

Rating Rationale

Kamala Rolling Mills Private Limited

Ratings

Facility/ Instrument	Amount (Rs. In Million)	Rating ¹	Rating Action
Short Term Bank Facilities	2,526.02	CARE-NP A3 [A Three]	Assigned
Total facilities	2,526.02		

Details of Facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has assigned rating of ‘CARE-NP A3’ to the short term bank facilities of Kamala Rolling Mills Private Limited (KMPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of KMPL derive strength from established and long track record of operations along with experienced directors in the related field and moderate operational and financial performance in last two years ended FY18 (refers to 12 months period ended mid-July 2018), however subdued performance during FY19 (unaudited, refers to 12 months period ended mid-July 2019). The ratings also factor in moderate capital structure and debt service coverage indicators, established brand with country wide market presence, diverse product range catering to wide spectrum of industries and established marketing setup with expected growth in demand of steels products in the country. The ratings are however constrained by raw material price volatility risk, foreign exchange fluctuation risk and working capital intensive nature of operations. The ratings also factor in company’s exposure to volatile interest rates with presence in highly fragmented and competitive nature of steel industry.

The ability of KMPL to manage growth in the operations & maintaining the 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 Strengths

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

KMPL has an operational track record of more than two decades in manufacturing TMT Bars, Galvanized Iron/Hard Bright (GI/HB) wires and allied steel products. KMPL derives strength from its strong promoters belonging to Vishal Group, which is engaged in diversified business of trading, banking, insurance and manufacturing. The company is managed under the overall guidance of its two-member board of directors who possess wide experience in various industries and trading business. Mr. Jagadish Prasad Agrawal, Director and Chairman of KMPL is engaged in industry, import, export, banking and commerce/business sector for more than 4 decades. Mr. Nikunj Agrawal is the managing director of KMPL and also supervises the operations of the

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

automobile distribution / dealership of the group and has an experience of more than a decade through various entities in the same group.

Moderate operational and financial performance in last two years, however subdued performance in FY19 (UA)

KMPL had total installed capacity of 60,000 MTPA in FY18 which was increased to 80,000 MTPA by increasing the capacity of rolling mills section. Capacity utilization was at 61.89% in FY18 which declined to 44.57% in FY19 on the enhanced capacity. Total revenue increased by ~9% in FY18 to Rs. 3,042 Mn over FY17. However, the revenue declined in FY19 by ~15% majorly due to intensified competition in the market on account of increase in installed capacity in the steel industry primarily in TMT bars segment. This drop in sales of TMT products was backed to an extent by increase in demand of other products of the company coupled with increase in its average price realization during FY19. Company achieved PBILDT margin of 10.40% during FY18 which declined to 5.12% during FY19 on the back of increase in cost of raw materials consumed which could not be passed on to the consumers due to competition induced market. The PAT of the company also declined substantially from Rs. 148 Mn in FY18 to Rs. 10 Mn in FY19 on back of substantial decline in PBILDT coupled with increase in interest expense. However, the company generated sufficient Gross cash accruals of Rs. 50 Mn during FY19 for the repayment of term debt obligations.

Moderate capital structure and debt service coverage indicators

The outstanding long-term facilities of the company was low at Rs. 10 Mn as on July 16, 2019 which is scheduled to be repaid during FY20. Due to low term debt availed by the company Debt-Equity ratio was low at 0.04x at the end of FY18 which further declined to 0.01x at the end of FY19. Total gearing ratio of the company was moderate at 1.36x at the end of FY18 and the same was marginally improved to 1.30x at the end of FY19 due to marginal reduction in debt levels of the company. KMPL had healthy interest coverage ratio of 6.67x in FY18 which deteriorated to 2.16x during FY19 on back of decline in the PBILDT. Total debt/ GCA was moderate at 5.32x in FY18 which deteriorated to 18.99x during FY19 due to sharp decline in GCA on back of decline in PAT.

Established brand with country wide market presence

The company sells TMT bars under the brand name of “Kamala Gold TMT Steel Bars” which is an established brand in the Nepal market on account of its long-standing presence in the construction industry. This provides leverage to the company in front of new players entering the industry. Further, KMPL has a customer base of around 325 customers across all major cities in the country which provides a ready market for its products.

