Vijayshri Steel Private Limited

Rating

Facility/Instrument	Amount (Rs. in Million)	Ratings[1]	Rating Action
Long Term Bank Facilities	**1,043.74 (Decreased from 1,160.50)**	**CARE-NP BB- [Double B Minus]**	**Reaffirmed**
Short Term Bank Facilities	**2,900.00**	**CARE-NP A4 [A Four]**	**Reaffirmed**
Total Facilities	**3,943.74 (Three Billion Nine Hundred Forty-Three Million and Seven Hundred Forty 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 of Vijayshri Steel Private Limited (VSPL) and 'CARE-NP A4' assigned to the short-term bank facilities of VSPL.

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of VSPL is constrained by its leveraged capital structure coupled with modest debt service coverage indicators amid suppressed profitability and working capital intensive nature of operations leading to increased reliance on borrowings. The ratings also factor in raw material price volatility and foreign exchange fluctuation risk, and presence in highly fragmented and competitive nature of steel industry. The ratings also take cognizance of decline in operational performance of the company in FY23 (Audited, FY refers to the twelve-month period ending mid-July) amid sluggish demand, albeit with sequential improvement in H1FY24 (Unaudited, H1 refers to the six-month period ending mid-January). The ratings, however, continue to derive strength from the company being a part of an established business group with promoters' experience in cement manufacturing and trading businesses and locational advantage of VSPL's manufacturing facility in terms of procurement and sales.

Going forward, the ability of the company to profitably scale up its operations with sustained improvement in capacity utilization will be the key rating sensitivities. Also, stabilization of company's newly operational CCM plant and its ability to derive envisaged benefits from the backward integration will also be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Declined operational and financial performance in FY23, although rebound in income during H1FY24

Total operating income (TOI) of Vijayshri Steel Private Limited (VSPL) declined by ~25% year-on-year (y-o-y) to Rs. 3,564 Mn in FY23 on account of decrease in sales volume. In FY23, the company sold 35,744 metric ton (MT) of TMT bars, which is a decline of 25% y-o-y amid low demand of steel. Sales were also partly impacted, by disruption in production due to installation of Continuous Casting Machine (CCM) plant during the year. After successful backward integration by installation of CCM plant in February 2023, VSPL began importing of sponge iron, pig iron, and scraps as raw material for inhouse manufacturing of MS Billets and Steel rods. Following the change in import regime from MS Billets to aforementioned raw materials, PBILDT margin has grown to ~6% in FY23, from previous ~1% in FY22, supported by decline in input cost by ~20% in FY23. Despite improvement in PBILDT margin, VSPL was hardly profitable on account of increased interest outgo and deferred tax expense during FY23. Gross Cash Accruals also improved to Rs. 56 Mn from previous negative GCA in FY22. However, income levels have rebounded so far in FY24 with the company booking total income of ~Rs. 2,069 Mn (H1FY23:

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

Rs. 894 Mn). This was supported by increase in sales volume by 165% to 24,326 MT. Ability of the company to profitably scale up its operations with sustained improvement in capacity utilization will be critical from credit perspective.

Leveraged capital structure and weak debt service coverage indicators

Capital structure of VSPL has remained leveraged as indicated by its overall gearing ratio of 3.83x at the end of FY23. The overall gearing ratio deteriorated from 2.39x at the end of FY22 majorly on account of increase in external borrowings in FY23. Long term debt increased to Rs. 1,154 Mn in FY23 (including loan from promoter of Rs. 214 Mn) from previous Rs. 402 Mn in FY22 due to disbursement of additional term loans for funding of CCM plant installation. On the other hand, coverage metrices have improved, though weak, in FY23 on account of capitalization of interest expenses of Rs. 118 Mn, increased PBILDT margin and consequent improvement in gross cash accruals (GCA) from previous negative GCA in FY22. Interest coverage improved to 1.39x at the end of FY23 from 1.10x at the end of FY22 and Total Debt/GCA of the company stood at 50.29 times at the end of FY23 from previous negative at the end of FY22.

