sensitivities. Deterioration in capitalization 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 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.

##### Sustained low gearing levels with adequate debt service coverage indicators, however high dividend payouts remain a concern

Adjusted overall gearing ratio (net of cash and bank balances) of the company remained steady at 0.62x at the end of FY22 (PY: 0.68x). Total debt of the company declined to Rs. 390 Mn as on mid-July 2022 from Rs. 1.178 Mn as on mid-July 2021, mainly on account of lower utilization of working capital loans amid muted sales. Debt service coverage indicators have

accordingly moderated in FY22 as compared to previous years, however, still remained at moderate levels aided by lower overall debt levels. The company's interest coverage remained adequate at 3.77x in FY22 although declining from 9.83x in FY21 due to lower profit generated in FY22. Similarly, total debt/ Gross Cash Accruals stood at 5.38x in FY22 compared to 4.08x in FY21. Despite certain operating challenges and industry headwinds in FY22, the company's capital structure continues to remain fairly resilient with sufficient gearing headroom.

Furthermore, BSPL paid dividend of Rs. 143 Mn in FY22 which led to year-on-year decline in the company's tangible net worth as on mid-July 2022. The reduction in debt and dividend payouts in FY22 were majorly funded through the surplus cash balance BSPL had on its books. Consequently, cash and cash balance has declined to Rs. 13 Mn as on mid-July 2022 from Rs. 696 Mn as on mid-July 2021 resulting in lower liquidity cushion compared to previous year. Any substantial dividend payouts in the future that could materially impact company's net worth base and capital structure will remain key from credit perspective.

#### **Moderate order book position of the company giving near-term revenue visibility**

The company has unexecuted order book at hand of Rs. 3,352 Mn (as confirmed by management) as on mid-November 2022, which provides reasonable cushion in terms of revenue visibility for FY23. The company's Total Operating Income is expected to bounce back supported by execution of these orders at hand. However, the extent to which the company can execute these remains to be seen and will remain a key monitorable.

#### **Diverse product range 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. In addition to steel products, the company has also started to provide engineering services as well such as installation, commissioning, testing and follow-ups from this year onwards. The success of this model remains to be seen. 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 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.

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.

#### **Stable demand outlook for steels products in the country over medium term**

Nepalese economy is developing, and is in the phase of investment and growth in infrastructure, power sector and tourism sector, notwithstanding the lingering impact of the covid-19 pandemic. In the budget presented by finance minister of Nepal for FY23, Rs. 161.56 Bn has been allocated for infrastructure development along with an estimated GDP growth of 8.00%. Government's continued high emphasis on infrastructure development, namely development of roads, hydropower, airports and other infrastructures augurs well for the business prospects of iron and steel manufacturers like RSPL over the medium term.

## Key Rating Weaknesses

### **Sub-optimal operational performance during FY22 characterized by decline in sales and lower profitability**

During FY22, BSPL's total operating income declined to Rs. 1,835 Mn from Rs. 3,220 Mn in FY21. The decline was mainly on account of sluggish demand amid slower than earlier expected pace of economic growth in the country. Furthermore, sales were also impacted in FY22 as the company was not able to adequately markup selling price corresponding to the substantial upward costing pressures amid higher input prices. Consequently, PBILDT margin plunged to 7.93% in FY22 from 13.31% in FY21 mainly due to diseconomies of scale amid declining operations coupled with relatively high input prices. Similarly, PAT of the company declined to Rs. 55 Mn in FY22 from Rs. 274 Mn in FY21.

As the overall economy continues to recover from the lingering impact of the pandemic exacerbated further by the ongoing liquidity crisis in the country, the company's business prospects are likely to improve accordingly going forward, indicative also by the improved order book at hand of the company as on mid-November 2022.

### **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 208 days in FY22 which increased from 167 days in FY21 due to increase in inventory days in FY22. This was mainly on account of lower-than-expected sales. 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. However, this is likely to improve going forward with increasing contribution from tender based business. 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.

### **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 88% of the Total Operating Income (TOI) of the company in FY22. 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. 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 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. Put for tender driven business also

### About the Company

Bhagawati Steel Industries Private Limited (BSPL) is a private limited company incorporated in 1991. The company is involved in manufacturing of pipes, sheets, door and window frames, shutter profiles, side channels, truss, poles and towers, suspension and motorable bridge and related products. BSPL has its manufacturing plant in Chhatapipra, Bara, Nepal with total installed capacity of 85,500 Metric Tons Per Annum (MTPA). Brief financials of BSPL for the past three years ended FY22 are given below:

(Rs. Million)

For the year ended Mid-July	FY20	FY21	FY22
	(Audited)	(Audited)	(Unaudited)
Income from Operations	4,101	3,220	1,835
PBILD T Margin (%)	11.04	13.31	7.93
Overall Gearing (times)*	1.64	0.68	0.62
Interest Coverage (times)	7.04	9.83	3.77
Current Ratio (times)	1.28	1.44	1.85
Total Debt/Gross Cash Accruals (times)	9.68	4.08	5.38

\*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 by netting off working capital loans with such deposits in banks at the year end.

### 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	77.64	CARE-NP BBB-
Short Term Bank Facilities	Fund Based Limit	1,610.00	CARE-NP A3
Short Term Bank Facilities	Non-Fund Based Limits	1,370.00	CARE-NP A3
<b>Total</b>		<b>3,057.64</b>	

### Contact us

#### Analyst Contact

Ms. Poonam Agarwal

Contact No.: +977-01-4012628

Email: poonamagarwal@careratingsnepal.com

Mr. Santosh Pudasaini

Contact No.: +977-01-4012629

Email: pudasaini.santosh@careratingsnepal.com

#### Relationship Contact

Mr. Achin Nirwani

Contact No.: +977 9818832909

Email: achin.nirwani@careratingsnepal.com

#### About CARE Ratings:

CARE Ratings Nepal Limited (CRNL) is licensed by the Securities Board of Nepal w.e.f. November 16, 2017. CRNL is supported by CARE Ratings Limited through a technical services agreement to provide technical support in the areas such as rating systems and procedures, methodologies, etc. from CARE Ratings on an ongoing basis. The technical support shall ensure that CRNL has adequate resources to provide high quality credit opinions in Nepal.

Our parent company, CARE Ratings Limited commenced operations in April 1993 and over two decades, it has established itself as one of the leading credit rating agencies in India. CARE is registered with the Securities and Exchange Board of India (SEBI) and also recognized as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI).

#### Disclaimer

CRNL's ratings are opinions on credit quality and are not recommendations to sanction, renew, disburse or recall the concerned bank facilities or to buy, sell or hold any security. CRNL has based its ratings on information obtained from sources believed by it to be accurate and reliable. CRNL does not, however, guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. Most entities whose bank facilities/instruments are rated by CRNL have paid a credit rating fee, based on the amount and type of bank facilities/instruments.

In case of partnership/proprietary concerns, the rating assigned by CARE is, inter-alia, based on the capital deployed by the partners/proprietor and the financial strength of the firm at present. The rating may undergo change in case of withdrawal of capital or the unsecured loans brought in by the partners/proprietor in addition to the financial performance and other relevant factors. CARE is not responsible for any errors and states that it has no financial liability whatsoever to the users of CARE's rating.