Rating Rationale

Ashok Steel Industries Private Limited

Rating

Facility	Amount (Rs. In Million)	Rating	Rating Action
Long Term Bank Facilities	456.06	CARE-NP BB- [Double B Minus]	Reaffirmed
Short Term Bank Facilities	2,155.00	CARE-NP A4 [A Four]	Reaffirmed
Total Facilities	**2,611.06**		

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 Ashok Steel Industries Private Limited (ASPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of ASPL are constrained by impact of COVID-19 on the business of the company, deteriorated financial performance in FY19 (audited, refers to 12 months period ended mid-July 2019) and highly leveraged capital structure and weak debt service coverage indicators. The rating is also constrained by working capital intensive nature of operations and stressed liquidity position, raw material price volatility risk and foreign exchange fluctuation risk, exposure to volatile interest rates and presence in highly fragmented and competitive nature of steel industry. The ratings, however, derive strength from established and long track record of operations along with experienced management team in the related field, continued financial support from the promoters of the company in form of funds infusion to cover the losses incurred by the company, established brand with country wide market presence and demand of steels products in the country. Ability of ASPL to manage growth in the operations and improve profitability margins and rationalization of its debt through efficient working capital management are the key rating sensitivities.

Impact of Covid-19 on the business of the company

With outbreak of Coronavirus disease 2019 (COVID-19) recognized as Pandemic, which has affected Nepal as well, Government of Nepal (GoN) has imposed travel restrictions and countrywide lockdown since March 24, 2020 halting operations of most of the organizations and slowing down of the economic activities. Due to the lockdown, sales of ASPL has slowed down which has directly impacted the revenue of the company. Nepal Rastra Bank (NRB) has provided an extension of 3 months for the repayment of loans falling due in mid-April 2020 to provide some temporary relief. ASPL is eligible for 2% rebate on interest charged for the quarter ended on mid-July 2020 as per the provision of NRB. Lower sales than the projected levels and pressure on the profitability of the company due to high competition along with high

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

interest cost and debt repayment obligations, the liquidity position of the company is expected to be remain stretched.

Detailed Description of the Key Rating Drivers

Key Rating Weakness

Deteriorated financial performance during FY19

ASPL revenue declined by ~7% during FY19 in comparison to FY18 majorly on account of decline in total quantity sold of TMT bars and torkari in FY19, however partially offset by increase in overall average price realization. PBILDT margin of the company declined substantially to 1.84% during FY19 from PBILDT margin of 9.55% in FY18. ASPL incurred net loss of Rs. 172 Mn in FY19, majorly on account of decline in PBILDT unable to cover depreciation and interest expenses. The directors of the company have also infused fund in the form of unsecured loan amounting to Rs. 40 Mn in FY19 and Rs. 60 Mn in FY20 to cover the losses and fund the operations of the company.

Highly Leveraged capital structure and weak debt service coverage indicators

The financial risk profile of the company was below average marked by eroded Networth in the books of the company during FY19. Networth of the company was negative during FY19 due to loss suffered by the company during FY19. As a result, Debt equity ratio and overall gearing ratio of the company which was at 1.26x and 8.24x at the end of FY18 was negative at the end of FY19. The interest coverage ratio of the company was very low at 0.37x in FY19 which declined from 3.05x in FY18.

Working capital intensive nature of operations and stressed liquidity position

The operations of the company are working capital intensive in nature with high reliance on bank finance as ASPL is involved in the manufacturing of TMT Bars by using imported and locally purchased raw materials through Letter of Credit as well as by making advance payment. ASPL also has to fund inventory and debtors which lead to high reliance on working capital limits. In FY19, ASPL generally allowed 2-2.5 months credit period to its customers and kept inventory for around three months. Total operating cycle of the company was 130 days in FY19 which increased from 101 days in FY18. This leads to high reliance of the company on the bank finance for working capital needs. Also, the liquidity profile of the company stood stressed as characterized by below unity current ratio of 0.81 times and quick ratio of 0.50 times as on FY19 end. The company had been availing ad-hoc working capital limits from the banks to fund increased working capital requirements.

