

**Rating Rationale
Shree Krishna Steel Industries Private Limited**

Rating

Facility/ Instrument	Amount (Rs. In Million)	Rating	Rating Action
Long Term Bank Facilities	89.25	CARE-NP BB [Double B]	Assigned
Short Term Bank Facilities	2,375.00	CARE-NP A4 [A Four]	Assigned
Total facilities	2,464.25		

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 Shree Krishna Steel Industries Private Limited (SSPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of SSPL are constrained by subdued performance in FY19 (audited, refers to 12 months period ended mid-July 2019) leading to net loss coupled with leveraged capital structure and weak debt service coverage indicators. The ratings also factor in SSPL’s working capital intensive nature of operations, raw material price volatility and foreign exchange fluctuation risk, exposure to volatile interest rates coupled with presence in highly fragmented and competitive nature of steel industry. The ratings, however, derive strength from strong presence of the promoter group in steel sector supported by experienced management team, diverse product range catering to wide spectrum of industries, established brand and marketing network of the group with country wide presence, demand of steel products in the country and locational advantage with scope of export. Ability of the company to pass through changes in raw material prices to the customers to improve the operating profit margins and rationalization of its debt through efficient working capital management will be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Subdued performance in FY19 leading to net loss

SSPL reported marginal decline in revenue by ~1% to Rs. 3,161 Mn during FY19 due to decline in quantity sold of manufactured items which was however, offset by some extent with increase in trading sales. This decline in sales was also partially offset by increase in average price realization during FY19. PBILDT of the company declined during FY19 to Rs 125 Mn from Rs. 185 Mn in FY18 with reduction in PBILDT margin to 3.94% from 5.78% in FY18 on back of decline in sales of manufacturing goods coupled with increase in trading sales, having lower profitability margins. PBILDT was further impacted by increase in cost of goods sold as % of net sales from 91% in FY18 to 94% in FY19. The company incurred net loss of Rs. 10 Mn during FY19 on account of decline in PBILDT along with increase in

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

interest expenses. Gross Cash Accruals (GCA) of the company reduced to Rs. 19 Mn during FY19 from Rs. 94 Mn in FY18.

Leveraged capital structure and weak debt service coverage indicators

Debt-Equity ratio of the company was low at 0.53x at the end of FY19 compared to 0.63x at the end of FY18, on back of repayment of term loans. Total Gearing Ratio of the company was high at 7.17x at the end of FY19 which increased from 5.01x at the end of FY18 due to loss incurred during the year leading to decline in the net-worth coupled with increased debt levels upon increase in working capital loans. SSPL had a low interest coverage ratio of 1.20x in FY19 which reduced from 3.05x during FY18. Total debt/ GCA deteriorated to 70.79x during FY19 compared to 10.22x during FY18. This was majorly due to reduction in GCA to Rs. 19 Mn in FY19 along with increase in working capital loans.

Working capital intensive nature of operations

The operations of the company are working capital intensive in nature. SSPL is involved in manufacturing wide range of steel products by importing along with locally purchasing raw materials. Import purchases are made through Letter of Credit. SSPL also has to fund the inventory and debtors which lead to high reliance on working capital limits. During FY19, debtor turnover days was at 75 days while inventory turnover was at 42 days. Total operating cycle of the company was 115 days in FY19 which increased from 69 days in FY18. This leads to high reliance of the company on the bank finance for working capital needs. The average utilisation of working capital limits against drawing power was around 88.73% during last 12 months period ended mid-January, 2020.

Raw material price volatility risk and foreign exchange fluctuation risk

Hot Rolled/Cold Rolled (HR/CR) Coils and Hot Rolled strips are the major raw materials for SSPL and are majorly imported from India. The prices of the SSPL's 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 consumption cost along with trading purchases contributed around 93% of the total operating income of the company during FY19, thus, any volatility in prices of the same impacts the profitability of the company. Also, the company is exposed to foreign exchange fluctuation risk as the prices of imported raw materials are linked to USD. 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 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, funding from Bank and Financial Institutions 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. Furthermore, the value addition in the steel products like pipes, sheets 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***Strong presence of the promoter group in steel sector supported by experienced management team***

SSPL has an operational track record of more than two decades in manufacturing of Pipes and Sheets. The promoters of the company have wide experience in manufacturing steel and other construction materials for more than three decades. SSPL is part of the Keyal group of companies of Nepal which is a diversified business group with strong presence in a broad range of business, manufacturing and industrial interests with main focus on manufacturing construction materials. The group also has 15 hardware outlets across the country which are strongly contributing to the group's steel business. The company is managed under the overall guidance of its ten members Board of Directors (BoD) which includes experienced businessmen/industrialist from the Keyal group with wide experience in the manufacturing sector. Mr. Satya Narayan Keyal, Chairman of NSPL and also the chairman of the Keyal group of companies has more than 30 years of experience in trading and manufacturing industry. Mr. Bikash Kumar Keyal, Director, has been involved in the groups business for the past 15 years and looks after the whole group's accounting and finance.

Diverse product range catering to wide spectrum of industries

SSPL is into manufacturing Hot Rolled (HR) and Cold Rolled (CR) pipes, and their variants along with shutter patti, Chequer plate etc. Company is also involved in selling hot rolled coil (HRC) sheet and cold rolled coil (CRC) sheet by cutting it in different sizes. These products have various household, official and engineering applications. SSPL 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 domestic sales through its trading houses.

Established brand and marketing network of the group with country wide presence

The company sells pipes, sheets and other allied products under the brand name of “Narayani Steels” which is already an established brand in the Nepal market on account of its long-standing presence in the construction materials manufacturing and trading industry. This provides leverage to the company in front of new players entering the industry. The group also has 15 in-house hardware trading outlets in and around the Kathmandu Valley along with a well-established dealer/distributor network in around 129 areas across the country which provides a ready market for its products.

Demand of steels products in the country

Nepalese economy is developing and growing, and 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 Nepal. As a result of increased development works, demand for iron and steel is expected to grow by 10% annually.

Locational advantage and scope of export

The plant site is located in Chhatapipra, Simara, around 15 Kms from Indo-Nepal borders in Birgunj dry-port. Since majority of raw materials used by SSPL are imported from India, the factory’s proximity to the border remains a positive point leading to savings in huge freight cost. Upon favorable market conditions in the future, SSPL can also exploit the opportunity of exporting its products such as pipes and other products to India and Bhutan.

About the Company

Shree Krishna Steel Industries Private Limited (SSPL) is a private limited company incorporated on February 28, 1995 for manufacturing Pipes, Sheets, Shutter Patti, having plant in Chhatapipra, Bara, Nepal and is in operation for more than two decades. SSPL is part of the Keyal group of companies of Nepal and all the shares of the company are held by individual promoters from Keyal group.

Brief financials of SSPL during last 3 years is given below:

	(Rs. Million)		
For the year ended Mid-July	FY17 (A)	FY18 (A)	FY19 (A)
Income from Operations	2,000	3,194	3,161
PBILDIT	115	185	125
PAT	47	71	(10)
Overall Gearing (times)	1.85	5.01	7.17
Interest Coverage (times)	3.34	3.05	1.20

**Audited*

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Annexure 1: Details of the Facilities rated

Nature of the Facility	Type of the Facility	Amount (Rs. In Million)	Rating
Long Term Bank Facilities	Term Loan	89.25	CARE-NP BB
Short Term Bank Facilities	Working Capital Limit	835.00	CARE-NP A4
Short Term Bank Facilities	Letter of Credit	1,540.00	CARE-NP A4
Total		2,464.25	