

Rating Rationale
Vijayshri Steel Private Limited

Rating

Facility/ Instrument	Amount (Rs. In Million)	Rating	Rating Action
Long Term Bank Facilities	542.20	CARE-NP BB [Double B]	Assigned
Short Term Bank Facilities	3,200.00	CARE-NP A4 [A Four]	Assigned
Total Facilities	3,742.20		

Details of Facilities in Annexure 1

CARE Ratings Nepal Ltd. (CRNL) has assigned Rating of ‘CARE-NP BB’ to the long term bank facilities and ‘CARE-NP A4’ 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 project stabilization risk coupled with presence in highly fragmented and competitive nature of steel industry. The rating also factors in VSPL’s exposure to volatile interest rates, raw material price volatility and foreign exchange fluctuation risk. The ratings, however, derive strength from established business group and promoter’s experience in cement manufacturing and trading business, healthy demand of TMT bars in the country, locational advantage of its facilities and threats of imports nullified by import parity price due to import duty and other incidental expenses.

Going forward, satisfactory operation of the company, ability of the company to pass on the changes in raw material prices to the customers and managing the foreign exchange fluctuation risks are the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weakness

Project stabilisation risk

The TMT steel bars manufacturing project of the company has been completed and is operational from November 25, 2018. However, the smooth and satisfactory operations leading to achievement of sales target and positive cashflows from the operations are yet to be seen. The initial project cost was estimated at Rs. 774.69 million which was proposed to be financed with Term loan of Rs. 542.20 million and rest through promoters' contribution/equity. Financial closure of the project was achieved in December 2017. Due to additional civil construction, machinery and VAT thereon, the project cost increased to Rs. 901.49 million and the incremental

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

cost of the project was funded through unsecured loans from the promoters with no additional bank loans.

Presence in highly fragmented and 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. Further many steel manufacturing factories that are under construction will come into operation soon and other domestic factories are also expanding their production capacity. 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 TMT & plain bars 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 TMT bars and construction material etc. is low, resulting in low product differentiation in the market. The producers of steel construction materials are essentially price-takers in the market, which directly expose their cash flows and profitability to volatility in the steel prices.

Exposure to volatile interest rates

Nepalese banking sector fix interest rates on lending, based on quarterly published base rate by the banks. Due to tight liquidity in the market, the interest rate has been high and volatile during the last 12 months. Therefore, funding from Banks and Financial Institutions are exposed to volatile interest rate.

Raw material price volatility risk and foreign exchange fluctuation risk

VSPL does not have any backward integration for its basic raw material (MS Billets) for producing TMT steel bars. The billets are proposed to be majorly imported from India. The prices of the billets are market linked and determined on a periodic basis, thus exposing the company to the volatility in the prices of raw materials which has a bearing on its profitability margins. The raw material cost is expected to contribute more than 80% of the total operating income of the company, thus, any volatility in prices of the same will directly impact the profitability of the company. Further, the raw material requirements will be met through imports and the price of the same will be linked to USD, for which it is exposed to the foreign exchange fluctuation risk. The company hedges its forex exposure through forward contracts with the bank keeping in mind the market scenario. The ability of the company to pass through of changes in raw material prices to the finished products and managing the foreign exchange fluctuation risks related to raw materials will be the key rating sensitivities.

Key Rating Strength***Established business group and experienced promoter in cement manufacturing and trading business***

VSPL is promoted by individuals, who is associated with Vijaya Group of companies. Vijaya Group is into the industry for more than 30 years. The group was initially involved in importing cement from India. Later, the Group setup a cement plant under Bijaya Cements P. Ltd. Currently, the Group is involved in importing and manufacturing cement, manufacturing batteries, importing bitumen and trading, 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. Mr. Vikash Kedia, Chairman, having experience of more than 17 years of industrial experience. Mr. Pradeep Agarwal, Director, looks after the day to day operations of the company.

Demand of TMT Bars in the country

Nepalese economy is developing and growing and is in phase of investments in infrastructure sectors, power sector and tourism sector. It is highly probable that the national economy will be in need of construction materials in developing public as well as private infrastructures, road, bridges and other public facilities. Further followed by devastating earthquake of April 2015, Government's commitment towards infrastructure and rebuilding housing sector has increased the demand of iron and steel products in Nepal. According to the Vice Chairman of Nepal Steel Rolling Mills Association, the annual demand for iron and steel in the country stands at 2 million tons and domestic producers are supplying the required quantity. The demand is expected to grow at an annual rate of about 10% for the coming few years. Also, the government's continued thrust on the construction, infrastructure development and power sector and targeted GDP growth of 8% is likely to benefit the long products manufacturers like VSPL.

Locational advantage

The plant site is located at Shivaraj, Kapilvastu which is at a distance of ~11km from Barhni border, India and ~98 km from Sonauli border, India, which gives VSPL an advantage of supply of raw material at lower transportation cost in comparison to their competitors. Presently, VSPL is importing raw materials from Sonauli border. However, it plans to import raw materials from Barhni border in the future. The plant is situated nearby to the East-West Highway of Nepal

which provides a road access for supply of finished products to the major markets. Also, most of the steel factories are concentrated in Bhairahawa (Sonauli) or in eastern parts of Nepal. Hence, VSPL can exploit opportunities while focusing in the Central and Western parts of Nepal.

About the Company

VSPL is a private limited company promoted by businessmen engaged in manufacturing and trading businesses, for setting up of rolling mill to manufacture TMT Steel Bars in Kapilvastu district of Nepal. The project is located at Shivaraj, Kapilvastu of Nepal. The company will manufacture TMT Steel Bars by importing raw materials from India and selling them into Nepal's market with production capacity of 700 MT of TMT Steel Bars per day. The project has been completed and is in operation from November 25, 2018.

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Annexure 1: Details of the Facilities

Nature of the Facility	Type of the Facility	Amount (Rs. Million)	Rating
Long Term Bank Facilities	Term Loan	542.20	CARE-NP BB
Short Term Bank Facilities	Letter of Credit	1,000.00	CARE-NP A4
Short Term Bank Facilities	Trust Receipt Loan	800.00	CARE-NP A4
Short Term Bank Facilities	Overdraft Loan	100.00	CARE-NP A4
Short Term Bank Facilities	Demand Loan	100.00	CARE-NP A4
Short Term Bank Facilities (Proposed)	Letter of Credit	500.00	CARE-NP A4
Short Term Bank Facilities (Proposed)	Trust Receipt	400.00	CARE-NP A4
Short Term Bank Facilities (Proposed)	Overdraft Loan	300.00	CARE-NP A4
Total		3,742.20	