Rating Rationale

Aarti Strips Private Limited

Rating

Facility/ Instrument	Amount (Rs. Million)	Rating[1]	Rating Action
Long Term Bank Facilities	1,574.70	CARE-NP BB+[Double B Plus]	Reaffirmed
Short Term Bank Facilities	10,200.00	CARE-NP A4+[A Four Plus]	Reaffirmed
Total Bank Facilities	**11,774.70**		

Details of Facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has reaffirmed the rating of 'CARE-NP BB+' assigned to the long term bank facilities and 'CARE-NP A4+' assigned to the short term bank facilities of Aarti Strips Private Limited (ASPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of ASPL are constrained by subdued financial performance of the company in FY20 (refers to 12 months period ended mid-July 2020) marked by decline in sales and profitability, implementation and stabilization risk associated with debt funded brownfield project and raw material price volatility risk along with foreign exchange fluctuation risk. The ratings also factor in working capital intensive nature of operations, exposure to volatile interest rates and presence in highly fragmented & competitive nature of steel industry. The ratings also took cognizance of improvement in financial risk profile during 9MFY21 (Unaudited, refers to 9 months period ended mid-April, 2021).

The ratings however, derives strength from long track record of operations in Nepal with experienced professional management team and moderate capital structure and debt service coverage indicators. The ratings also factors in established brand with country wide market presence and large scale of operations, diverse product range catering to wide spectrum of industries with strong marketing setup and expected demand of steel products in the country post COVID-19 crisis and ability of the company to export steel products.

Ability of ASPL to manage growth in the operations & improve the profit margins and rationalization of its debt through efficient working capital management would be the key rating sensitivities. Furthermore, timely completion of the capex within proposed cost estimations and realizing envisaged benefits therefrom would also be the key rating sensitivities.

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

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Subdued financial performance in FY20

During FY20, ASPL witnessed decline in capacity utilization in almost all the verticals with total quantity produced dropping by 18% to 135,788 MT coupled with decline in total quantity sold by 15% to 130,764 MT. Attributed to same, total sales of the company declined by 28% in FY20 to Rs. 12,301 Mn. The operations of the company was significantly impacted in Y20 due to the lockdown imposed during the year by the GoN on account of Covid-19 which has directly impacted the sales of the company. During FY20, the sales mix of the company changed as compared to FY19 which also resulted into declining margins coupled with decline in average price realization.

PBILDT of the company declined to Rs. 723 Mn in FY20 with reduced PBILDT margin of 5.87% in FY20 from 7.62% in FY19. Profitability of the company was severely impacted during FY20 with decline in PAT margins due to above mentioned factors.

Current year performance in 9MFY21:

During 9 months period ended Jan 21, the company has achieved sales of Rs. 10,446 Mn with improvement in average price realization by 18% to Rs. 109,421 per MT from FY20 average realization. Due to this PBILDT margin has improved to 15.04% with PBILDT of Rs 1,574 Mn with significant improvement in profitability of the company.

Implementation and stabilization risk associated with debt funded brownfield project

The company is expected to incur a capex of Rs. 2,000 Mn in the next two years by setting up a new Cold Rolling Mill (CRM) in its premises. The funding of the same would be done by a combination of debt: equity mix of 70:30 and debt for the same is yet to be tied up. CRM plant is proposed to be operational from January 2022 and part cost has already been incurred till 9MFY21. The ongoing expansion is on account of company's planning to reduce its dependence on import of Cold Rolled Coil and would be a backward integrated unit.

The capital expenditure will reduce the dependency on importing CR coil, however company currently remains susceptible to risk related with implementation and funding. Any delays in the implementation may impact the company's financial risk profile and is also crucial from credit perspective. The debt funded project is expected to moderate the gearing levels in the medium term.

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Raw material price volatility risk and foreign exchange fluctuation risk

ASPL does not have any backward integration for its basic raw material (HR/CR Coils & Sheets, MS Billets) and the raw materials are majorly imported from India and China. The prices of the HR/CR Coils & Sheets and billets are market linked and determined on a periodic basis. The company keeps inventory of around two months, thus exposing the company to the volatility in the prices of raw materials which has a bearing on its profitability margins. The cost of raw material consumed as % of the total operating income of the company was around 78% in FY20, thus, any volatility in prices of the same impacts the profitability of the company. Further, around 99% of its raw material requirements is met through imports and the price of the same are linked to USD, for which it is exposed to the foreign exchange fluctuation risk. To prevent the impact of foreign exchange fluctuation on profitability, ASPL does forward contract for all forex transactions on regular basis. The ability of the company to pass through of changes in raw material prices to the finished products and managing the foreign exchange fluctuation risks related to raw materials by hedging will be the key rating sensitivities.

Working Capital Intensive Nature of Operations

The company has working capital intensive nature of operations as reflected by low current ratio of 1.04x at the end of FY20. The company has exceptionally high average operating days of 195 days in FY20 on account of lockdown imposed in the last financial year due to which company had high levels of debtors and inventory in the year end. Being a highly competitive business, the company has to extend credit period to its dealers which is upto 90 days whereas company has to make immediate payment to its suppliers. The company is required to maintain adequate inventory of raw material for smooth running of its production processes. Furthermore, being a manufacturer, it is critical for the company to maintain minimum inventory levels to meet immediate demand of its customers; all this led to high working capital requirements. The high working capital requirements were met largely through bank borrowings which resulted in an average utilization of approximately 87% of its working capital limits for the last 12 months period ended March 2021.

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. Given the fact that the entry barriers to the industry are low, the players in the industry do not have pricing power and are exposed to competition-induced pressures on profitability. 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 MS. Black Pipe, TMT bar & related products is low, resulting into low product differentiation in the market. ASPL is one of the leading player in Nepal market in galvanized and colour coated sheet segment and also has dominant position in manufacturing ultra-thin flat products which reduces competition to certain extent.

