Narayani Ispat Private Limited

Ratings

Facilities	Amount (Rs. in Million)	Ratings[1]	Rating Action
Long Term Bank Facilities	1,517.88 (Increased from 977.25)	CARE-NP BB [Double B]	Reaffirmed
Short Term Bank Facilities	3,525.00 (Increased from 2,970.00)	CARE-NP A4 [A Four]	Reaffirmed
Total Facilities	5,042.88 (Five Billion Forty-Two Million and Eight Hundred Eighty Thousand Only)		

Details of instruments/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 Narayani Ispat Private Limited (NIPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of NIPL continue to be constrained by the company's highly leveraged capital structure and working capital intensive nature of operations. 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 continue to derive strength from experienced promoters and management in the related field, locational advantage of the manufacturing facilities, established marketing setup and demand of steel products in the country. The ratings also take cognizance of commencement of operations of continuous casting machine (CCM) for in-house production of billets used for TMT bars production and the improving trend in operational performance of the company in FY22 (Audited, refers to the twelve-month period ending mid-July). Although near-term industry dynamics remain challenging amid sluggish demand scenario, the backward integration is expected to be margin accretive for the company leading to improved financial profile over medium term.

Going forward, the ability of the company to improve capacity utilizations with better profitability margins and rationalization of its debt level by managing the working capital requirements leading to improved solvency indicators will be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Highly leveraged capital structure

Debt-equity ratio of the company was high at 3.00x at the end of FY22 which deteriorated from 2.66x at the end of FY21 mainly due to increase in term loans for ongoing capex. Overall gearing ratio (including provision for LC) stood substantially high at 6.90x at the end of FY22, albeit decreasing slightly from 7.36x at the end of FY21. Interest coverage ratio was adequate at 3.57x in FY22 improving from 1.91x in FY21 aided by higher PBILDT generation during FY22. Total Debt/Gross Cash Accruals (GCA) improved from 31.80x in FY21 to 15.32x in FY22.

Exposure to raw material price volatility risk and foreign exchange fluctuation risk

The major raw materials are imported from India and the price of the raw materials are market linked and determined on a periodic basis, thus exposing the company to the volatility in the prices of raw materials which has a bearing on its profitability margins. The raw material cost contributes around 93% of the total operating cost of the company, thus, any volatility in prices of the same impacts the profitability of the company. Furthermore, the majority of its raw material

[1] *Complete definitions of the ratings assigned are available at www.careratingsnepal.com and in other CRNL publications*

requirements is imported, prices of which is linked to USD, for which it is exposed to the foreign exchange fluctuation risk. Any sudden spurt in these raw material prices might not be passed on to the end customers, instantly, on account of highly fragmented and competitive nature of the industry, which could lead to decline in profitability margins.

Presence in highly competitive nature of steel industry in Nepal

The iron and steel industry is intensely competitive marked by the presence of both larger players and numerous smaller players in the unorganized segment. The demand of 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 TMT bars & related products is low, resulting into low product differentiation in the market. The producers of steel construction materials are essentially price takers in the market, which directly expose their cash flows and profitability to volatility in the steel prices.

Exposure to volatile interest rate

The company has substantial interest outgo lined up over the next couple of years amid relatively high debt levels. The company's interest rates are based on 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. Sustained high interest rates, as seen over the last year or so, add to the interest burden of the company, squeezing its profitability and impacting its liquidity position. However, Nepal Bankers Association's decision to lower premium on loans by 1% from March 2023 could provide some relief. Nevertheless, funding taken by the company remains exposed to volatile interest rate.

Key Rating Strengths

Strong presence of the promoter group in steel sector supported by experienced management team

Although NIPL commenced its operations only in July 2018, the promoters of the company have wide experience in manufacturing steel and other construction materials for more than three decades. NIPL is part of the Keyal group of companies of Nepal which is a diversified business group with strong presence in a broad range of business, manufacturing and industrial interests with main focus on manufacturing construction materials. The group presence is reflected from hardware outlets spreading across the country which contributes to the group's steel business. The company is managed under the overall guidance of its nine members Board of Directors (BoD) which includes experienced businessmen/industrialist from the Keyal group with wide experience in the manufacturing sector. Mr. Bikash Kumar Keyal, Chairman of NIPL, has been involved in the groups business for the past 15 years and looks after the whole group's accounting and finance. Mr. Satya Narayan Keyal, Director of NIPL and also Chairman of the Keyal group of companies has more than 30 years of experience in trading and manufacturing industry.

Improved operational performance during FY22

NIPL's total revenue improved in FY22 to Rs. 9,293 Mn from Rs. 5,605 Mn in FY21. This increase was majorly due to increase in quantity sales sold by ~30% to 105,734 MT majorly in TMT bars as well as improvement in average price realization. PBILDT increased by ~91.83% in FY22 to Rs. 481 Mn, with improvement in PBILDT margin to 5.17% in FY22 from 4.47% in FY21. This improvement was majorly due to decrease in raw material cost during FY22. With the improvement in PBILDT and marginal increase in interest expense from Rs 131 Mn in FY21 to Rs 135 Mn in FY22, net profit of the company improved to Rs 123 Mn from Rs 98 Mn in FY21. Some portion of interest expenses were capitalized as capital WIP work is going on. GCA of the company also increased from Rs. 91 Mn in FY21 to Rs. 247 Mn in FY22.

