Ten Steels Private Limited

Ratings

Facility	Amount (Rs. in Million)	Ratings[1]	Rating Action
Long Term Bank Facilities	611.00	CARE-NP BB- [Double B Minus]	Assigned
Short Term Bank Facilities	589.00	CARE-NP A4 [A Four]	Assigned
Total Facilities	1,200.00 (Twelve Hundred Million Only)		

Details of Facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has assigned the rating of 'CARE-NP BB-' to the long term bank facilities and the rating of 'CARE-NP A4' to the short term bank facilities of Ten Steels Private Limited (TSPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of TSPL is constrained by its highly leveraged capital structure, working capital intensive nature of operations and stretched liquidity position. The ratings also factor in the raw material price volatility risk and foreign exchange fluctuation risk, exposure to volatile interest rates and presence in competitive nature of steel industry. The ratings also take cognizance of the decline in profitability and weakening of debt service coverage indicators of the company in FY22 (Unaudited, FY refers to the twelve-month period ending mid-July) along with near-term pressure on earnings of the company amid a sluggish demand scenario also reflective in the below-par capacity utilization trend of the company in H1FY23 (H1 refers to the six-month period ending mid-January).

The ratings, however, derives strengths from the experienced promoters and management in the related field, locational advantage, improving product diversification, growing scale of operations. The ratings also take note of the completion of the capacity enhancements of the company in FY22, with no major capital expenditure planned in the near future, leading to low requirement of additional debt except the borrowings related to working capital. Furthermore, the rating also takes comfort in the expected equity infusion leading to improvement in the gearing headroom of the company by FY23.

Going forward, the ability of the company to profitably scale up the operations, manage foreign exchange fluctuation risks related to raw materials, rationalization of its debt through efficient working capital management and timely infusion of additional equity as envisaged leading to improved solvency and debt service coverage indicators will be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Below average financial risk profile

The company's financial risk profile is marked by highly leveraged capital structure with modest debt service coverage indicators owing to weak operating performance in FY22 amid low profitability margins despite year-on-year growth in Total Operating Income (TOI).

During FY22, the company's TOI grew by 63% year-on-year to Rs. 583 Mn from Rs. 357 Mn during FY21. However, ramp up in scale has been slower amid muted demand, reflective in the low capacity utilization of the company at 19% and 12% in FY21 and FY22, respectively. Demand for steel products has been muted in the country over FY22-H1FY23 amid slower pace of construction activities. Lower government public spending coupled with dip in industrial sector activity amid contraction in overall loanable funds in the market amid tightened monetary policies led to lower than expected demand creation for steel product manufacturers like TSPL.

PBILDT margin declined to 6.72% in FY22 from 15.23% in FY21 on account of increase in raw material costs and the company's inability to fully pass on the same to its customers. Amid declined operating efficiency coupled with increased interest expenses owing to debt funded capex coupled with higher rates the company reported net losses of Rs. 9 Mn in FY22 as compared to net profit of Rs. 8 Mn during FY21. Consequently, interest coverage ratio of the company was low at around 1x in FY22 (FY21: 2.86x).

TSPL's capital structure stood highly leveraged with overall gearing of 5.05x at the end of FY22, although slight improvement from 5.20x as on mid-July 2021 aided by infusion of additional equity of Rs. 39.30 Mn in FY22. Gearing level is expected to improve by FY23 end supported by additional equity infusion, timely infusion of which as envisaged will remain a key monitorable aspect. Furthermore, amid near-term operational challenge, particularly if demand offtake remains unfavorable, TSPL would rely on financial support from promoters to meet any shortfall.

Elongated operating cycle with working capital-intensive nature of operations

TSPL is involved in manufacturing of wide range of steel products by majorly importing raw materials. TSPL purchases its raw materials through Letter of Credit and also has to fund the inventory and debtors which lead to high reliance on working capital limits. Total operating cycle of the company was 201 days in FY22 with average collection period from customers of 45 days and average inventory holding period of 168 days in FY22. The inventory holding in FY22 is high on account of lower sales during the initial year of operation. The inventory holding period was high in FY22 on account of lower sales amid sluggish demand of steels in FY22. This leads to high reliance of the company on the bank finance for working capital needs. The average utilization of fund-based working capital limit against drawing power was around 60% during last 12 months' period ending mid-July, 2022 and low current ratio as on the last two balance sheet dates reflects working capital intensive nature of operations.