Key Rating Strengths

Established and long track record of operations in Nepal with experienced professional management team

ASPL has an operational track record of more than 15 years in manufacturing galvanized and color coated iron sheets and has been manufacturing MS black pipes for more than 5 years. The company is promoted by four Indian investment companies which has been primarily incorporated for promoting ASPL and are core investment companies. The ultimate beneficiary of the above mentioned investment companies is Mr. Aniket Singal, son of Mr. Sanjay Singal, who is an Indian Businessman related to steel industry. Mr. Aniket Singal is an M.B.A. from Oxford University & has experience of around 6 years in the industry. ASPL is managed under the overall guidance of its two member Board of Directors (BoD) who are qualified professionals with wide experience in the manufacturing industry. Mr. Vishal Gupta, Director of ASPL has an overall experience of 22 years and looks after day to day operations of the company.

Moderate capital structure and debt service coverage indicators

Debt-Equity ratio of the company continues to remain low at 0.31x at the end of FY20 which improved marginally from 0.38x at the end of FY19 on account of scheduled repayment of term loans and accretion of profit to reserves.

However, with company proposing to avail additional term loan in FY22 to part finance the capital expenditure for setting up a cold rolling mill, the gearing ratios are expected to be impacted, although being at moderate levels.

Total gearing ratio of the company continues to be moderate at 1.59x at the end of FY20. Interest coverage ratio of ASPL deteriorated from 5.17x in FY19 to 2.55x in FY20 due to decline in PBILDT generated in FY20. Total debt/GCA has deteriorated from 9.17x in FY19 to 25.76x in FY20 majorly due to decline in GCA generated during the year. At the end of 9MFY21, overall gearing stood moderate at 1.38x with interest coverage ratio of 2.39x, however, total debt to GCA continued to remain high at 9.24x during the period.

Established brand with country wide market presence and large scale of operation

ASPL sells its color coated sheets under the brand name "Aarti Spectra" and galvanized sheets and MS pipes under the brand name "Aarti Suraksha" which is an established brand in the Nepal market on account of its long-standing presence in the construction industry. TMT bar are sold under the brand name of "Aarti Perfect" and "Aarti Tiger". The company is into the business for more than 15 years and is one of the major player in the country. This provides leverage to the company in front of new players entering the industry. Established brand image ensures customer loyalty and aid in the differentiation of products with the competitors. Additionally, the company markets and sells its entire range of products through a well-established network of around 200 dealers across all major cities in the country which provides a ready market for its product

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

ASPL manufactures an array of flat products ranging from Galvanized Plain/Galvanized Corrugated, Ridge Galvanized Iron & Colour Coated with Zinc Based Pre-Printed Galvanized Iron (PPGI), Profile Sheets, MS Tube and Shutter Patti. ASPL has further expanded its portfolio by entering into manufacturing TMT bar from January 2019 onwards. ASPL manufactures a range of galvanized sheets of varying thickness. The products manufactured by the company find applications in varied industries such as construction and infrastructure, white goods and automotive industry. Further, ASPL has created a niche market for its colour coated products and multi colour sheets etc. The wide application not only diffuses the risk of dependency on a single industry but also allows the company to cater to a larger market with a broad customer base.

Proximity to Indian border leading to savings in freight cost and generating export sales

The plant site is located in Biratnagar around 15 kms from Indo-Nepal borders. Since majority of raw materials used by ASPL are imported from India, the factory's proximity to the border remains a positive point leading to savings in freight cost. Further, ASPL has also been exporting its products mainly colour coated sheets to neighboring Indian states like West Bengal, Bihar and Assam and has made export sales of Rs. 2,920 Mn during FY19 and Rs. 1,055 Mn during FY20 which accounts for ~ 17% and 9% of total sales respectively.

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. It is highly probable that the national economy will be in need of construction materials in developing public as well as private infrastructures, road, bridges and other public facilities. Further, followed by devastating earthquake of April 2015, Government commitment towards infrastructure and rebuilding the housing sector has increased demand of iron and steel products in Nepal. However, with the outbreak of COVID-19 resulting into nationwide lockdown and slowdown in economic activities the demand of steel products is expected to be impacted in the near term. The demand for iron and steel is expected to grow in the long term as a result of increased development works post the COVID-19 crisis.

About the Company

Aarti Strips Pvt. Ltd. (ASPL) is a private limited company which was incorporated on January 21, 2001 for setting up a wet flux galvanized plain and corrugated sheets manufacturing facility at Biratnagar, district Morang, Nepal. The company is into manufacturing wide range of steel products with total installed plant capacity of 340,000 Metric Tons Per Annum (MTPA) in FY20 and is one of the leading player in the industry.

Brief Financial Performance during the last 3 years is as follows:

(Rs. In Million)

For the year ended Mid July	FY18	FY19	FY20	9MFY21
	Audited			*Unaudited*
Income from Operations	15,142	16,996	12,320	10,466
PBILDT Margin (%)	8.92	7.62	5.87	15.04
Overall Gearing (times)	1.30	1.71	1.59	1.38
Interest coverage (times)	4.44	5.17	2.55	2.39
Current Ratio (times)	1.08	1.06	1.04	1.07
Total Debt/Gross Cash Accruals (times)	5.66	9.17	25.76	9.24

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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	1,574.70	**CARE-NP BB+**
Short Term Bank Facilities	Working Capital Loan	6,880.00	**CARE-NP A4+**
Short Term Bank Facilities	Non-fund based limits	3,320.00	**CARE-NP A4+**
Total		**11,774.70**	