Backward integration of the plant and favourable government policies

To reduce production cost, the company has completed backward integration of its plant by installing continuous casting machine (CCM) for manufacturing of M.S. Billet which is the key raw material in manufacturing TMT bars. Billet manufacturing capacity of the company currently stands at 175,000 MTPA. The key raw material required in manufacturing of MS Billets is sponge iron and scrap, where sponge iron is being imported from India and scrap is being locally procured from the vendors directly. Processing of sponge iron and scrap materials is economically viable, because of high value of raw materials and the relatively low cost of processing leading to savings in cost of power and fuel. Furthermore, the company's operational profile has also been supported by the regulatory changes making sponge iron (raw material for billet) having nil custom duty (reduction from 5%) with levy of additional excise on billet of NPR 2.5 per kg. The company has integrated manufacturing facilities and this amendment in policy/custom tariff by Government of Nepal argues well for the company. Backward integration by setting up CCM plant not only boosts the product portfolio, but also surges prospects of better profitability vis-à-vis peers given the scope for more value addition and competitive advantage over companies who depend upon high value imports for procurement of these raw materials.

Improved operating cycle however, albeit with continued high reliance on bank finance amid growing scale

Total operating cycle of the company decreased to 49 days in FY22 from 93 days in FY21. In FY22, average collection period for the company was 22 days which decreased from 44 days in FY21 majorly due to shift towards cash sales from credit sales. Also, company keeps stock for around 2 months and average inventory days was 38 days in FY22 decreased from 68 days in FY21. NIPL received credit period of around 11 days in FY22. The company imports its raw material mainly from India and mainly backed by sight letter of credit leading to low average payable period. All this leads to high reliance of the company on the bank finance for working capital requirements. The average monthly outstanding of fund-based working capital limit against drawing power was around 78% during last 12 months period ended mid-December 2022.

Locational advantage with established brand and marketing network

The plant site is located in Chatapipra, Bara, around 15 Kms from Indo-Nepal borders in Birgunj dry-port. Since majority of raw materials used by NIPL are imported from India, the factory's proximity to the border which argues well for importer and provides a competitive advantage in terms of savings in freight cost. The company sells TMT bars under the brand name of "Narayani Steels" which is already an established brand in the Nepal market on account of its long-standing presence in the construction materials manufacturing and trading industry. This provides leverage to the company in front of new players entering the industry. The group has 15 in-house hardware trading outlets in and around the Kathmandu Valley. Also, the group already has a well-established dealer/distributor network in 129 locations across the country.

Established brand and marketing network of the group with country wide presence

The company sells TMT bars under the brand name of "Narayani Steels" which is already an established brand in the Nepal market on account of its long-standing presence in the construction materials manufacturing and trading industry. This provides leverage to the company in front of new players entering the industry. The group also has 15 in-house hardware trading outlets in and around the Kathmandu Valley which makes it easier to penetrate into the market and cater to large section of customers. Also, the group already has a well-established dealer/distributor network in around 129 areas across the country which provides a ready market for its products.

About the Company

Narayani Ispat Private Limited (NIPL) is a private limited company incorporated on September 17, 2009 for manufacturing of TMT bars and other allied steel products at factory located in Chatapipra, Bara. NIPL is part of the Keyal group of companies of Nepal and all the shares of the company are held by individual promoter from Keyal group. The company commissioned operations in July 2018 and has capacity of 322,000 MTPA for manufacturing rolled products such as TMT bars, M.S Round etc. Brief financials of NIPL during last 3 years is given below:

Financial Performance

(Rs. Million)

For the Period	FY20 (A)	FY21 (A)	FY22 (A)
Income from Operations	3,587	5,605	9,293
PBILDT Margin (%)	6.29	4.47	5.17
Overall Gearing (times)	11.52	6.64	3.00
Total Outstanding Liabilities/Tangible Net worth (times)	13.34	8.17	7.53
Interest Coverage (times)	0.77	1.91	3.57
Current Ratio (times)	0.77	0.74	0.73
Total Debt/Gross Cash Accruals (times)	Negative	31.80	15.32

A: Audited

Annexure 1: Details of the Facilities Rated

Name of the Bank Facilities	Type of the Facility	Amount (Rs. In Million)	Ratings
Long Term Bank Facilities	Term Loan	1,517.88	CARE-NP BB [Double B]
Short Term Bank Facilities	Fund/Non-Fund Based Limits	3,525.00	CARE-NP A4 [A Four]
Total		**5,042.88**	

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About CARE Ratings Nepal Limited:

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