

Rating Rationale
Aarti Strips Private Limited

Rating

Facility/ Instrument	Amount (Rs. Million)	Rating ¹	Rating Action
Long Term Bank Facilities	1,574.70	CARE-NP BB+[Double B Plus]	Assigned
Short Term Bank Facilities	10,200.00	CARE-NP A4+[A Four Plus]	Assigned
Total Bank Facilities	11,774.70		

Details of Facilities in Annexure 1

CARE Ratings Nepal Limited (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 Aarti Strips Private Limited (ASPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of ASPL are constrained by negative implications of COVID-19 on the operations and financials of the company in the short term period, dependence of the company on one raw material supplier with weak financial standing and raw material price volatility risk along with foreign exchange fluctuation risk. The ratings also factor in working capital intensive nature of operations, exposure to volatile interest rates and presence in highly fragmented & competitive nature of steel industry. The ratings however, derives strength from strong operational and financial performance of the company characterized by growth in sales however, with decline in profitability margins, moderate capital structure and debt service coverage indicators in FY19 (audited, refers to 12 months period ended mid-July 2019). The ratings also factors in long track record of operations in Nepal with experienced professional management team, established brand with country wide market presence and large scale of operation, diverse product range catering to wide spectrum of industries with strong marketing setup and expected demand of steel products in the country post COVID-19 crisis and ability of the company to export steel products.

Ability of ASPL to manage growth in the operations & improve the profit margins and rationalization of its debt through efficient working capital management would be the key rating sensitivities. Ability of the company to pass through changes in raw material prices to the customers and manage the foreign exchange fluctuation risks related to raw materials will be the key rating sensitivities. Further, diversifying the raw material suppliers of the company and reducing dependencies on one supplier by developing alternate sources for raw material procurement at cost effective pricing to maintain the margins and ensure smooth production process would also be the key rating sensitivities.

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

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Negative implications of COVID-19 on the operations and financials of the company in the short term period

With the outbreak of Coronavirus disease 2019 (COVID-19) recognised as Pandemic by World Health Organization on March 11, 2020 which has affected Nepal as well, the Government of Nepal (GoN) has imposed travel restrictions and countrywide lockdown since March 24, 2020 closing most of the organizations and slowing down the economic activities. Further, the lockdown has been extended multiple times with current extension till June 02, 2020. With lockdown imposed by the GoN, ASPL has suspended all its manufacturing activities from March 24, 2020. The Outbreak of COVID-19 has also negatively impacted the revenue of the company for the year. With lockdown imposed in most of the countries shipment of imported raw material has also been impacted during the period which may impact operations of the company in the near future. The company currently has raw material and finished goods stock for around 2 months which may reduce the impact to certain extent. While ASPL's performance in H1FY20 was comfortable, the revenue growth momentum, profitability and debt coverage indicators are expected to be under pressure. The company's ability to achieve sales and profitability as envisaged and maintain its debt coverage indicators would remain critical.

Dependence on one raw material supplier with weak financial standing

The major raw materials of the company i.e Hot Rolled (HR)/Cold Rolled (CR) coil and Zinc is imported from India and comprises around 96% of the total raw material cost. During FY19, around 60% of the total raw material purchases was procured from one single supplier which has a weak financial standing. ASPL is currently exploring new suppliers of raw material and has also started purchasing from new suppliers to reduce the dependence upon BPSL. Diversifying the raw material suppliers of the company and reducing dependencies on one supplier by developing alternate sources for raw material procurement at cost effective pricing to maintain the margins and ensure smooth production process remains key rating sensitivity.