Raw material price volatility risk and foreign exchange fluctuation risk

Sponge Iron and Scrap are the major raw materials for ASPL and are majorly imported from India. With company started to manufacture billet by itself, billet which was 58% of total raw material purchase during FY19 has reduced to 2% in 9MFY20 (unaudited, refers to 9 months period ended mid-April 2020). The prices of the ASPL'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 cost contributed around 86% of the total operating income of the company, thus, any volatility in prices of the same impacts the profitability of the company. Further, In FY19 ~ 56% of the total raw material requirement was imported and the prices of the same are linked to USD, for which the company is exposed to the foreign exchange fluctuation risk. ASPL incurred foreign exchange fluctuation loss of Rs. 35 Mn in FY19 which increased from Rs. 7 Mn in FY18. 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 sector fixes lending interest rate based on quarterly base rate and interest rate can 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 banks and financial institutions is subject to volatile interest rate.

Fragmented industry with competition from both domestic and international players

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 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 competition has intensified which has resulted into substantial decline in profitability margins of the industry players in the current year. As per latest NRB report published on mid-January, 2020, the total capacity utilization of TMT Bars and other allied products in Nepal was at 63.60% during FY18 which reduced to 61.50% during FY19, however with increase in total production by ~8% during FY19. 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 Strength

Established and long track record of operations along with experienced management team in the related field

ASPL has an operational track record of more than three decades in manufacturing TMT Bars and allied steel products. The promoters of ASPL have an experience of three decades in the Steel industry. ASPL is managed under the overall guidance of its two members Board of Directors (BoD) who possess wide experience in the manufacturing sector. Mr. Poonam Chand Agrawal is the Chairman and the managing director of ASPL and has 30 years of experience in steel manufacturing industry. Mr. Abhishek Tulsian is the Chief Executive Officer who has been working in ASPL actively from last 7 years. The Directors of the company have been also infusing funds into the company in the form of directors' loan and share application money to fund the operations as and when required by the company.

Established brand with country wide market presence

The company sells TMT bars under the brand name of "Ashok TMT" which is an established brand in the Nepal market on account of its long-standing presence in the construction industry. This provides leverage to the company in front of new players entering the industry. Further, ASPL has a developed dealer/distributor network of around 271 dealers 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. Also, in the recent budget presented by finance minister of Nepal for FY21, government has allocated Rs. 55 Bn for reconstruction and also government has majorly focused towards development of health sectors, tourism sectors and other infrastructure development. Further, the government's high emphasis on infrastructure development, namely development of roads, hydropower, airports and other infrastructures and estimated GDP growth of 7.00% as included in the budget for FY20-21 is likely to benefit the steel manufacturers like ASPL.

About the Company

Ashok Steel Industries Private Limited (ASPL) is a private limited company incorporated on February 22, 1984 for manufacturing TMT Bars and Ingot, having plant in Gadhimai Municipality-10, Bara, Nepal. Currently, the company is manufacturing TMT by importing sponge iron and scrap majorly from India and selling in domestic market under the brand name "Ashok TMT". In order to achieve cost efficiency in production, the company underwent capex to install induction furnace to melt scrap and manufacture ingots post which the company has been producing TMT bars by direct charging method.

Brief Financial Performance during last 3 years:

(Rs. In Million)

For the year ended Mid July,	FY17 (A)	FY18 (A)	FY19 (A)
Income from Operations	1,358	3,594	3,354
PBILDT	156	343	62
PAT	74	102	(172)
Overall Gearing (times)	8.74	8.24	(95.32)
Interest coverage (times)	3.63	3.05	0.37

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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	456.06	CARE-NP BB-
Short Term Bank Facilities	Working Capital Loans	1,405.00	CARE-NP A4
Short Term Bank Facilities	Non-Funded Limit	750.00	CARE-NP A4
Total		**2,611.06**	