

## Rating Rationale

### Saakha Steel Industries Private Limited

#### Rating

Facility	Amount (Rs. In Million)	Rating <sup>1</sup>	Rating Action
Long Term Bank Facilities	299.32	CARE-NP B+ [Single B Plus]	Assigned
Short Term Bank Facilities	1,600.00	CARE-NP A4 [A Four]	Assigned
<b>Total Facilities</b>	<b>1,899.32</b>		

*Details of Facilities in Annexure 1*

CARE Ratings Nepal Ltd. (CRNL) has assigned rating of ‘CARE-NP B+’ to the long term bank facilities and ‘CARE-NP A4’ to the short term bank facilities of Saakha Steel Industries Private Limited (SSIPL).

#### Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of SSIPL is constrained by declining trend in sales and profitability, leveraged capital structure and weak debt service coverage indicators. 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 business group and experienced promoter in the related field, demand of steel products in the country and locational advantage. The ability of the company to manage the growth in the operations & improve the profitability will be key rating sensitivities.

#### Detailed Description of the Key Rating Drivers

##### Key Rating Weaknesses

*Declining trend in sales and profitability during the last three years ended mid-July 2019 leading to negative cash accruals*

SSIPL reported sales of Rs 1,066 Mn in FY19 recording a decline of 2.90% as compared to Rs. 1,094 Mn in FY18 on account of reduction in quantity of TMT sold by the company. Reduction in sales quantity during FY19 was due to high competition in the steel industry. Further, SSIPL recorded decline in PBILDT by 4.22% in FY19 from Rs. 84.74 Mn in FY18 to Rs. 80.99 Mn in FY19 with PBILDT margin of 7.80x against 7.93x in FY18. The net profit of the company has declined substantially and company has recorded net loss of Rs. 11.45 Mn in FY19 as compared to net profit of Rs. 0.65Mn in FY18. Decline in PAT was mainly on account of decline in PBILDT and increase in interest cost on back of increase in debt availed by the company. Ability of the company to manage the growth in the operations & improve the profitability will be key rating sensitivities.

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

***Leveraged capital structure and weak debt service coverage indicators***

SSIPL's capital structure is highly leveraged with debt equity ratio of 4.93x at the end of FY19. Overall gearing ratio of the company deteriorated to 19.51x at the end of FY19 from 12.35x at the end of FY18 on the back of additional loan availed by the company and decline in net worth due to losses incurred. Due to negative GCA reported by the company, total debt to GCA deteriorated from 75.02x in FY18 to negative in FY19. Further, interest coverage ratio declined to 0.92x in FY19 from 1.17x in FY18 due to decline in PBILDT and increase in interest cost during FY19. During FY19, the promoters infused additional funds to support debt obligation of the company.

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

SSIPL does not have any backward integration for its basic raw material (MS Billets) for manufacturing TMT steel bars and majorly imports from India. Also, M.S Wire which is used to manufacture binding wire is also imported from India. Around 73% of the total raw material requirement is met through imports. The prices of the billets and MS Wire 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 contributes more than 75% of the total operating income of the company, thus, any volatility in prices of the same impacts the profitability of the company. Further, the majority of its raw material requirements is proposed to be met through imports and the price of the same is linked to USD, for which it is exposed to the foreign exchange fluctuation risk. 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.

***Exposure to volatile interest rates***

Nepalese banking sectors are fixing interest rate on lending by adding certain percentage of premium on quarterly base rate and interest rate will be changed accordingly on quarterly basis. Base rate of the Bank and Financial Institutions will be changed by change in liquidity position which leads to change in interest rate. Interest rate has been changing frequently in Nepal market since last 1-2 year. Therefore, funding from Bank and Financial Institutions are exposed to volatile interest rate.

***Presence in highly fragmented and competitive nature of steel industry***

The iron and steel industry are 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. Further, with increase in the capacities of the existing plants and new capacities coming into operation completion has intensifies which has resulted into substantial decline in profitability margins of the industry players in the current year. Also,

in order to push sales to sustain the competition, credit sales in the market has substantially increased leading to increased debtor days and high working capital requirement for companies. 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 business group and experienced promoter in the related field***

SSIPL is part of Saakha Group which is one of the established business group in Nepal. The group is promoted by Mr. Ganesh B. Saakha, who is the Chairman of the group and founder promoter of Saakha group and has wide experience across different sectors. The Group was involved in manufacturing adhesive, noodles and garments in the past. Group is also involved in manufacturing dyes and wall paints in the brand name of Nepal Paints for over 35 years. Mr. Bishwa Prakash Saakha, Managing Director, manages day to day operation of the company and has more than 20 years of experience in manufacturing of paints, chemicals, non-ferrous metals. Senior management team members have wide work experience in the related field.

#### ***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 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 the rebuilding the housing sector has increased demand of iron and steel products in Nepal. As per report published by NRB, Nepal imported MS Steel Billet (major raw material in Steel industry) worth Rs. 57.9 Bn in FY18 which further increased to Rs. 66.9 Bn in FY19 registering a growth of ~15% which is further set to grow in FY20. Further, the government's continued thrust on the construction, infrastructure development and power sector and targeted GDP growth of 7.01% for FY20 is likely to benefit the steel products manufacturers like SSIPL.

#### ***Locational advantage***

The plant site is located within ~20 Kms from Birgunj dry port in Nepal-India Border which makes the location of the plant near to the Indian border and large Indian State Bihar and provides SSIPL an advantage of supply of raw material at lower transportation cost.

**About the Company**

Saakha Steel Industries Private Limited (SSIPL) is a private limited company established in 1997 in Simara, Bara district of Nepal. The company manufactures TMT Steel Bars of different sizes under the brand name “Saakha TMT”. In addition to production line of TMT bars, SSIPL also produces variety of steel wires and rods. The installed capacity of SSIPL is 72,000 Metric Tons Per Annum for TMT.

**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	1,555	1,095	1,067
PBILDT	123	87	83
PAT	22	1	(11)
Overall Gearing (times)	13.95	12.35	19.51
Interest Coverage (times)	1.62	1.17	0.92

\*Unaudited

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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	299.32	CARE-NP B+
Short Term Bank Facilities	Working Capital Loan	1,300.00	CARE-NP A4
Short Term Bank Facilities	Non Fund Based Limits	300.00	CARE-NP A4
<b>Total Bank Facilities</b>		<b>1,899.32</b>	