Raw material price volatility risk and foreign exchange fluctuation risk

ASPL does not have any backward integration for its basic raw material (HR/CR Coils & Sheets, MS Billets) and the raw materials are majorly imported from India. The prices of the HR/CR Coils & Sheets and billets are market linked and determined on a periodic basis. The company keeps inventory of around two months, thus exposing the company to the volatility in the prices of raw materials which has a bearing on its profitability margins. The cost of raw material consumed as % of the total operating income of the company was around 85% in FY19, thus, any volatility in prices of the same impacts the profitability of the company. Further, around 99% of its raw material requirements is met through imports and the price of the same are linked to USD, for which it is exposed to the foreign exchange fluctuation risk. To prevent the impact of foreign exchange fluctuation on profitability, ASPL does forward contract for all forex transactions on regular basis. 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 by hedging will be the key rating sensitivities.

Working Capital Intensive Nature of Operations

ASPL is involved in manufacturing wide range of steel products by majorly importing raw materials through Letter of Credit and also has to fund the inventory and debtors which leads to high reliance on working capital limits. ASPL generally allows around three months credit period to its customers, average debtors turnover days was 49 days during FY19. The company keeps inventory for around two months and the average inventory turnover was 63 days for FY19. Further, average credit period allowed to the company during FY19 was at 8 days. Total operating cycle of the company was 104 days in FY19 which increased from 71 days in FY18 due to increase in collection period. This leads to high reliance of the company on the bank finance for working capital needs. Further the working capital limits utilisation have increased due to increase in the business size following capacity enhancement and increase in the working capital cycle.

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, 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. Furthermore, the value addition in the steel products like MS. Black Pipe, TMT bar & related products is low, resulting into low product differentiation in the market. ASPL is one of the leading player in Nepal market in galvanized and colour coated sheet segment and also has dominant position in manufacturing ultra-thin flat products which reduces competition to certain extent.

Key Rating Strengths

Established and long track record of operations in Nepal with experienced professional management team

ASPL has an long operational track record in manufacturing galvanized and color coated iron sheets and has been manufacturing MS black pipes for more than 5 years. The company is promoted by four Indian investment companies which has been primarily incorporated for promoting ASPL and are core investment companies. The ultimate beneficiary of the above mentioned investment companies is Mr. Aniket Singal, son of Mr. Sanjay

Singal, who is an Indian Businessman related to steel industry. Mr. Aniket Singal is an M.B.A. from Oxford University & has experience of around 6 years in the industry. ASPL is managed under the overall guidance of its three member Board of Directors (BoD) who are qualified professionals with wide experience in the manufacturing industry. Mr. Vishal Gupta, Director of ASPL has an overall experience of 22 years and looks after day to day operations of the company.

Strong operational and financial performance characterized by growth in sales however with reduced profitability margins in FY19

ASPL's overall capacity utilization dipped to 69% in FY19 which was 99% in FY18 on account of addition of 200,000 MTPA capacity of TMT bar manufacturing facility in January 2019 which operated at an annualized capacity at 33% during the year. During FY19, company's total revenue increased by 12% to Rs. 16,984 Mn out of which export sales attributed nearly 17% to the total sales. This growth in revenue in FY19 was majorly due to addition of TMT bar capacity which contributed to the quantity sold by the company coupled with increase in per unit sales realization of the existing products of the company (excluding TMT). Despite growth in revenue in FY19, PBILDT of the company impacted on account of higher proportionate increase in cost of raw material prices than increase in sales realizations. PAT of the company reduced to Rs. 614 Mn in FY19 with PAT margin of 3.61% majorly due to lower PBILDT generated coupled with increased foreign exchange loss. This increase in foreign exchange loss was partially offset by reduction in interest cost charged to Profit and loss account in FY19 due to higher capitalization of interest as compared to FY18. During FY20 till March 24, 2020, the company has achieved total net sales of Rs. 10,000 Mn.