Diverse product range catering to wide spectrum of industries and established marketing setup

The company is into manufacturing of various types of wires such as GI wires, HB wires and other products such as TMT Bars, Flats, and Section which are produced in various variants as per the demand in the market. Corcertina wires, barbed wires are majorly used for border security as well as in industrial and household security purposes. These GI wires have various household, industrial and engineering applications. Products such as TMT

Bars, Barbed wire, Torkari, Flat, Section are used for various construction and engineering projects. KMPL sells its product all over Nepal and the sales are through direct marketing to existing as well as new customers. Most of the sales revenue comes through direct sales.

Expected growth in demand of steels products in the country

Nepalese economy is developing and growing, as is in phase of investment 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 commitment towards infrastructure and rebuilding the housing sector has increased demand of iron and steel products in the country. Products such as GI and HB wires having various industrial, commercial and engineering applications are in regular demand. In FY17, Nepal imported MS steel billet, a major raw material in steel industry, worth Rs. 46.5 billion which increased to Rs.57.9 billion in FY18 registering a growth of 25%. In 11MFY19, the import of MS billets accounted for Rs. 61.88 billion a growth of 21% from 11MFY18. This indicates a growing demand for steel products in Nepal. Government's continued thrust on the construction, infrastructure development and power sector and targeted GDP growth of 8.50% is likely to benefit steel manufacturers like KMPL.

Key Rating Weaknesses

Raw material price volatility risk and foreign exchange fluctuation risk

Zinc, MS Wire Rod and Billets are the major raw materials for KMPL and are majorly imported from India. The prices of raw materials 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 contributed around 85% of the total operating income of the company during FY19, thus, any volatility in prices of the same impacts the profitability of the company. Further, in FY19 ~99% 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. KMPL incurred foreign exchange fluctuation loss of Rs. 40 Mn during FY18 and Rs. 18 Mn during FY19. 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.

Working capital intensive nature of operations

The operations of the company are working capital intensive in nature as KMPL is involved in manufacturing of TMT Bars, Angle, Section, GI/HB wires by primarily importing raw materials for which it has to make advance payment and also fund inventory and debtors which lead to high reliance on working capital limits. KMPL generally allows two-three months credit period to its customers, debtors turnover days was 70 days during FY19. The company keeps inventory for around three-four months and the inventory turnover was 105 days for FY19. Further, the credit period allowed to the company during FY19 was at 10 days. Total operating cycle of the company was 165 days in FY19. This leads to high reliance of the company on the bank finance for working

capital needs. The average utilisation of fund-based working capital limit against drawing power was around 79% during last 12 months period ended mid-June, 2019.

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. Also, 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 during FY19. 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.

About the Company

KMPL is a private limited company incorporated on December 2, 1991 for manufacturing TMT Bars, Flat, Sections, Galvanized Iron/Hard Bright (GI/HB) Wires, Shutter Spring, Barbed Wire, etc., having plant in Biratnagar, Morang, Nepal. The company is promoted by different individuals belonging to the Vishal group of companies. Currently, the total installed capacity of the plant is 80,000 Metric Tons Per Annum (MTPA) out of which the capacity for Rolling Mills is 60,000 MTPA and Wire Section is 20,000 MTPA.

Brief Financial Performance during the last 3 years is as follows:

(Rs. In Million)

For the year ended Mid July	FY17 (A)	FY18 (A)	FY19 (UA)*
Income from Operations	2,796	3,042	2,571
PBILDT	281	316	132
PAT	151	148	10
Overall Gearing (times)	0.89	1.36	1.30
Interest coverage (times)	6.63	6.67	2.16

*Unaudited

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Annexure 1: Details of the Facilities rated

Nature of the Facility	Type of the Facility	Amount (Rs. Million)	Rating
Short Term Bank Facilities	Working Capital Loan	1,120.00	CARE-NP A3
Short Term Bank Facilities	Letter of Credit	1,396.02	CARE-NP A3
Short Term Bank Facilities	Bank Guarantee	10.00	CARE-NP A3
Total		2,526.02	