Working capital intensive nature of operations

As VSPL is engaged in importing of raw materials for manufacturing of TMT bars, it is required to maintain adequate inventory levels to mitigate any disruptions in supply chain and to ensure regular supply of its TMT bars. Additionally, with lower demand for steel in FY23, inventory levels for finished goods also swelled. Consequently, the inventory holding period prolonged to 67 days in FY23 from previous 20 days in FY22. This has led to VSPL's increased reliance on external borrowings in FY23 to meet its working capital requirements. While average collection period sustained to 68 days in FY23, average creditor period increased to 12 days in FY23 from five days in FY22. Despite increase in average creditor days, operating cycle elongated from 74 days in FY22 to 122 days in FY23 owing to increase in average inventory holding period. Average utilization of VSPL's fund-based working capital limits during the last twelve months ended mid-January 2024 was around 97%.

Raw material price volatility risk and foreign exchange fluctuation risk

VSPL imports its major raw materials- sponge iron and pig iron from India, prices of which are market linked and 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 102% of the total operating income during FY23. 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 material prices are linked to USD. VSPL incurred foreign exchange gain of Rs. 0.97 Mn during FY23 (FY22: loss of Rs. 36 Mn). 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 which has a presence of more than 30 years in Nepal's industrial sector. Currently, the group is involved in importing and manufacturing cement, manufacturing batteries, trading bitumen, and also in agriculture and education sector. 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 19 years.

Locational advantage

VSPL's manufacturing facility is located at Shivaraj, Kapilvastu which is at a distance of around 11 km from Barhani border, India and around 98 km from Sunauli border, India, which gives the company an advantage of lower transportation cost during raw material procurement. Presently, VSPL is importing raw materials from Barhani border. Furthermore, the plant is situated nearby the East-West Highway of Nepal which provides road access for supply of products to the major markets. With most of the steel factories concentrated in Eastern region of Nepal, VSPL has locational advantage to exploit market opportunities in Central and Western regions.

Growing demand outlook for steel products in the mid-term

Demand of steel products in the country is expected to grow in the medium-term despite near-term industry headwinds. Nepalese economy is developing and growing, and is in phase of investment in infrastructure sectors, power sector and tourism sector. Sustained demand for steel is likely given the need of construction materials in developing public as well as private infrastructures, road, bridges and other public facilities. Furthermore, the government's continued emphasis on infrastructure development, namely development of roads, hydropower, airports and other infrastructures etc. is likely to benefit the steel manufacturers like VSPL. This is also evident in the budget presented by finance minister of Nepal for FY24, where Government of Nepal has allocated Rs. 131 Bn towards the physical infrastructure and transport sector. However, with the construction sector in Nepal impacted by slower pace of economic growth coupled with relatively lower infrastructure spending by the government, the outlook of steel industry in Nepal looks challenging in the near term, particularly if actual government spending continues to be much lower than budgeted.

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 has rolling mill with production capacity of 700 Metric Ton Per Day (MTPD) to manufacture TMT bars and CCM plant with installed capacity of 400 MTPD to manufacture billets. The plant started commercial operation of its rolling mill on November 25, 2018 and its CCM plant was operational since February 20, 2023.
Brief financials of VSPL for the past three years are given below:

(Rs. Million)

For the year ended Mid-July	FY21 (Audited)	FY22 (Audited)	FY23 (Audited)
Income from Operations	5,349	4,718	3,564
PBILDT Margin (%)	2.28	1.18	5.62
Overall Gearing (times)	2.81	2.39	3.83
Interest Coverage (times)	4.44	1.12	1.39
Current Ratio (times)	0.93	0.80	0.88
Total Debt/Gross Cash Accruals (times)	44.62	Negative	50.29

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	745.74	CARE-NP BB- [Double B Minus]
Long Term Bank Facilities	Permanent Working Capital Loan	298.00	CARE-NP BB- [Double B Minus]
Short Term Bank Facilities	Fund Based Limit	1,900.00	CARE-NP A4 [A Four]
Short Term Bank Facilities	Non-Fund Based Limit	1,000.00	CARE-NP A4 [A Four]
Total		**3,943.74**	

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