

**Rating Rationale
Vijayshri Steel Private Limited**

Rating

Facility	Amount (Rs. In Million)	Grading	Rating Action
Long Term Bank Facilities	514.74	CARE-NP BB [Double B]	Reaffirmed
Short Term Bank Facilities	3,500.00	CARE-NP A4 [A Four]	Reaffirmed
Total facilities	4,014.74 (Increased from Rs. 3,742.20 Mn)		

Details of Facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has reaffirmed rating of ‘CARE-NP BB’ assigned to the long-term bank facilities and ‘CARE-NP A4’ assigned to the short-term bank facilities of Vijayshri Steel Private Limited (VSPL).

Detailed Rationale & Key Rating Drivers

The rating assigned to the bank facilities of VSPL are constrained by subdued operational and financial performance of the company during the first year of operation in FY19 (audited, refers to 12 months period ended mid-July 2019) with net loss, leveraged capital structure and weak debt service coverage indicators. The rating also factors in VSPL’s exposure to volatile interest rates, working capital intensive nature of operations, raw material price volatility and foreign exchange fluctuation risk coupled with presence in highly fragmented and competitive nature of steel industry. The ratings, however, derive strength from established business group and promoter’s experience in cement manufacturing and trading business, demand of steel products in the country, locational advantage of its facilities and presence of import parity pricing reducing the threat of imports majorly from India to a considerable extent. Ability of the company to pass through changes in raw material prices to the customers to improve the operating profit margins 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 Weaknesses

Subdued operational and financial performance of the company during the first year of operation in FY19 with net loss

During FY19, the company generated total revenue of Rs. 1,843 Mn in which the company was operational for ~7 months. PBILDT of the company was Rs. 11 Mn with low PBILDT margin of 0.57%. During FY19, the company registered net loss of Rs. 40 Mn majorly due to lower PBILDT coupled with high depreciation of Rs. 46 Mn. The company incurred cash loss of Rs. 4 Mn in FY19.

Leveraged capital structure and weak debt service coverage indicators

Debt-equity ratio of the company was high at 4.10x at the end of FY19 compared to 3.08x at the end of FY18, due to increased long term debts to fund capital expenditures of the company and availing of working capital loans to fund operation of the company. Long term debt increased from Rs. 489 Mn

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

(including Director's loan of Rs.67 Mn) in FY18 to Rs. 895 Mn (including Director's loan of Rs. 392 Mn) in FY19. This was partially offset by introduction of share application money of Rs. 120 Mn by the promoters. Total gearing ratio of the company was high at 10.49x at the end of FY19 (FY18: 3.08x) with low interest coverage ratio of 1.05x in FY19. Total debt/ GCA for FY19 was negative on account of negative gross cash accruals. Gearing levels of the company is high being first year of operation.

Working capital intensive nature of operations

The operations of the company are working capital intensive in nature as VSPL is involved in the manufacturing of TMT Bars by procuring raw materials through imports through Letter of Credit. VSPL also has to fund inventory and debtors which lead to high reliance on working capital limits. In FY19, debtor turnover days for VSPL was 73 days and the inventory turnover was 78 days. Further, credit period allowed to the company during FY19 was at 13 days. Total operating cycle of the company was 138 days in FY19. This leads to high reliance of the company on the bank finance for working capital needs. The average monthly outstanding of fund-based working capital limit against drawing power was around 92.68% during last 12 months period ended mid-January 2020.

Raw material price volatility risk and foreign exchange fluctuation risk

VSPL does not have any backward integration for its basic raw material (MS Billets) for producing TMT steel bars and imports from India. The prices of the billets 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 generally stands at around ~85% of the total operating income in the steel industries, 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 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.

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 Binding Wires, 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 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.

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.

Key Rating Strengths

Established business group and experienced promoter in cement manufacturing and trading business

VSPL is promoted by individuals who are associated with Vijaya Group of companies of Nepal which has a presence of more than 30 years in the industry. Currently, the Group is involved in importing and manufacturing cement, manufacturing batteries, importing bitumen and trading, agriculture and education sector. The group manufactures cement under the company Bijaya Cements Private Limited which has a grinding capacity of 900 Metric Tonnes Per Day. Since the group is operating in cement business in the Nepalese market for more than a decade with over 400 dealers, it gives them an advantage of existing distribution channel for marketing of goods manufactured by VSPL. The company is managed under overall guidance of its four members Board of Directors. Mr. Vikash Kedia, Chairman, has industrial experience of more than 18 years. Mr. Pradeep Agarwal, Director, looks after the day to day operations of the company.

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

The plant site is located at Shivaraj, Kapilvastu which is at a distance of ~11km from Barhni border, India and ~98 km from Sunauli border, India, which gives VSPL an advantage of supply of raw material at lower transportation cost in comparison to their competitors. Presently, VSPL is importing raw materials from Barhni border. The plant is situated nearby to the East-West Highway of Nepal which provides road access for supply of finished products to the major markets. Also, most of the steel factories are

concentrated in eastern parts of Nepal. Hence, VSPL can exploit opportunities while focusing in the Central and Western parts of Nepal.

About the Company

VSPL is a private limited company, incorporated on February 23, 2017, to set up a TMT bar manufacturing plant in Kapilvastu district of Nepal. The company is promoted by businessmen engaged in manufacturing and trading business. The company manufactures TMT bars by importing raw materials from India and selling them into Nepal's market with production capacity of 700 MT of TMT bars per day. The project has been in operation from November 25, 2018.

Brief financials of VSPL for FY19 is given below:

(Rs. Million)

For the year ended Mid-July	FY19 (Audited)
Income from Operations	1,843
PBILDT	11
PAT	(40)
Overall Gearing (times)	10.49
Interest Coverage (times)	1.05

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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	464.74	CARE-NP BB
Long Term Bank Facilities (Proposed)	Term Loan	50.00	CARE-NP BB
Short Term Bank Facilities	Working Capital Limit	1,400.00	CARE-NP A4
Short Term Bank Facilities (Proposed)	Working Capital Limit	600.00	CARE-NP A4
Short Term Bank Facilities	Non-Funded Limit	1,500.00	CARE-NP A4
Total		4,014.74	