Raw material price volatility risk and foreign exchange fluctuation risk

Hot rolled (HR)/ Cold rolled (CR) Slits and Coils are the major raw materials for TSPL and are majorly imported from India. The prices of TSPL's raw materials are market linked and determined on a periodic basis, thus exposing the company to volatility in the prices of raw materials which has a bearing on its profitability margins. The raw material cost contributes around 90% of the total cost of production of the company. The raw material cost contributed around 81% of the total operating income for FY21 and 89% for FY22, thus, any volatility in prices of the same impacts the profitability of the company. With prices of raw material import linked to USD, the company is exposed to the foreign exchange fluctuation risk. The ability of the company to pass through changes in raw material prices to the customers and managing the foreign exchange fluctuation risks related to raw materials will be the key rating sensitivities.

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 few quarters. A contractionary monetary policy for FY23 coupled with increasing inflation has only added to the upward pressure on interest rates, resulting in increased base rates of BFIs in the first half of FY23. 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.

Presence in highly competitive nature of steel industry

The iron and steel industry are intensely competitive 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 CR and HR pipes, strips & 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

TSPL is managed under the overall guidance of the company's Board of Directors (BoD), who possesses wide experience in the manufacturing and trading. The board is chaired by Mr. Anil Kumar Agrawal, who is proprietor of Maruti Traders with more than two decades of operation. He is also Chairperson of Maruti Business Concern Pvt Ltd. Mr. Ajay Kumar Jalan, Managing Director, is Director of Swastik Exim and Managing Director of Annapurna Enterprises Trade Concern. Mr. Dhiraj Kumar Agrawal, Director, is the Managing Director (MD) of Maruti Business Concern Pvt. Ltd., Chairman of Maruti Food Park Pvt. Ltd. (rice plant industry), DR Multi Trade Pvt. Ltd. and Director of Ten Plast Pvt. Limited. The board is supported by an experienced management team across various functions.

Locational Advantage and Product diversification

TSPL manufactures MS Pipe that has great usage in construction, automobile, chemical and oil industries including residential housing, shed construction. The company has also added shutter profiles along with Hot Rolled Sheet and Cold Rolled Sheet in FY23. Diversification allows for more variety and options for the customers and consequently provides supports to market the product in diversified industries. Also, being in close proximity with the Indian border, TSPL has potential for export sales in adjacent Indian states.

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 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 TSPL over the medium term.

About the Company

Ten Steels Private Ltd. (TSPL) is the private limited company incorporated on August 26, 2018 for manufacturing Mild Steel (MS) black pipes, MS sheets and shutter profile having plant in Nawalparasi, Nepal. TSPL came in commercial operation on August, 2020 with installed capacity of 30,000 MTPA for MS Pipe. TSPL enhanced its installed capacity of tube mill to 60,000 MTPA for MS Pipe, 12,000 MTPA for Hot-Rolled Sheets (HR sheet)/ Cold- Rolled Sheets (CR sheets) and 3,000 MTPA for Shutter Profile from July 2022 onwards. The company manufactures MS Pipes, MS sheets, Shutter profile by importing raw materials from India and selling them in Nepal's Market.

Brief financials of TSPL for the past two years ended FY22 are given below:

(Rs. Million)

For the year ended Mid-July	FY21 (Audited)	FY22 (Provisional)
Income from Operations	357	583

PBILDT Margin (%)	15.23	6.72
Overall Gearing (times)	5.20	5.05
Interest Coverage (times)	2.86	0.99
Current Ratio (times)	1.10	0.95
Total Debt/Gross Cash Accruals (times)	16.94	Negative

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	611.00	CARE-NP BB-
Short Term Bank Facilities	Fund Based Limit	388.70	CARE-NP A4
Short Term Bank Facilities	Non-Fund Based Limit	200.30	CARE-NP A4
Total		**1,200.00**	

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About CARE Ratings:

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