

## Rating Rationale

### Real Steels Private Limited

#### Rating

Facility/ Instrument	Amount (Rs. In Million)	Rating <sup>1</sup>	Rating Action
Long Term Bank Facilities	410 (enhanced from 320)	CARE-NP B + [Single B Plus]	Reaffirmed
Short Term Bank Facilities	530 (reduced from 620)	CARE-NP A4 [A Four]	Reaffirmed
<b>Total Facilities</b>	<b>940 (Rs. Nine Hundred Forty Million Only)</b>		

*Details of Facilities in Annexure 1*

CARE Ratings Nepal Limited (CRNL) has reaffirmed rating of ‘CARE-NP B +’ assigned to the long term bank facilities and ‘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 are constrained by funding risk of the project as the financial closure not achieved for the revised project cost, project implementation risk - delay in execution of project and cost overrun, raw material price volatility risk & foreign exchange fluctuation risk and expected exposure to risk of volatile interest rates. The ratings also factor in presence in highly fragmented & competitive nature of steel industry. The ratings, however, derive strength from experienced promoters & management in the related field, demand of steels products in the country, locational advantage & scope of export and product diversification.

Timely financial closure of the project, completion of the project within the revised cost estimates and satisfactory operations thereafter, 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.

#### Detailed Description of the Key Rating Drivers

##### Key Rating Weakness

##### *Funding risk of the project as the financial closure not achieved for the revised project cost*

The project was appraised by Nepal SBI Bank Limited (NSBI) and the financial closure for the initial project cost was done on September 18, 2018. Initial project cost estimates of Rs.461.38 Mn was proposed to be financed in a debt-equity mix of 54:46 with Rs.246 Mn debt portion. Due to delay in the project execution by the various reasons and due to low estimates of cost of civil works, the project cost was increased to Rs.597.50 Mn as per the latest estimates by the company. The revised project cost is proposed to funded through equity of Rs.187.50 Mn and long term loans of Rs.410 Mn. The financial closure for the additional amount of project

<sup>1</sup>Complete definitions of the ratings assigned are available at [www.careratingsnepal.com](http://www.careratingsnepal.com)

cost (other than equity and tied up debt) is yet to be achieved. RSPL has incurred Rs.414.82 Mn (including advances to suppliers) over the project till August 13, 2019 and the same is funded through debt of Rs. 203 Mn, rest is funded through equity (including advance for share capital) and sundry payables.

***Project implementation risk - delay in execution of project and cost overrun***

RSPL started construction of the project with the expected commercial operations by Mid-January 2019. However, due to the works not carried out as scheduled, rainy season, lack of labor during construction period led to delay in project execution and the management expects to complete construction by November 2019. The project is still in the implementation stage and continues to remain exposed to the risks associated with project implementation and satisfactory operations thereafter. Delays in project execution cannot be completely ruled out, given that the project is completed only ~69% in financial terms till August 13, 2019 and financial closure for the revised debt portion is yet to be achieved. Considering the present status of works, achieving revised commercial operation date of November 2019 seems to be challenging.

***Raw material price volatility risk and foreign exchange fluctuation risk***

RSPL does not have any backward integration for its basic raw materials, Hot Rolled Coil (HRC) and Cold Rolled Coil (CRC), for producing products like MS pipes and would majorly imports from India. Prices of the 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 is projected to contribute around 79% of the total operating income of the company, thus, any volatility in prices of the same impacts the profitability of the company. Further, the total raw material requirement is proposed to be met through imports and the price of the same will be linked to USD, for which the company is exposed to foreign exchange fluctuation risk.

***Expected exposure to risk of volatile interest rates***

Nepalese banking sectors are fixing lending interest rate based on quarterly base rate and interest rate will be changed accordingly on quarterly basis. Due to tight liquidity in the market, the interest rate has been high and volatile during the last 12 months. Therefore, the funding from Bank and Financial Institutions to the company is 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. However, diverse application of steel and pipes insulates RSPL from a downturn in any particular industry. Further, with increase in the capacities of the existing plants and new capacities coming into operation completion 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 Strength**

#### ***Experienced promoters and management in the related field***

RSPL is promoted by traders and businessmen from Birgunj City of Nepal. RSPL is managed under the overall guidance of the Company's Board of Directors (BoD) who possesses wide experience in the industry and trading. Mr. Prem Kumar Jatiya is the Chairman and Managing Director of the Company. Mr. Jatiya, has been involved in different business for more than 19 years. Mr. Dipal Khanna, Executive Director, holds Chartered Accountancy degree from India and is also engaged in the trading of TMT bars, MS Pipes and other hardware items. However, the scale of the current operations of the entities engaged by promoters in the similar business to the RSPL is low in comparison to the projected scale of operations of RSPL.

#### ***Demand of steels products in the country***

Nepalese economy is developing and growing, as it is in phase of 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 earthquake of April 2015, Government's commitment towards infrastructure and rebuilding the housing sector has increased demand of iron and steel products in Demand for iron and steel is expected to grow by 10% annually for the coming few years. Government's continued thrust on the construction, infrastructure development and power sector and targeted GDP growth of 8.5% keeping inflation level below 6% for FY20 is likely to benefit the flat products manufacturers like RSPL.

#### ***Locational advantage and scope of export***

The plant site is located around 15 Kms from Birgunj dry-port, which makes the location of the plant near to the Indian Border and large Indian State Bihar and give RSPL an advantage of supply of raw material at lower transportation cost. Further, RSPL can exploit opportunity of exporting its products to nearby places of India.

#### ***Product diversification***

RSPL will manufacture MS Pipe that has great usage in construction and oil industries including residential housing, shed construction. Shutter patti and shutter guide will be manufactured which will be used at several places for safety purposes. The company will offer its customers these shutters in varied sizes. Further, RSPL will sell Hot Rolled Coil (HRC) and Cold Rolled Coil (CRC) by cutting it in different sizes.

### **About the Company**

RSPL is a private limited company promoted by traders and businessmen from Birgunj mainly engaged in trading businesses for setting up of MS Steel Pipe plant in Parsa district of Nepal. The project is located at Bagahi-28, Birgunj of Nepal with expected operation date of November 2019. The company will manufacture MS Pipes, Shutter Patti, Shutter Guide and other related products with annual production capacity of 30,000

tons of MS Pipes, 15,000 tons of Shutter Patti, 9,000 tons of Shutter Guide and 9,000 tons of Hot Rolled Coil (HRC) and Cold Rolled Coil (CRC) per year. Promoters of RSPL had infused Rs.71.65 Mn equity capital till July 16, 2019 towards the project execution.

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**Annexure 1: Details of the Facilities**

<b>Nature of the Facility</b>	<b>Type of the Facility</b>	<b>Amount (Rs. Million)</b>	<b>Rating</b>
Long Term Bank Facilities	Term Loan	247	CARE-NP B+
Long Term Bank Facilities (Proposed)	Term Loan	163	CARE-NP B+
Short Term Bank Facilities	Working Capital Loans	500	CARE-NP A4
Short Term Bank Facilities (Proposed)	Working Capital Loans	30	CARE-NP A4
<b>Total</b>		<b>940.00</b>	