

Rating Rationale
Bhagawati Steel Industries Private Limited

Rating

Facility/ Instrument	Amount (Rs. In Million)	Rating ¹	Rating Action
Long Term Bank Facilities	140.71	CARE-NP BBB- [Triple B Minus]	Reaffirmed with removal of rating from credit watch with negative implications
Short Term Bank Facilities	2,980.00	CARE-NP A3 [A Three]	Reaffirmed with removal of rating from credit watch with negative implications
Total facilities	3,120.71 (Reduced from 3,151.48)		

Details of Facilities in Annexure 1

CARE Ratings Nepal Ltd. (CRNL) has reaffirmed rating of ‘CARE-NP BBB-’ assigned to the long-term bank facilities and ‘CARE-NP A3’ assigned to the short-term bank facilities of Bhagawati Steel Industries Private Limited (BSPL). The ratings have been removed from credit watch with negative implications considering comfortable financial profile of the company and its ability to withstand the implications of ongoing Covid-19 without impacting the debt servicing capability of the company.

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of BSPL continue to derive strength from established and long track record of operations along with experienced management team in the related field and healthy profitability margins. The ratings also factor in moderate gearing levels and comfortable debt service coverage indicators of the company at the end of FY20 (Audited, refers to 12 months period ended mid-July 2020), diverse product range catering to wide spectrum of industries, established marketing setup and brand with strong customer base and demand of steels products in the country. The ratings are however constrained by decline in operational and financial profile of the company characterized by decline in revenue and profit during FY20 due to impact of COVID-19 pandemic. The ratings also continue to be constrained by raw material price volatility and foreign exchange fluctuation risk, working capital intensive nature of operations, exposure to volatile interest rates and presence in highly fragmented and competitive nature of steel industry. The ability of BSPL to manage growth in the operations, maintaining the profit margins and rationalization of its debt through efficient working capital management would be the key rating sensitivities.

Impact of COVID-19 on the operations and financials of the company

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) had imposed travel restrictions and countrywide lockdown since March 24, 2020 till June 14, 2020. During

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

the lockdown period, sales of the company has been directly impacted in FY20. The expected economic slowdown in the construction sector due to the ongoing pandemic and the resulting impact on demand of products in iron and steel sector is likely to keep the near-term revenue growth subdued.

Detailed Description of the Key Rating Drivers

Key Rating Strengths

Established & long track record of operations along with experienced management team

BSPL has an operational track record of almost three decades in manufacturing pipes, tubes and other allied steel products. The promoters of BSPL have an experience of more than three decades in the steel industry. BSPL is managed under the overall guidance of its three-member Board of Directors (BoD) which includes experienced businessmen/industrialist with wide experience in the manufacturing sector.

Moderate gearing levels and comfortable debt service coverage indicators of the company at the end of FY20

Debt-equity ratio of the company has been low at 0.21x at the end of FY20 which increased from 0.19x at the end of FY19 on account of disbursement of new term loan during FY20 for funding the capital expenditure. Total adjusted gearing ratio of the company improved to 1.74x at the end of FY20 as compared to 2.05x at the end of FY19 majorly due to net decline in working capital loans and increase in the networth of the company on back of accretion of profit to networth. BSPL has healthy interest coverage ratio of 7.04x and Total debt/ Gross Cash Accruals of 5.68x in FY20.

Diverse product range catering to wide spectrum of industries and established marketing setup

The company is into manufacturing mild steel (MS) black pipes & galvanized (GI) pipes and their variants along with tubular pole, telescopic pole, structure, shutter profile etc. Company is also involved in selling galvanized plain sheets (GP Sheet), hot rolled coil (HRC) sheet and cold rolled coil (CRC) sheet by cutting it in different sizes. BSPL sells its product all over Nepal through direct marketing network. Most of the sales revenue comes through direct domestic sales, followed by tender based sales.

