Rating Rationale

Ashok Steel Industries Private Limited

Rating

Facility/ Instrument	Amount (Rs. In Million)	Rating[1]	Rating Action
Long Term Bank Facilities	515.57	**CARE-NP BB- [Double B Minus]**	Assigned
Short Term Bank Facilities	2,155.00	**CARE-NP A4 [A Four]**	Assigned
Total facilities	**2,670.57**		

Details of Facilities in Annexure 1

CARE Ratings Nepal Limited (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 Ashok Steel Industries Private Limited (ASPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of ASPL are constrained by highly leveraged capital structure and weak debt service coverage indicators, working capital intensive nature of operations and stressed liquidity position. The rating is also constrained by raw material price volatility, foreign exchange fluctuation risk, exposure to volatile interest rates and presence in highly fragmented and competitive nature of steel industry. The ratings however, derives strength from established and long track record of operations and growth in operational and financial performance during last 2 years ended FY18 (refers to 12 months period ended mid-July 2018), however subdued performance in 6MFY19 (provisional, refers to 6 months period ended mid-January 2019). The rating also factors in experienced management team in the related field, established brand of the company and demand of steel products in the country. The ability of ASPL to manage growth in the operations & maintaining profit margins and rationalization of its debt through efficient working capital management would be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Highly leveraged capital structure and weak debt service coverage indicators

Debt-equity ratio of the company was moderate at 1.26x at the end of FY18 which declined from 1.98x at the end of FY17, on back of repayment of term loans and increase in net worth due to accretion of the profit to the net-worth. Total gearing ratio of the company was very high at 8.23x at the end of FY18 (FY17: 8.74x) with moderate interest coverage ratio of 3.05x in FY18 (FY17: 3.63x). Gearing levels of the company further deteriorated in 6MFY19 due to weak financial performance leading to decline in the net-worth coupled with increased debt levels due to high utilization of working capital limits. At the end of 6MFY19, the Debt-equity ratio and gearing ratio of the company increased to 1.80x and 13.50x respectively.

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

Working capital intensive nature of operations and stressed liquidity position

The operations of the company are working capital intensive in nature with high reliance on bank finance as ASPL is involved in manufacturing of TMT Bars by using imported and locally purchased raw materials for which it has to make advance payments and also fund inventory and debtors. In FY18, total operating cycle of the company was 101 days which increased to 152 days in 6MFY19. Also, the liquidity profile of the company stood stressed as characterized by below unity current ratio of 0.99 times and quick ratio of 0.47 times as on July 16, 2018. The company had been availing ad-hoc working capital limits from the banks to fund the increased working capital requirements. The average utilisation of fund-based working capital limit against drawing power was high during last 12 months period ended June 17, 2019. Further, the company is incurring capex of ~Rs. 371.18 Mn which is being financed in debt-equity ratio of 80:20. The equity portion is being funded through internal accruals of the company and also sanctioning of part of the term loan is yet to be done, which has further resulted into stressed liquidity and high utilization of working capital limits.

Raw material price volatility risk and foreign exchange fluctuation risk

Billet, Sponge Iron and Scrap are the major raw materials for ASPL and are majorly imported from India. The prices of raw materials are market linked and are determined on a periodic basis, thus exposing the company to the volatility in the prices of raw materials which has a bearing on company's profitability margins. The raw material cost contributed around 84% of the total operating income of the company, thus, any volatility in prices of the same impacts the profitability of the company. Further, in FY18 ~ 75% of the total raw material requirement was imported and the prices of the same are linked to USD, for which the company is exposed to the foreign exchange fluctuation risk. ASPL incurred foreign exchange fluctuation loss of Rs. 6.77 Mn during FY18. The ability of the company to pass through 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.

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

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. 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 TMT bars and 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 in the current year. 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.