Moderate capital structure and debt service coverage indicators

Debt-Equity ratio of the company has been low at 0.31x at the end of FY18 which increased marginally to 0.38x at the end of FY19 on account of new term loan availed for financing the TMT plant of the company. Despite availing term loan, the debt to equity ratio has been on a lower side on account of high net worth of the company due to profit accumulation over the period. Total gearing ratio of the company has also been comfortable at 1.30x at the end of FY18 due to low working capital utilization which increased to at 1.71x at the end of FY19 due to increase in working capital loans. Interest coverage ratio of ASPL has been comfortable at 4.44x in FY18 which improved to 5.17x in FY19 majorly due to capitalization of portion of interest of term loan. A portion of interest has been capitalized during FY18 and FY19 due to TMT bar project but as the project has come into operation during FY19, the interest expenses are expected to increase significantly during FY20. Total debt/GCA was moderate at 5.66x in FY18 which increased to 9.16x at the end of FY19 majorly due to increase in working capital loan and term loans coupled with decline in GCA.

Established brand with country wide market presence and large scale of operation

ASPL sells its color coated sheets under the brand name "Aarti Spectra" and galvanized sheets and MS pipes under the brand name "Aarti Suraksha" which is an established brand in the Nepal market on account of its long-

standing presence in the construction industry. TMT bar are sold under the brand name of “Aarti Perfect” and “Aarti Tiger”. The company is into the business for more than 18 years and is one of the major player in the country with significant turnover. This provides leverage to the company in front of new players entering the industry. Further, ASPL has a dealer base of around 200 dealers 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 strong marketing setup

ASPL manufactures an array of flat products ranging from Galvanized Plain/Galvanized Corrugated, Ridge Galvanized Iron & Colour Coated with Zinc Based Pre-Printed Galvanized Iron (PPGI), Profile Sheets, MS Tube and Shutter Patti. ASPL has further expanded its portfolio by entering into manufacturing TMT bar from January 2019 onwards. These sheets find application in a number of industries such as construction and infrastructures, white goods, automotive industry and containers such as grain silos, trunk, drum & barrels etc. ASPL is also into manufacturing colour coated sheets of different colours which is available in coils, sheets and profiles tailored to meet the requirements of increasingly demanding OEMs like automobile, white goods, furniture and other manufacturers besides the construction sector. MS Black Pipes manufactured by ASPL find usage in construction, chemical and oil industries.

Proximity to Indian border leading to savings in freight cost and generating export sales

The plant site is located in Biratnagar around 15 kms from Indo-Nepal borders. Since majority of raw materials used by ASPL are imported from India, the factory’s proximity to the border remains a positive point leading to savings in freight cost. Further, ASPL has also been exporting its products mainly colour coated sheets to neighboring Indian states like West Bengal, Bihar and Assam and has made export sales of Rs. 2,856 Mn during FY18 and of Rs. 2,920 Mn during FY19 which accounts for ~ 19% and 17% of total sales respectively.

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. However, with the outbreak of COVID-19 resulting into nationwide lockdown and slowdown in economic activities the demand of steel products is expected to be impacted in the near term. The demand for iron and steel is expected to grow by 10% annually in the later years as a result of increased development works post the COVID-19 crisis.

About the Company

Aarti Strips Pvt. Ltd. (ASPL) is a private limited company which was incorporated on January 21, 2001 for setting up a wet flux galvanized plain and corrugated sheets manufacturing facility at Biratnagar, district Morang, Nepal. The company is into manufacturing wide range of steel products with total installed plant capacity of 340,000 Metric Tons Per Annum (MTPA) in FY19 and is one of the leading player in the industry.

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 (A)*
Income from Operations	10,305	15,142	16,996
PBILDT	1,010	1,351	1,297
PAT	429	790	614
Overall Gearing (times)	1.36	1.30	1.71
Interest coverage (times)	3.17	4.44	5.17

*Audited

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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	1,574.70	CARE-NP BB+
Short Term Bank Facilities	Working Capital Loan	6,880.00	CARE-NP A4+
Short Term Bank Facilities	Non-fund based limits	3,320.00	CARE-NP A4+
Total		11,774.70	