Established brand with strong customer base

The company sells pipes, sheets and other allied products under the brand name of “BST” 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. The company has a strong customer base with majority of the customers being Government Departments, NGOs, Local government authorities and renowned business houses.

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. In the budget presented by finance minister of Nepal for FY21, government has allocated Rs. 55 Bn for reconstruction and Rs. 36 Bn for construction of various transmission line and substations. However, with economic activities affected by COVID-19 pandemic,

demand for steel may be subdued in short term, but with government focus on infrastructure, demand is likely to grow in long run. Government's high emphasis on infrastructure development and power sector in the budget for FY20-21 is likely to benefit the flat products manufacturers like BSPL.

Key Rating Weaknesses

Decline in operational and financial profile of the company characterized by decline in revenue and profit during FY20, however with healthy profitability margins

BSPL was able to maintain healthy capacity utilization of 65% during FY19 which has however reduced to 47% during FY20. Manufacturing operations of BSPL has been impacted by lockdown imposed by the GoN due to which the revenue of the company has also been impacted with total revenue declined by ~17% during FY20. Despite decline in the total revenue, PBILDT and PBILDT margins of the company improved due to better realization from the products sold as well as decline in raw material costs. PAT of the company declined by ~14% during FY20 majorly due to significant increase in foreign exchange loss which was partially offset by decline in interest cost.

Raw material price volatility risk and foreign exchange fluctuation risk

The major raw materials are majorly imported from India and China and the price of the 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 contributed around 78% of the total operating income of the company in FY20, thus, any volatility in prices of the same is expected to impact the profitability of the company. Further, the total raw material requirement is met through imports and the prices of the same are linked to USD, for which the company is exposed to the foreign exchange fluctuation risk. However, same is mitigated to some extent as the company has practice of hedging foreign exchange exposure. The ability of the company to pass through changes in raw material prices to the customers and managing the foreign exchange fluctuation risks related to raw materials will be the key rating sensitivities.

Working capital intensive nature of operations

The operations of the company are working capital intensive in nature as the operations are dependent upon imported raw materials. The company also has to fund the inventory and debtors which lead to high reliance on working capital requirements. In absolute value, the debtors declined at the end of FY20 due to lower sales during last quarter due to the lockdown followed by realization from the old debtors at year end. Total operating cycle of the company was high at 153 days in FY20 which increased from 107 days in FY19 majorly due to increase in inventory holding period. This has led to high reliance of the company on the bank finance for working capital needs. The average utilisation of fund-based working capital limit against drawing power was around 88.90% during last 12 months period ended mid-September, 2020.

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. 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 M.S. Black, galvanized pipes & 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 FY20.

About the Company

Bhagawati Steel Industries Private Limited (BSPL) is a private limited company incorporated on January 10, 1991 for manufacturing Pipes and Sheets, having plant in Chhatapipra, Bara, Nepal. The company has diversified its products to door and window frames, shutter profiles, side channels, truss, poles and towers, suspension and motorable bridge and related products. Currently, the total installed capacity of the plant is 85,500 Metric Tons Per Annum (MTPA).

Brief financial performance during the last 3 years ending FY20 is as follows:

(Rs. In Million)

For the year ended Mid July	FY18 (A)	FY19 (A)	FY20 (A)
Income from Operations	3,350	4,930	4,101
PBILDT	340	409	453
PAT	163	189	163
Adjusted Overall Gearing (times)*	2.50	2.05	1.74
Interest coverage (times)	9.47	4.95	7.04

* BSPL has policy to invest surplus cash in short term fixed deposits which are later used to pay off working capital loans once they mature. Considering the same, CRNL has calculated adjusted gearing ratio by netting off working capital loans with such deposits in banks at the year end.

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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	140.71	CARE-NP BBB-
Short Term Bank Facilities	Working Capital Loan	1,610.00	CARE-NP A3
Short Term Bank Facilities	Letter of Credit	1,280.00	CARE-NP A3
Short Term Bank Facilities	Bank Guarantee	90.00	CARE-NP A3
Total		3,120.71	