Rating Rationale

M.S. Hightech Steel Private Limited

Rating

Facility	Amount (Rs. In Million)	Rating	Rating Action
Long Term Bank Facilities	335.00	CARE-NP B+ [Single B Plus]	Assigned
Short Term Bank Facilities	465.00	CARE-NP A4 [A Four]	Assigned
Total Facilities	**800.00**		

Details of Facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has assigned rating of 'CARE-NP B+' to the long-term bank facilities and 'CARE-NP A4' to the short-term bank facilities of M.S. Hightech Steel Private Limited (MHPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of MHPL are constrained by eroded networth of the company coupled with highly leveraged capital structure and weak debt service coverage indicators at the end of FY20 (Unaudited, refers to 12 months period ended mid-July 2020), subdued operational and financial performance characterized by decline in sales and net loss in FY20 mainly due to impact of COVID-19 on the business of the company. The ratings also factor in limited track record of operations, raw material price volatility risk, working capital intensive nature of operations, exposure to volatile interest rates and presence in highly fragmented & competitive nature of steel industry. The ratings however, derive strength from experienced management team, backward integration of the plant likely to provide cost benefits in future and demand of steel products in the country. Ability of MHPL to manage growth in operations & to maintain 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 business 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 the lockdown period, sales of the company has been directly impacted for FY20. However, with government easing restriction for various activities recently, operations, revenue and profitability of the company is also expected to improve in FY21. With various construction activities taking pace, demand of steel products is also likely to improve.

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

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Eroded networth followed by highly leveraged capital structure and weak debt service coverage indicators at the end of FY20

The financial risk profile of the company was below average marked by negative Networth in the books of the company at the end of FY20. Networth of the company was negative due to continuous loss suffered by the company over the period resulting into negative reserve and surplus. MHPL had weak interest coverage ratio of 0.39x in FY20. During FY20, the promoters have injected Rs. 20 Mn as equity share capital to support the operations of the company.

Subdued operational and financial performance characterized by decline in sales with net loss in FY20

MHPL had low-capacity utilization of 28% during FY20 which reduced from 43% during FY19. Manufacturing operations as well as revenue of MHPL has been impacted by lockdown imposed by the GoN. Total revenue of the company declined by ~26% in FY20 to Rs. 467 Mn due to which PBILDT of the company also declined by ~62%. The reduction in PBILDT was also due to increased electricity expenses during FY20 on account of full year operation of the ingot manufacturing plant. This was partially offset by decline in average raw material cost during FY20 by ~27%. MHPL incurred net loss of Rs. 58 Mn during FY20 majorly due to increase in interest expense of the company.

Limited track record of operations, however with experienced management team in various sectors

MHPL has limited operational track record of around four years in manufacturing Angle, Channel, Flat, and Square. The promoters of MHPL have an experience of more than a decade in various industries. MHPL is managed under the overall guidance of its five members Board of Directors (BoD) which includes experienced businessmen/industrialist with wide experience in the manufacturing sector. Mr. Mahesh Bhattarai is the Chairman of MHPL and has 25 years of experience in various types of business and industries. He is also director in Broadband Nepal Private Limited and Jagadamba Cold Store and Seeds Production Private Limited.

Raw material price volatility risk

The major raw material for MHPL is ingot and billet. The company also has backward integration for manufacturing of ingot for which MHPL procures iron scrap and sponge iron locally from the domestic market. However, billet is imported from India. The prices of the MHPL'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. Raw material cost continues to be the major cost component of MHPL constituting around 79% of the total operating income of the company, thus, any volatility in prices of the same impacts the profitability of the company. The ability of the company to pass through adverse changes in raw material prices to the customers will be the key rating sensitivities.

Working capital intensive nature of operations

The operations of the company are working capital intensive in nature. Raw material such as iron scrap and sponge iron for producing ingot is procured domestically for which company has to make advance payment. Further, billet is imported from India through Letter of credit. Also, MHPL has to fund the inventory and debtors which lead to high reliance on working capital limits. MHPL generally allows three-four months credit period to its customers, average debtors turnover days was 132 days during FY20. The company keeps inventory for around three months and the average inventory turnover was 87 days for the FY20. Total average operating cycle of the company was 154 days in FY20 which increased from 100 days in FY19. 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 90% during last 12 months period ended mid-December, 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 angle, flat, channels & related products is low, resulting into low product differentiation in the market. 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

Backward integration of the plant likely to provide cost benefits in future

The company has expanded its business by starting its own unit for manufacturing of the major raw material i.e. ingot for in house consumption with capacity of 27,000 MTPA. The in-house consumption of ingot into angle, flat, channel and square is expected to reduce the production cost of the company. The key raw material required in manufacturing of ingot is sponge iron and iron scrap, both of which are locally procured from the vendors directly. Processing of sponge iron and scrap materials is economically viable, because of high value of raw materials and the relatively low cost of processing leading to savings in cost of power and fuel.

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 recent budget presented by finance minister of Nepal for FY21, government has allocated Rs. 55 Bn towards post-earthquake reconstruction. 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 in the budget for FY20-21 is likely to benefit the steel products manufacturers like MHPL.

About the Company

M.S. Hightech Steel Private Limited (MHPL) is a private limited company incorporated on September 10, 2014 for manufacturing Angle, Channel, Flat and Square steel products with total installed capacity of 27,000 MTPA for these products. The company has also backward integrated its plant recently and has started to manufacture Ingot with installed capacity of 27,000 MTPA. The plant is located in Nawalparasi district, Nepal.

Brief financial performance of MHPL during last 3 years is given below:

(Rs. Million)

Particulars	FY18	FY19	FY20
	(Audited)		(Provisional)
Income from Operations	395	628	467
PBILDT	6	65	24
PAT	(37)	1	(58)
Overall Gearing (times)	(12.11)	(203.05)	(9.80)
Interest coverage (times)	0.19	1.45	0.39

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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	Long Term Loan	335.00	CARE-NP B+
Short Term Bank Facilities	Fund Based Limits	465.00	CARE-NP A4
Total		**800.00**	