Rating Rationale

Mainawati Steel Industries Private Limited

Rating

Facilities	Amount (Rs. In Million)	Rating[1]	Rating Action
Long Term Bank Facilities	314.10	CARE-NP BBB- [Triple B Minus]	Reaffirmed with removal of ratings from credit watch with negative implications
Short Term Bank Facilities	5,302.86	CARE-NP A3 [A Three]	Reaffirmed with removal of ratings from credit watch with negative implications
Total Facilities	**5,616.96 (Reduced from Rs. 5,617.42 Mn)**		

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 Mainawati Steel Industries Private Limited (MSPL). 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 MSPL continue to derive strength from established and long track record of operations along with strong promoters and experienced management team in the related field, improvement in PBILDT and PBILDT margin in FY20 (Audited, refers to 12 months period ended mid-July 2020), alongwith improvement in the capital structure and debt service coverage indicators of the company. The rating also factors in diverse product range catering to wide spectrum of industries with established marketing setup and demand of steels products in the country. The ratings are, however, constrained by decline in operational and financial profile during FY20 characterized by decline in sales, PAT and internal accruals due to impact of COVID-19 pandemic. The ratings also continue to be constrained by raw material price volatility risk 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 the company to manage growth in operations, 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.

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

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

the lockdown period, sales of the company has been directly impacted in 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.

Detailed Description of the Key Rating Drivers

Key Rating Strength

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

MSPL has an operational track record of more than two decades in manufacturing of MS black pipes, galvanized pipes, tubes and pipes. The promoters of MSPL have an experience of over two decades in the tubes & pipes industry. MSPL derives strength from its strong promoters and being a part of the Vishal Group of Companies, which have a strong presence in Nepal through their group entities in trade, manufacturing, hospitality, insurance and banking. MSPL is managed under the overall guidance of its two-member Board of Directors (BoD) which includes eminent Businessmen/Industrialists with wide experience in the manufacturing sectors. Mr. Tulsi Ram Agrawal is the Chairman of MSPL, and has more than 45 years of experience in manufacturing industry, banking sector, insurance sector and trading business. He is the Chairman of NIC Asia Bank Limited (rated CARE NP A). The promoters are supported by a team of technically qualified and experienced professionals to run the day-to-day operations of MSPL.

Moderate capital structure and debt service coverage indicators of the company

Debt-Equity ratio of the company has been low at 0.26x at the end of FY20 which however increased from 0.20x at the end of FY19 on account of additional term loan availed for part funding the capital expenditure. Overall gearing ratio of the company was moderate at 1.94x at the end of FY20 which improved substantially from 3.28x at the end of FY19 due to decline in working capital loans utilization at the end of FY20 followed by increase in net worth on back of accretion of the profit to the net worth. MSPL had comfortable interest coverage ratio of 4.32x and Total debt/ Gross Cash Accruals was high at 8.69x in FY20.

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

MSPL has been manufacturing iron & steel products in wide range having different usages. They are manufacturing mild steel (MS) black pipes & galvanized (GI) pipes and their variants. Tubular pole, telescopic pole, structure, shutter profile etc. are the major products that MSPL are selling in the market along with selling galvanized plain sheets (GP Sheet), hot rolled coil (HRC) sheet and cold rolled coil (CRC) sheet by cutting it in different sizes. MSPL sell its product all over Nepal and the sales are majorly through direct marketing to existing as well as new customers. Most of the sales revenue comes through direct domestic sales, followed by tender based sales and a minimal sale is through export to India.

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 MSPL.

Key Rating Weakness

Decline in operational and financial profile during FY20 characterized by decline in sales, PAT and internal accruals, however with increased PBILDT and PBILDT margin

MSPL was able to maintain moderate utilization of 58% during FY19 which has however reduced to 53% during FY20. Manufacturing operations as well as revenue of MSPL has been impacted by lockdown imposed by the GoN resulting into decline in total revenue by ~9% during FY20. Despite decline in the total revenue, PBILDT and PBILDT margins of the company improved majorly due to higher proportionate decline in cost of raw material compared to decline in sales price realization leading to better margins. PAT of the company declined by ~27% in FY20 majorly due to provision for doubtful debtors followed by significant increase in foreign exchange loss as well as increased depreciation on account of capex during the year. This was marginally offset by decline in interest expenses in FY20 as well as company booking gain from sale of listed shares held by the company.

Working capital intensive nature of operations

The operations of the company are working capital intensive in nature. MSPL is involved in manufacturing wide range of steel products by majorly importing raw materials which are procured through Letter of Credit. Also, the company has to fund the inventory and debtors in line with the industry trend which lead to high reliance on working capital limits. In absolute value terms, the debtor outstanding at the end of FY20 declined, however. average debtors' turnover days increased due to impact of base decline in FY20 on account of reduced sales. Due to base decline in revenue during FY20, total operating cycle of the company increased from 168 days in FY19 to 218 days in FY20 leading to high reliance of the company on the bank finance for working capital needs. The average utilization of fund-based working capital limit against drawing power was around 83% during last 12 months period ended mid-November, 2020.

Raw material price volatility risk and foreign exchange fluctuation risk

The major raw materials for MSPL are majorly imported from India and the prices 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 76% of the total operating income of the company, thus, any volatility in prices of the same impacts the profitability of the company. Further, the majority of the raw material requirements are met through imports and the price of the same are linked to USD, for which the company is exposed to the foreign exchange fluctuation risk. MSPL has incurred foreign exchange fluctuation loss of Rs. 1 Mn during FY19 which increased to Rs. 98 Mn during FY20. However, same is also mitigated to some extent as the company has started practice of regularly monitoring the foreign exchange market and has been making forward booking also. The ability of the company to pass through of 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.

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 other industry players in FY20.

About the Company

Mainawati Steel Industries Private Limited (MSPL) is a private limited company incorporated on May 17, 1995 for setting up of M.S. Black & Galvanized pipe plant in Sunsari district of Nepal. The company is into manufacturing wide range of steel products which primarily include MS black pipes, galvanized pipes, tubes and its variants. Currently, the total installed plant capacity of the plant is 94,450 Metric Tons Per Annum (MTPA).

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

(Rs. In Million)

Particulars	FY18 (A)	FY19 (A)	FY20 (A)
Income from Operations	4,766	5,744	5,245
PBILDT	583	580	699
PAT	328	294	213
Overall Gearing (times)	2.80	3.28	1.94
Interest coverage (times)	8.56	3.42	4.32

Analyst Contact	Group Head	Relationship Contact
Mr. Utsav Baral	Ms. Shalini Sanghai	Mr. Sajan Goyal
utsav.baral@careratingsnepal.com	shalini.sanghai@careratingsnepal.com	sajan.goyal@careratingsnepal.com
Tel No.: +977-01-4012628	Tel No.: +977-01-4012629	Tel No.: 9818832909/+977-01-4012628/29/30

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	314.10	CARE-NP BBB-
Short Term Bank Facilities	Fund Bases Limit	4,860.16	CARE-NP A3
Short Term Bank Facilities	Non-Fund Based Limit	442.70	CARE-NP A3
Total		**5,616.96**	