

Rating Rationale

Vijayshri Steel Private Limited

Rating

Facility	Amount (Rs. In Million)	Rating ¹	Rating Action
Long Term Bank Facilities	347.92	CARE-NP BB [Double B]	Reaffirmed
Short Term Bank Facilities	3,200.00	CARE-NP A4+ [A Four Plus]	Revised from CARE-NP A4 [A Four]
Total Facilities	3,547.92 (Reduced from Rs. 4,014.74 Mn)		

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 revised the rating of ‘CARE- NP A4’ to ‘CARE-NP A4+’ assigned to the short-term bank facilities of Vijayshri Steel Private Limited (VSPL).

Detailed Rationale & Key Rating Drivers

The revision in the rating assigned to VSPL majorly takes into account the improvement in the financial risk profile of the company during FY20 (audited, refers to 12 months period ended mid-July 2020) and H1FY21 (Provisional, refers to 6 months period ended mid-January 2021) leading to increase in the cash generation and prepayment of the term debt in the current financial year. The ratings however, continues to be constrained by leveraged capital structure and weak debt service coverage indicators at the end of FY20, working capital intensive nature of operations, raw material price volatility and foreign exchange fluctuation risk. The rating also factors in VSPL’s exposure to volatile interest rates, and presence in highly fragmented and competitive nature of steel industry. The ratings, however, derive strength from growth in revenue in FY20 being the first full year of operation, improvement in the financial risk profile leading to improvement in debt service coverage indicators, established business group and promoter’s experience in cement manufacturing and trading businesses, demand of steel products in the country and locational advantage of its facilities. Ability of the company to scale up its operation with improvement in capacity utilization, manage growth in revenue and improve profitability margins will be the key rating sensitivities. Also, ability to pass through changes in raw material prices to the customers and manage 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 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

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

expected to improve in FY21. With various construction activities taking pace, demand of steel products is also likely to improve during current year.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Leveraged capital structure and weak debt service coverage indicators

Debt-equity ratio of the company was low at 0.85x at the end of FY20 which improved from 4.10x at the end of FY19 upon scheduled repayment of term loans as well as conversion of promoters' loan into share application money resulting improvement in networth of the company. Total gearing ratio of the company remained high at 4.73x at the end of FY20 which however, improved from 7.71x at the end of FY19. Interest coverage ratio of the company was moderate at 1.89x and Total debt/ Gross Cash Accruals was high at 68.52x in FY20. Interest coverage ratio has further improved to 3.81x during H1FY21.

Working capital intensive nature of operations

The operations of the company are working capital intensive in nature as VSPL is involved in the manufacturing of TMT Bars by importing raw materials through Letter of Credit. Also, VSPL has to fund inventory and debtors which lead to high reliance on working capital limits. Total operating cycle of the company was 147 days in FY20 which increased from 138 days in FY19 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 98.23% during last 12 months period ended mid-January 2021.

Raw material price volatility risk and foreign exchange fluctuation risk

VSPL not having any backward integration, imports its basic raw material (MS Billets) from India, the prices of which 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 85% of the total operating income 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. VSPL incurred foreign exchange loss of Rs. 48 Mn during FY20 which increased from Rs. 4 Mn during 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

Growth in revenue in FY20 being the first full year of operation

VSPL had commenced its manufacturing operations from November 25, 2018 and hence FY20 was the first full year operation for the company, however impacted by the lockdown imposed on account of Covid-19. The capacity utilization of the company improved to 28.91% in FY20 compared to 21.85% in FY19. The total revenue of the company increased by ~115% to Rs. 3,954 Mn in FY20 resulting improvement in PBILDT and PBILDT margin in FY20. Improvement in PBILDT margin was also due to decline in raw material cost during the period followed by saving in the manufacturing cost with scaling up of operation. With this, VSPL booked net profit in FY20 compared to net loss in FY19. During H1FY21, the company has booked total revenue of Rs. 2,446 Mn and PBILDT of Rs. 132 Mn with PBILDT margin of 5.41%.

Established business group and experienced promoter in cement manufacturing and trading business

VSPL is promoted by individuals who are associated with Vijaya Group of companies of Nepal which has a presence of more than 30 years in the industry. Currently, the Group is involved in importing and manufacturing cement, manufacturing batteries, importing bitumen and trading, agriculture and education sector. The group manufactures cement under the company Bijaya Cements Private Limited. Since the group is operating in cement business in the Nepalese market for more than a decade with over 400 dealers, it gives them an advantage of existing distribution channel for marketing of goods manufactured by VSPL. The company is managed under overall guidance of its four members Board of Directors. Mr. Vikash Kedia, Chairman, has industrial experience of more than 18 years. Mr. Pradeep Agarwal, Director, looks after the day to day operations of the company.

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 VSPL.

Locational advantage

The plant is located at Shivaraj, Kapilvastu which is at a distance of ~11km from Barhni border, India and ~98 km from Sunauli border, India, which gives VSPL an advantage of supply of raw material at lower transportation cost in comparison to their competitors. Presently, VSPL is importing raw materials from Barhni border. The plant is situated nearby to the East-West Highway of Nepal which provides road access

for supply of finished products to the major markets. Also, most of the steel factories are concentrated in eastern parts of Nepal. Hence, VSPL can exploit opportunities while focusing in the Central and Western parts of Nepal.

About the Company

VSPL is a private limited company, incorporated on February 23, 2017 to set up a TMT bar manufacturing plant in Kapilvastu district of Nepal. The company is promoted by businessmen engaged in manufacturing and trading business. The company manufactures TMT bars by importing raw materials from India and selling them into Nepal's market with production capacity of 700 MT of TMT bars per day. The plant achieved Commercial Operation Date on November 25, 2018.

Brief financials of VSPL for FY19 and FY20 is given below:

(Rs. Million)		
For the year ended Mid-July	FY19 (Audited)	FY20 (Audited)
Income from Operations	1,843	3,954
PBILDT Margin (%)	0.57	4.59
Overall Gearing (times)	7.71	4.73
Interest Coverage (times)	1.05	1.89
Current Ratio (times)	1.13	0.98
Total Debt/Gross Cash Accruals (times)	(599.45)	68.52

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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	347.92	CARE-NP BB
Short Term Bank Facilities	Fund Based Limit	1,700.00	CARE-NP A4+
Short Term Bank Facilities	Non-Fund Based Limit	1,500.00	CARE-NP A4+
Total		3,547.92	