Aarti Strips Private Limited

Ratings

Facilities	Amount (Rs. Million)	Rating[1]	Rating Action
Long Term Bank Facilities	2,489.40 (Increased from 1,574.70)	CARE-NP BBB- [Triple B Minus]	Revised from CARE-NP BB+
Short Term Bank Facilities	9,280.00 (Decreased from 10,200.00)	CARE-NP A3 [A Three]	Revised from CARE-NP A4+
Total	**11,769.40**		

Annexure-1 Details of Facilities/Instruments to be rated

CARE Ratings Nepal Limited (CRNL) has revised the ratings assigned to long term bank facilities of Aarti Strips Private Limited (ASPL) to `CARE-NP BBB-' from `CARE-NP BB+'. CRNL has also revised the ratings assigned to short term bank facilities of ASPL to `CARE-NP A3' from `CARE-NP A4+'.

Detailed Rationale & Key Rating Drivers

The revision in ratings assigned to ASPL takes into account improving financial performance marked by substantial improvement in margins and profitability in FY21-9MFY22 (Unaudited, refers to the nine-month period ended mid-April, 2022) and backward integration of Flat sheets which provides flexibility, boost product portfolio, revenue scope and enhance profitability. The ratings continue to derive strength from long track record of operations in Nepal with experienced management team and moderately leveraged capital structure and adequate debt service coverage indicators. The ratings also factor in established brand with country wide market presence, diverse product range catering to wide spectrum of industries and stable demand outlook of steel products in the country over the medium term.

The ratings are however, constrained by stabilization risk associated with debt-funded brownfield expansion, working capital intensive nature of operations, foreign exchange fluctuation risk and exposure to fluctuations in raw material price volatility. The ratings also factor in its presence of the company in highly competitive and cyclical nature of steel industry and exposure to volatile interest rates.

Going forward, stabilization of the brownfield expansion project with capacity utilization levels thereafter to generate sufficient cash-flows as envisaged will be the key rating sensitivity. The ability of the company to profitable scale up its operations coupled ability of the company to rationalize its debt levels though efficient working capital management would also be key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Strengths

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

ASPL has an operational track record of more than 16 years in manufacturing galvanized and color coated iron sheets and has been manufacturing MS black pipes for more than 6 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. Mr. Aniket Singal is post graduate degree in management from Oxford University & has experience of around a decade 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 23 years and looks after day to day operations of the company.

[1]Complete definition of the ratings assigned are available at www.careratingsnepal.com and other CARE publications

Established brand with country wide market presence

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 are an established brand in the Nepal market on account of its long-standing presence in the construction industry. TMT bars are sold under the brand name of "Aarti Perfect" and "Aarti Tiger". Galvalume Sheets are sold under the brand "Aarti Silver". The company is into the business for more than 16 years and is one of the major players 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 & Color 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 Galvaume Plain/Galvalume Corrugated from September, 2021 onwards. 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 less competitive market for its color coated products and multi-color 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.

Backward Integration of Flat Sheets provides flexibility, boost product portfolio, revenue scope and enhance profitability

The company has completed a brownfield expansion project of setting up a 150,000 MTPA of Cold Rolling Mill (CRM) Plant. The expansion was done to reduce its dependence on import of CR Coil from India and China and become self-reliant in making Cold Rolled sheets of desired thinness from HR Coil. Furthermore, the in-house production of Cold Rolled Sheets is expected to generate cost efficiencies and improve profitability margins. Furthermore, the company also will be able to explore sales opportunities for CR products both domestically and to India.

Similarly, ASPL had two galvanize line of capacity of 55,000 MTPA each, out of which one was converted to Galvalume with capacity of 100,000 MTPA. Galvalume line started commercial production from mid-sept, 2021. Scope of margins is higher in Galvalume sheets compared to galvanized sheets, which will also add up to the company's profitability profile going forward.

Improving financial performance marked by substantial improvement in margins and profitability in FY21-9MFY22

During FY21 (audited, refers to the twelve-month period ended mid-July, 2021) , ASPL reported increase in total income from operations by 10.52% yoy to Rs. 13,617 Mn owing to higher price realization in all product lines despite decrease in production and sales. Decrease in production and sales was on account of expansion going on during the period with one galvanized sheet unit being converted to Galvalume, impacting the overall production and sales. Similarly, favorable change in sales mix during FY21, resulted into substantial improvement in PBILDT margin, i.e., up by 638 bps to 12.25%. Consequently, net-profitability of the company was favorably impacted with increase in margins during FY21.

During 9MFY22, company has achieved sales of Rs. 10,117 Mn which is supported by increase in average price realization per ton. Similarly, PBILDT margin has improved to 13.93% with PBILDT of Rs. 1,410 Mn during the said period.

