Panchakanya Steel Private Limited

Ratings

Facility	Amount (Rs. in Million)	Rating[1]	Rating Action
Long Term Bank Facilities	**219.93**	**CARE-NP BB [Double B]**	**Reaffirmed**
Short Term Bank Facilities	**5,030.07**	**CARE-NP A4 [A Four]**	**Reaffirmed**
Total Facilities	**5,250.00**		

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 of Panchakanya Steel Private Limited (PSPL). CRNL has also reaffirmed the rating of 'CARE-NP A4' assigned to the short-term bank facilities of PSPL.

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of PSPL continue to remain constrained by below average financial risk profile marked by volatile profitability and modest debt service coverage indicators, working capital intensive nature of operations, exposure to volatile raw material price and foreign exchange fluctuation risk, exposure to volatile interest rate risk and presence in highly fragmented and competitive nature of steel industry.

The ratings, however, derive strength from the company's established and long track record of operations along with experienced management team in the related field, established brand with country wide market presence coupled with stable demand outlook for steel products in the country over the medium-term. The ratings also factor in increasing scale of operations with growing sales and improving gearing headroom.

Ability of the company to continue increasing its scale of operations with steady profitability margins and rationalization of its debt through efficient working capital management leading to improved debt coverage and solvency indicators will be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Below average financial risk profile marked by volatile profitability and modest debt service coverage indicators

The profitability of the company has remained quite volatile over the last three financial years (FY19-FY21). With a view to increase the market share, company did not increase its prices in tandem with the increase in cost of production, which resulted in lower margins in FY21. The same resulted into decline in PBILDT margin of the company by 381 basis points (bps) to 3.97% on account of lower price realizations amid increased competition and lower than expected demand during FY21 with muted economic activities owing to lingering impact of the covid-19 pandemic. Earlier in FY20, PBILDT margin had improved by 234 bps to 7.78% mainly on account of favorable product mix despite lower sales. On account of subdued profitability, debt service coverage indicators of the company remained modest during FY21 as indicated by interest coverage of 1.36x, despite substantially lower interest outgo during FY21 compared to previous financial year (FY20). Similarly, total debt to GCA also stood high at 37.61x in FY21 although improved from 74.77x in FY20 amid lower debt levels. The company's ability to achieve a steady profitability profile leading to improved debt service coverage indicators will remain critical from credit perspective.

Working capital intensive nature of operations

The operations of PSPL is working capital intensive in nature marked by a high average operating cycle of 163 days during FY21 (Audited, refers to the twelve-month period ended mid-July 2021). Being a highly competitive business, the company needs to extend credit period to its dealers for upto three months, whereas the company needs to make immediate payment to its suppliers. This was reflected by the company's average collection period of 93 days and average creditor period of 3 days. In addition, the company is required to maintain adequate inventory of raw material for smooth running of its production processes as well as to meet immediate demand of its customers. The average inventory days during FY21 stood at 72 days. An elongated operating cycle increases reliance on bank borrowings to meet working capital requirements. Average utilization of working capital limits for the twelve-month period ended mid-June, 2022 was around 75% of the sanctioned limits.

Raw material price volatility risk and foreign exchange fluctuation risk

The major raw materials for PSPL are MS billets imported from India, prices of which are market linked and determined on a periodic basis. This exposes the company to volatility in input prices and has a bearing on its profitability margins. Raw material cost contributed to around 92% of the total operating income of the company during FY21 (FY20: 87%), thus any volatility in prices of the same impacts the profitability of the company, as it did adversely in FY21. Also, the company is exposed to foreign exchange fluctuation risk as the prices of imported raw materials are linked to USD. The company's scope to improve margins will depend on its ability to pass through changes in raw material prices to the finished products while also managing the foreign exchange fluctuation risks related to raw material procurement.

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.

Presence in highly fragmented and competitive nature of steel industry

The iron and steel industry are 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 and related products is low, resulting into low product differentiation in the market.

Key Rating Strengths

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

PSPL has an operational track record of more than two decades in manufacturing of TMT Bars. PSPL derives strength from its strong promoter group belonging to Panchakanya Group. Panchakanya Group is one of the established business groups with presence from 1970s in the Nepalese market with involvement in diversified sectors such as trading, manufacturing, energy, automobiles, etc. The company is managed under the overall guidance of its seven-member Board of Directors led by Mr. Prem Bahadur Shrestha, Chairman. Mr. Shrestha is engaged in business sector including import/export for more than 5 decades. Mr. Pradip Kumar Shrestha, Managing Director, has an experience of more than four decades in the various entities within Panchakanya Group.

Rebound in revenues and rationalization of debt levels leading to improved gearing headroom

During FY21, PSPL's total operating income (TOI) increased by 69% year on year (yoy) to Rs. 5,532 Mn. This was on account of improved demand scenario in FY21 after the initial wave of the covid-19 pandemic coupled with competitive pricing by PSPL leading to higher sales. Revenue rebound continued into FY22 with PSPL reporting total operating income of Rs. 5,332 Mn during 9MFY22 (Unaudited, refers to the nine-month period ended mid-April 2022). Furthermore, PSPL's capital structure improved in FY21 backed by lower debt levels coupled with increased net worth. The overall gearing ratio of the company improved to 3.29x in FY21 from 5.11x during FY20, sustainability of which will remain a challenge amid the need for increased working capital borrowing, particularly given the upward pressures on input prices.

Established brand with country wide market presence

The company sells TMT bars under the brand "Panchakanya" which is an established brand in the Nepalese market on account of its long-standing presence of more than two decades. This provides competitive advantage to the company against new players entering the industry. Furthermore, PSPL has a customer base of around 90 dealers across all major cities and depots in seven major cities of Nepal, 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 PSPL over the medium term.

About the Company

Panchakanya Steel Private Limited (PSPL) is a private limited company incorporated on May 31, 1995 for manufacturing TMT Steel bars, with manufacturing facility in Bhairahawa, Nepal. As on Mid-January, 2022, the company has installed capacity of 150,000 Metric Tons Per Annum (MTPA).

Brief financials of PSPL 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	4,574	3,265	5,532
PBILDT Margin (%)	5.44	7.78	3.97
Overall Gearing (times)	4.66	5.11	3.29
Interest Coverage (times)	0.88	1.15	1.36
Current Ratio (times)	1.01	1.14	1.25
Total Debt/Gross Cash Accruals (times)	-ve	74.75	37.61

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	219.93	CARE-NP BB
Short Term Bank Facilities	Fund Based Limit	4580.00	CARE-NP A4
Short Term Bank Facilities	Non-Fund Based Limit	450.07	CARE-NP A4
Total		**5,250.00**	

Contact us

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

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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