

Real Steels Private Limited

Ratings

Facility	Amount (Rs. in Million)	Ratings ¹	Rating Action
Long Term Bank Facilities	431.93	CARE-NP BB- [Double B Minus]	Reaffirmed
Short Term Bank Facilities	1,075.00	CARE-NP A4 [A Four]	Reaffirmed
Total Facilities	1,506.93 (Fifteen Hundred Six Million and Nine Hundred Thirty Thousand Only)		

Details of Facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has reaffirmed the rating of 'CARE-NP BB-' assigned to the long term bank facilities and the 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 the bank facilities of RSPL continue to be constrained by the company's leveraged capital structure and working capital intensive nature of operations. The ratings also factor in the raw material price volatility risk and foreign exchange fluctuation risk, exposure to volatile interest rates and presence in competitive nature of steel industry. The ratings also take cognizance of the decline in profitability and weakening of debt service coverage indicators of the company in FY22 (Unaudited, refers to the twelve-month period ended mid-July 2022).

The ratings, however, continue to derive strength from the experienced promoters and management in the related field, locational advantage, improving product diversification, growing scale of operations stable demand outlook for steel products in the country over the medium term and scope for export.

Going forward, the ability of the company to profitably scale up the operations, manage foreign exchange fluctuation risks related to raw materials and rationalization of its debt through efficient working capital management leading to improved debt coverage and solvency indicators will be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Below average financial risk profile

The company's below average financial risk profile is marked by low profitability margins despite year-on-year growth in Total Operating Income (TOI), highly leveraged capital structure with modest debt service coverage indicators owing to weak operating performance in FY22.

The company's TOI grew from Rs. 1,158 Mn to Rs. 1,375 Mn reflecting a compounded annual growth rate of around 19%. Despite growth in TOI growing in FY22 over FY21, PBILDT margin declined to 8.10% in FY22 from 10.85% in FY21 on account of increase in raw material costs and the company's inability to fully pass on the same to its customers. Amid declined operating efficiency coupled with increased finance expenses, the company reported net losses in FY22. Consequently, debt service coverage indicators of the company stood modest with interest coverage ratio and total debt/GCA also deteriorated of 1.26x and ~61x, respectively for FY22.

The capital structure of the company stood leveraged with overall gearing ratio of 3.99x at the end of FY22 (PY: 4.06x). Furthermore, Debt-equity ratio of the company also stood high at 1.71x at the end of FY22 which deteriorated from 1.08x at the end of FY21 on account of increase in long-term loans.

Elongated operating cycle with working capital-intensive nature of operations

RSPL is involved in manufacturing of wide range of steel products by majorly importing raw materials. RSPL purchases its 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 145 days in FY22 with average collection period from customers of 65 days and average inventory holding period of 99 days in FY22. This leads to high reliance of the company on the bank finance for working capital needs. The average utilization of fund-based working capital limit against drawing power was around 67% during last 12 months' period ending mid-July, 2022 and low current ratio as on the last two balance sheet dates reflects working capital intensive nature of operations.

Raw material price volatility risk and foreign exchange fluctuation risk

Hot rolled (HR)/ Cold rolled (CR) Coils are the major raw materials for RSPL and are majorly imported from India. The prices of RSPL's raw materials are market linked and determined on a periodic basis, thus exposing the company to volatility in the prices of raw materials which has a bearing on its profitability margins. The raw material cost contributes around 90% of the total cost of production of the company. With prices of raw material import 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.

Exposure to volatile interest rate risk

Nepalese banking sector has a floating interest rate regime, where a certain premium is added to the quarterly base rate and interest rate is changed accordingly on quarterly basis. The base rates of the banks and financial institutions (BFIs) in Nepal remain quite volatile as they are impacted by available liquidity in the system which leads to change in interest rates. The volatility in interest rate is more evident currently on account of the ongoing liquidity stress in the economy. Furthermore, increased bank rates announced in the Monetary Policy for FY23 is likely to add to the upward pressure on interest rates going forward. Any significant rate hikes could put increased interest burden on the company, squeezing its profitability and impacting its liquidity position. Therefore, funding taken by the company from BFIs is exposed to volatile interest rate risk.

Presence in highly competitive nature of steel industry

The iron and steel industry are intensely competitive marked by the presence of both larger players and numerous smaller players in the unorganized segment. Given the fact that the entry barriers to the industry are low, the players in the industry do not have pricing power and are exposed to competition-induced pressures on profitability. 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 CR and HR pipes, strips & related products is low, resulting into low product differentiation in the market.

Key Rating Strengths**Established track record of operations along with experienced management team in the related field**

RSPL is promoted by traders and businessmen from Birgunj City of Nepal who have wide experience in manufacturing steel and other businesses for more than two decades. RSPL is managed under the overall guidance of the Company's Board of Directors (BoD) who possesses wide experience in the industry. Mr. Prem Kumar Jatiya is the Chairman and Managing Director of the company. Mr. Jatiya, has been involved in different business for more than 20 years. Mr. Dipal Khanna, Executive Director, is Chartered Accountant by qualification and is also engaged in the trading of TMT bars, MS Pipes and other hardware items.

Locational Advantage and Product diversification

RSPL manufactures MS Pipe that has great usage in construction, automobile, chemical and oil industries including residential housing, shed construction. The company also offers its customers shutter profiles along with cutting Hot Rolled Coil (HRC) and Cold Rolled Coil (CRC) in different sizes. Also, the company has added new segment Shutter Spring, Lock Plate and Kaan Plate segment from FY22. The company has been focusing on supply of Prefabricated Trust Shed (PEB) and providing site installation services from this year onwards. Diversification allows for more variety and options for the customers and consequently provides a tremendous boost to product marketing. Also, being in close proximity with the Indian border, RSPL has potential for export sales in adjacent Indian states.

Stable demand outlook for steels products in the country

Nepalese economy is developing, and is in the phase of investment and growth in infrastructure, power sector and tourism sector, notwithstanding the 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.

About the Company

Real Steels Private Limited (RSPL) is a private limited company and was incorporated in March 2018. The manufacturing is located at Birgunj, Nepal and the company started its commercial operation since January, 2020. The company manufactures MS Pipes, Shutter Patti, Shutter Guide and other related products with total annual production capacity of 49,800 MT for MS Pipes, Shutter Patti, Shutter Guide, Hot Rolled (HR) Coil/ Sheet, Cold Rolled (CR) Coil/ Sheet, Lock Plate, Kaan Plate and Shutter Spring per year.

Brief financials of RSPL for the past two years ended FY22 are given below:

(Rs. Million)

For the year ended Mid-July	FY21	FY22
	(Audited)	(Provisional)
Income from Operations	1,158	1,375
PBILD Margin (%)	10.85	8.10
Overall Gearing (times)	4.06	3.99
Interest Coverage (times)	4.33	1.26
Current Ratio (times)	0.91	1.14
Total Debt/Gross Cash Accruals (times)	10.58	61.06

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	431.93	CARE-NP BB-
Short Term Bank Facilities	Fund Based Limit	1,075	CARE-NP A4
Total		1,506.93	

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