Moderately leveraged capital structure and adequate debt service coverage indicators

Capital Structure of the company is moderately leveraged as indicated by Debt-Equity ratio and Overall gearing ratio of 0.35x and 1.59x, respectively at the end of FY21 and remained almost stable over previous year. Furthermore, debt service coverage indicators were on improving trend in FY21 backed by increased profitability. Interest coverage ratio of ASPL improved to 2.86x in FY21 from 2.55x in FY20 and Total debt/GCA has improved to 7.81x in FY21, albeit still at high level from 25.76x in FY20. Although gearing levels are likely to moderate in FY22 amid additional debts taken to fund the expansion, it is likely to improve sequentially over the medium term with steady accretion of profits and moderation in debt levels as majority of the capex has already been completed in FY22.

Stable demand of steel products in the country expected to grow in the long term

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 and steel products in developing public as well as private infrastructures, road, bridges and other public facilities. Furthermore, the government's high emphasis on infrastructure development, namely development of roads, hydropower, airports and other infrastructures as included in the budget for FY23 is likely to benefit the steel manufacturers like ASPL.

Key Rating Weakness

Project stabilization risk associated with debt-funded expansion

The company has completed a brownfield expansion project of setting up a 150,000 MTPA Cold Rolling Mill (CRM) with a project cost of Rs. 2,500 Mn. The funding of the same was done by a combination of debt and equity mix of 66:34, out of which 91.24% (Rs. 1,505.60 Mn) of the debt is tied up and rest i.e. Rs. 144.60 Mn is expected to be sanctioned by FY23. The plant has two dimensions, 4HI and 6HI. Commercial production from 6HI plant has already started and for 4HI trail production started from mid-July, 2022. The expansion was done to reduce its dependence on import of CR Coil from India and China and become self-reliant in making Cold Rolled sheets of desired thinness from HR Coil. Being significant capacity expansion, the stabilization and streamlining of production remains to be seen. Furthermore, post project implementation risk, in the form of achieving the envisaged scale of business and improvement in profitability margins as envisaged will be the key rating sensitivities in the light of competitive nature of industry remains crucial for credit prospective.

Working capital intensive nature of operations

The company has working capital intensive nature of operations as reflected by low current ratio of 1.04x as at the end of FY21. ASPL is involved in manufacturing of wide range of steel products and is required to maintain adequate inventory of raw material for smooth running of its production processes and meet immediate demand of customers. Also, 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 net- operating days of 222 days in FY21 on account of high levels of inventory holding 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 which were largely met through bank borrowings.

Foreign exchange fluctuation risk and raw material price volatility risk

ASPL currently uses HR coils, Paints, aluminum, etc as major raw materials and the raw materials are majorly imported from India and China. The prices of the HR Coils & Sheets, Paints and aluminum 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 cost of production of the company was around 91% in FY21, thus, any volatility in prices of the same impacts the profitability of the company. Further in FY21, 99% of its raw material requirements is met through imports and the price of the same are linked to USD, however, after establishment of own CRM plant imports shall be reduced to around 75% of raw material requirement 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, however the cost of hedging has also gone up significantly. 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 crucial for maintaining its profitability margins.

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, galvalume and color coated sheet segment and also has dominant position in manufacturing ultra-thin flat products which reduces competition to certain extent.

Exposure to volatile interest rate risk

Nepalese banking sector has a floating interest rate regime, where a certain premium is added to the quarterly base rate and interest rate is changed accordingly on quarterly basis. The base rates of the banks and financial institutions (BFIs) in Nepal remain quite volatile as they are impacted by available liquidity in the system which leads to change in interest rates. The volatility in interest rate is more evident currently on account of the ongoing liquidity stress in the economy. Furthermore, increased bank rates announced in the Monetary Policy for FY23 is likely to add to the upward pressure on interest rates going forward. Any significant rate hikes could put increased interest burden on the company, squeezing its profitability and impacting its liquidity position. Therefore, funding taken by the company from BFIs is subject to volatile interest rate.

About the Company

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 335,000 Metric Tons Per Annum (MTPA) in FY21 and is one of the leading player in the industry.

Brief financials of ASPL for last three years ending FY21 are given below:

(Rs. in Million)

Particulars	FY19	FY20	FY21
	Audited	Audited	Audited
Income from Operations	16,996	12,320	13,617
PBILDT Margin	7.62	5.87	12.25
Overall Gearing (times)	1.71	1.59	1.59
Interest coverage (times)	5.17	2.55	2.86
Current ratio (times)	1.06	1.04	1.04
Total Debt/GCA	9.17	25.76	7.81

Annexure-1 Details of Facilities/Instruments to be rated

Name of Instrument	Type of Facility	Amount(Rs in Million)	Rating
Long Term Bank Facilities	Term Loan/BGL	2,489.40	CARE-NP BBB-
Short Term Bank Facilities	Working Capital Loans	6,530.00	CARE-NP A3
Short Term Bank Facilities	Non–Fund Based Loans	2,750.00	CARE-NP A3
Total		**11,769.40**	

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