Ashok Steel Industries Private Limited

Ratings

Facility	Amount (Rs. in Million)	Rating[1]	Rating Action
Long Term Bank Facilities	804.19 (Decreased from 876.22)	CARE-NP BB- [Double B Minus]	Reaffirmed
Short Term Bank Facilities	2,280.00 (Increased from 1,480.00)	CARE-NP A4 [A Four]	Reaffirmed
Total Facilities	3,084.19 (Increased from 2,356.22)		

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 the rating of 'CARE-NP A4' assigned to the short-term bank facilities of Ashok Steel Industries Private Limited (ASPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of ASPL continue to be constrained by the company's leveraged capital structure and weak debt service coverage indicators, working capital intensive nature of operations and stressed liquidity position. The ratings are also constrained by raw material price volatility risk and foreign exchange fluctuation risk, exposure to volatile interest rates and presence in the competitive nature of steel industry. The ratings also take cognizance of declined operating margins of the company in FY21 (Audited, refers to the twelve-month period ended mid-July 2021) despite substantial increase in total operating income, indicating inability to fully pass on increased input prices.

The ratings, however, derive strength from ASPL's established and long track record of operations along with experienced management team, established brand with country wide market presence and stable demand outlook for steel products in the country over the medium term.

Ability of ASPL to sustainably grow the operations while improving profitability margins and rationalization of its debt through efficient working capital management are the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Suppressed PBILDT margin in FY21 despite substantial growth in total operating income

During FY21, although total operating income increased by around 100% year on year (yoy) to Rs. 4,522 Mn, PBILDT margins declined by 511 basis points in FY21 to 6.92%. PBILDT margin has generally been quite volatile over the last few years with better margins when the company was able to make inventory gains. However, during FY21 the company was not able to fully pass on the hike in input prices leading to a subdued margins. The growth in sales was aided improved scale of operations on account of better efficiency of its production facility after backward integration. Amid increased sales, ASPL reported positive net profit in FY21 with PAT of Rs. 49 Mn, after two years of consecutive net losses. The ability of ASPL to sustainably increase its scale of operations while improving profitability margins will be critical from credit perspective.

Leveraged capital structure and weak debt service coverage indicators

The financial risk profile of ASPL was marked by leveraged capital structure with debt-equity ratio and overall gearing ratio of 6.76x and 14.44x, respectively at the end of FY21. While the improvement in net worth during FY21 due to accretion of profits improved the gearing levels on a year on year basis, it still remained on the higher side. Interest coverage ratio was moderate at 1.98x in FY21, which improved from 1.68x in FY20 mainly due to decrease in interest expenses amid lower interest rates in FY21. Total Debt/ GCA of the company remained high at 16.11x in FY21, albeit improving from 24.63x in FY20 backed by increase in net profits leading to higher gross cash accruals.

Working capital intensive nature of operations and stressed liquidity position

The operations of the company are working capital intensive marked by an average operating cycle of around 103 days during FY21. ASPL is required to maintain adequate inventory of raw material to ensure regular supply for uninterrupted manufacturing operations. The average inventory period stood at 72 days during FY21. ASPL procures its raw materials through local purchase as well as imports through Letter of Credit at sight. Average creditor period and the average collection period stood at 31 days and 62 days, respectively, during FY21. The average utilization of working capital limits for the twelve-month period ended mid-May 2022 was high at around 85%.

Raw material price volatility risk and foreign exchange fluctuation risk

The major raw materials of ASPL are sponge iron and scrap iron, the prices of which are market linked and determined on a periodic basis thus exposing the company to volatility in input prices, having a bearing on its profitability margins. The raw material cost contributed around 91% of the total operating income of the company in FY21. Furthermore, around 38% of the total raw material requirement in FY21 was imported and the prices of the same are linked to USD, for which the company is exposed to the foreign exchange fluctuation risk. The ability of ASPL to pass through changes in raw material prices to the finished products while also managing the foreign exchange fluctuation risks related to raw materials will be crucial for the company in order to stabilize its profitability margins.

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, with substantial upward pressure on interest rates in the last 2-3 quarters. Any further 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.

Highly competitive nature of industry

The iron and steel industry are intensely competitive and fragmented marked with 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 and related products is low, resulting into low product differentiation in the market.

Key Rating Strengths

Established track record of operations along with experienced management team in the related field

ASPL has an operational track record of more than three decades in manufacturing TMT Bars and allied steel products. ASPL is managed under the overall guidance of its two members in the Board of Directors (BoD) who possess wide experience in manufacturing sector. Mr. Poonam Chand Agrawal, Chairman and Managing Director, has over 30 years of experience in steel manufacturing industry. Mr. Abhishek Tulsian, Chief Executive Officer, has been working in ASPL from last nine years.

The directors have also been infusing funds into the company in the form of directors' loan to fund the operations as and when required by the company.

Established brand with country wide market presence

The company sells TMT bars under the brand "Ashok TMT" which is an established brand in the Nepalese market on account of its long-standing industry presence of more than three decades. This provides competitive advantage to the company against new players entering the industry. Furthermore, ASPL has a developed dealer/distributor network of more than 250 dealers and more than 500 retailers across the country which provides a ready market for its products.

Stable demand outlook for steels products in the country

Nepalese economy is developing and is in the phase of investment and growth in infrastructure, power sector and tourism sector, notwithstanding the impact of the covid-19 pandemic. In the recent budget presented by finance minister of Nepal for FY23, Rs. 161.56 Bn has been allocated for infrastructure development along with an estimated GDP growth of 8.00%. Government's continued high emphasis on infrastructure development, namely development of roads, hydropower, airports and other infrastructures augurs well for the business prospects of iron and steel manufacturers like ASPL over the medium term.

About the Company

Ashok Steel Industries Private Limited (ASPL) is a private limited company incorporated on February 22, 1984 for manufacturing TMT Bars, with manufacturing facilities in Gadhimai Municipality-10, Bara, Nepal. As on July 15, 2022, the total installed capacity for TMT bars is 100,000 Metric Tons Per Annum (MTPA). ASPL also manufactures MS Billet by using sponge iron, pig iron and scrap iron as raw materials.

Brief financials of ASPL for the past three years ended FY21 are given below:

(Rs. Million)

For the year ended Mid-July	FY19 (Audited)	FY20 (Audited)	FY21 (Audited)
Income from Operations	3,354	2,261	4,522
PBILDT Margin (%)	1.84	12.03	6.92
Overall Gearing (times)	-ve	-ve	14.44
Interest Coverage (times)	0.37	1.68	1.98
Current Ratio (times)	0.81	0.73	1.10
Total Debt/Gross Cash Accruals (times)	-ve	24.63	16.11

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	804.19	CARE-NP BB-
Short Term Bank Facilities	Fund Based Limit	200.00	CARE-NP A4
Short Term Bank Facilities	Non-Fund Based Limit	2,080.00	CARE-NP A4
Total		**3,084.19**	

Contact us

Analyst
Mr. Prashiddha Sharma Gaire
Contact No.: +977 9802335865
Email: prashiddhas@careratingsnepal.com

Senior Analyst
Mr. Santosh Pudasaini
Contact No.: +977 9802312855
Email: pudasaini.santosh@careratingsnepal.com

Relationship Contact
Mr. Achin Nirwani
Contact No.: +977 9818832909
Email: achin.nirwani@careratingsnepal.com

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