

Rating Rationale
Narayani Ispat Private Limited

Rating

Facility/ Instrument	Amount (Rs. In Million)	Rating ¹	Rating Action
Long Term Bank Facilities	1,101.34	CARE-NP BB- [Double B Minus]	Reaffirmed
Short Term Bank Facilities	2,806.00	CARE-NP A4 [A Four]	Reaffirmed
Total facilities	3907.34 (Reduced from Rs. 3,995.59 Mn)		

Details of Facilities in Annexure 1

CARE Ratings Nepal Ltd. (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 Narayani Ispat Private Limited (NIPL).

Detailed Rationale & Key Rating Drivers

The reaffirmation of the ratings assigned to the bank facilities of NIPL factors in deteriorated financial performance of the company during FY20 (audited, refers to 12 months period ended mid-July 2020) characterized by decline in sales and net loss due to impact of Covid-19 albeit with improved PBILDT margins coupled with highly leveraged capital structure and weak debt service coverage indicators at the end of FY20, however with improvement in financial performance during H1FY21 (provisional, refers to 6 months period ended mid-January 2021). The ratings also factor in working capital intensive nature of operations, raw material price volatility risk along with 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 strong presence of the promoter group in steel sector supported by experienced management team, backward integration of the plant resulting savings in manufacturing cost, established brand and marketing network of the group with country wide presence. The ratings also factor in locational advantage and demand of steels products in the country. The ability of the company to manage growth in the operations & improve profit margins along with 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 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.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

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

Deteriorated financial performance of the company during FY20 characterized by decline in sales and net loss, however with improved PBILDT in FY20 as well as improvement during H1FY21

Capacity utilization of the company was low at ~32% in FY19 which further declined to ~27% in FY20. Manufacturing operations as well as revenue of the company got impacted by lockdown imposed by the GoN leading to decline in total revenue by ~15% to Rs. 3,587 Mn in FY20. Despite decline in total revenue, PBILDT and PBILDT margin of the company improved in FY20 due to saving in manufacturing cost by the company on account of utilizing in-house produced billets for manufacturing. However, with increase in interest expenses on account of higher utilization of working capital loans, NIPL incurred net loss in FY20. During H1FY21, the capacity utilization of the company was low at 21.83% with NIPL booking total revenue of Rs. 2,558 Mn and PBILDT margin remained at same level of 6.25%.

Highly leveraged capital structure and weak debt service coverage indicators

Debt-equity ratio of the company was high at 4.17x at the end of FY20 which deteriorated from 2.58x at the end of FY19 mainly due to disbursement of term loan to fund capital expenditures of the company followed by decline in networth with company making continuous losses from its operation. This was however partially offset by repayment of loan from directors. Overall gearing ratio deteriorated in FY20 to 11.52x at the end of FY20 from 7.64x at the end of FY19. However, with improvement in the networth in H1FY21, despite increase in working capital loans to fund higher imports, overall gearing ratio has marginally improved to 10.86x at the end of H1FY21. Interest coverage ratio was low at 0.77x in FY20 which however has improved to 2.04x in H1FY21.

Working capital intensive nature of operations

The operations of the company are working capital intensive in nature as NIPL manufactures TMT Bars by procuring raw materials domestically as well as through imports. After the commencement of the billet manufacturing unit in May 2019, NIPL is importing sponge iron from India for manufacturing billets through Letter of Credit. Also, NIPL has to fund inventory and debtors which lead to high reliance on working capital limits. Total operating cycle of the company increased from 141 days in FY19 to 165 days in FY20 leading to high reliance of the company on the bank finance for working capital needs. The average monthly outstanding of fund-based working capital limit against drawing power was around 92% during last 12 months period ended mid-January 2021.

Raw material price volatility risk and foreign exchange fluctuation risk

The major raw materials for NIPL being sponge iron is imported from India while scrap is procured from the domestic market. The prices of the NIPL'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 having a bearing on its profitability margins. The raw material consumption cost contributed around 68% of the total operating income of the company during FY20, thus, any volatility in prices of the same impacts the profitability of the company. Also, the company is exposed to foreign exchange fluctuation risk as the prices are linked to

USD. NIPL incurred foreign exchange fluctuation loss of Rs. 9 Mn in FY20 which however reduced from Rs. 12 Mn in FY19. 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.