Key Rating Strengths

Established and long track record of operations along with experienced management team in the related field

ASPL has an operational track record of more than three decades in manufacturing TMT Bars and allied steel products. The promoters of ASPL have an experience of three decades in the Steel industry. ASPL is managed under the overall guidance of its two members Board of Directors (BoD) who possess wide experience in the manufacturing sector. Mr. Poonam Chand Agrawal is the Chairman and the managing director of ASPL and has 30 years of experience in steel manufacturing industry. Mr. Abhishek Tulsian is the Chief Executive Officer who has been working in ASPL actively from last 6 years.

Growth in operational and financial performance in last two years, however subdued performance in 6MFY19

ASPL reported revenue of Rs. 3,594 Mn during FY18 which increased by 165% from FY17 on account of additional TMT capacity of 55,000 MT coming into operation during the year. In FY18, the company achieved PBILDT margin of 9.55% with PBILDT of Rs. 343 Mn and PAT of Rs. 102 Mn as compared to PAT earned of Rs. 74 Mn in FY17. PAT of the company increased in absolute terms on account of high PBILDT earned due to increased level of operations. ASPL reported sales revenue of Rs. 2,088 Mn during 6MFY19 and achieved PBILDT margin of 4.95% with PBILDT of Rs. 103 Mn and incurred loss of Rs. 24.42 Mn. Operations of the company has suffered in the first half of FY19 on account of increase in cost of raw material consumed coupled by pressure on pricing due to increase in the installed capacity in steel industry which has intensified competition in the market. The generation of sufficient cashflows to service the debt obligations in the short to medium term will be the key rating sensitivities.

Established brand with country wide market presence

The company sells TMT bars under the brand name of "Ashok TMT" which is an established brand in the Nepal market on account of its long standing presence in the steel industry. This provides leverage to the company in front of new players entering the industry. Further, ASPL has a developed dealer/distributor network of around 271 dealers across the country which provides a ready market for its products.

Demand of steels products in the country

Nepalese economy is developing and growing leading to increasing investment in infrastructure sectors, power sector and tourism sector. It is expected 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 commitment towards infrastructure and the rebuilding the housing sector has increased demand of iron and steel products in the country. Further, the demand for the iron & steel products is expected to grow at about 10% for the coming few years. In FY17, Nepal imported MS steel billet, a major raw material in steel industry, worth Rs. 46.5 billion which increased to 57.9 billion in FY18 registering a growth of 25%. In 10MFY19 import of MS billets accounted for Rs. 56.4 billion a growth of 25.1% from 10MFY18. 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 ASPL.

About the Company

Ashok Steel Industries Private Limited (ASPL) is a private limited company incorporated on February 22, 1984 for manufacturing TMT Bars and Ingot, having plant in Gadhimai Municipality-10, Bara, Nepal. Total installed capacity of the plant is 113,000 Metric Tons Per Annum (MTPA) out of which the capacity of TMT Bar which is the primary product is 80,000 MTPA. The company is currently undergoing capex to install induction furnace to melt scrap and manufacture ingots. The total project cost for the capex is estimated to be around Rs. 371.18 Mn and will be financed in debt-equity ratio of 80:20.

Brief financial performance during the last 3 years is as follows: *(Rs. In Million)*

For the year ended Mid July	FY16 (A)	FY17 (A)	FY18 (A)
Income from Operations	934	1,358	3,594
PBILDT	43	156	343
PAT	(16)	74	102
Overall Gearing (times)	665.61	8.74	8.23
Interest coverage (times)	0.99	3.63	3.05

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Annexure 1: Details of the Facilities rated

Nature of the Facility	Type of the Facility	Amount (Rs. Million)	Rating
Long Term Bank Facilities	Term Loan	415.57	**CARE-NP BB-**
Long Term Bank Facilities (Proposed)	Term Loan	100.00	**CARE-NP BB-**
Short Term Bank Facilities	Working Capital Loan	1,185.00	**CARE-NP A4**
Short Term Bank Facilities	Overdraft	220.00	**CARE-NP A4**
Short Term Bank Facilities	Letter of Credit	750.00	**CARE-NP A4**
Total		**2,670.57**	