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 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 completion has intensified which has resulted into substantial decline in profitability margins of the industry players in FY20.

Key Rating Strengths

Strong presence of the promoter group in steel sector supported by experienced management team

Although NIPL commenced its operations only in July 2018, the promoters of the company have wide experience in manufacturing steel and other construction materials for more than three decades. NIPL is part of the Keyal group of companies of Nepal which is a diversified business group with strong presence in a broad range of business, manufacturing and industrial interests with main focus on manufacturing construction materials. The group also has 15 hardware outlets across the country which are strongly contributing to the group's steel business. The company is managed under the overall guidance of its nine members Board of Directors (BoD) which includes experienced businessmen/industrialist from the Keyal group with wide experience in the manufacturing sector. Mr. Bikash Kumar Keyal, Chairman of NIPL, has been involved in the groups business for the past 15 years and looks after the whole group's accounting and finance. Mr. Satya Narayan Keyal, Director of NIPL and also Chairman of the Keyal group of companies has more than 30 years of experience in trading and manufacturing industry.

Backward integration of the plant resulting savings in manufacturing cost

The company has expanded its business for manufacturing M.S. Billets for in house consumption with capacity 87,000 MTPA from May 2019. The in-house consumption of M.S. Billets into TMT Bars has reduced the production cost of the company. The key raw material required in manufacturing of MS Billets is sponge iron and scrap, where sponge iron is being imported from India and scrap is being 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.

Established brand and marketing network of the group with country wide presence

The company sells TMT bars under the brand name of “Narayani Steels” which is already an established brand in the Nepal market on account of its long-standing presence in the construction materials manufacturing and trading industry. This provides leverage to the company in front of new players entering the industry. The group also has 15 in-house hardware trading outlets in and around the Kathmandu Valley which makes it easier to penetrate into the market and cater to large section of customers. Also, the group already has a well-established dealer/distributor network in around 129 areas across the country which provides a ready market for its products.

Locational advantage

The plant site is located in Chhatapipra, Simara, around 15 Kms from Indo-Nepal borders in Birgunj dry-port. Since majority of raw materials used by NIPL are imported from India, the factory’s proximity to the border remains a positive point leading to savings in huge freight cost.

Demand of steels products in the country

Nepalese economy is developing and growing and is in phase of investment in infrastructure, power sector and tourism sector. In the budget presented by finance minister of Nepal for FY21, government has allocated Rs. 55 Bn for reconstruction with major focus towards development of health sectors, tourism sectors and other infrastructure development. 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 steel manufacturers like NIPL.

About the Company

Narayani Ispat Private Limited (NIPL) is a private limited company incorporated on September 17, 2009 for manufacturing of TMT bars and other allied steel products at factory located in Simara, Nepal. NIPL is part of the Keyal group of companies of Nepal and all the shares of the company are held by individual promoter from Keyal group. The company commissioned operations in July 2018 with capacity of 216,000 MTPA for manufacturing rolled products such as TMT bars, M.S Round etc. The company has also set up a M.S. Billet manufacturing plant of 87,000 MTPA capacity which commissioned operations in May 2019. Brief Financial Performance during the last 3 years and H1FY21 is as follows:

(Rs. In Million)

For the year ended Mid July	FY18	FY19	FY20	H1FY21
	(Audited)			(Unaudited)
Income from Operations	315	4,229	3,587	2,558
PBILD Margin (%)	3.00	4.33	6.29	6.25
Overall Gearing (times)	8.22	7.64	11.52	10.86
Interest coverage (times)	1.23	0.89	0.77	2.04
Current Ratio (times)	0.86	0.87	0.77	0.79
Total Debt/Gross Cash Accruals (times)	1,456.40	(93.37)	(41.94)	50.78

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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	1,101.34	CARE-NP BB-
Short Term Bank Facilities	Fund Based Limit	870.00	CARE-NP A4
Short Term Bank Facilities	Non-Fund Based Limit	1,936.00	CARE-NP A4
Total		3,907.34	