

Ashok Steel Industries Private Limited

Ratings

Facility	Amount (Rs. in Million)	Rating ¹	Rating Action
Long Term Bank Facilities	1,316.64 (Increased from Rs. 804.19)	CARE-NP BB- [Double B Minus]	Reaffirmed
Short Term Bank Facilities	1,730.00 (Decreased from Rs. 2,280.00)	CARE-NP A4 [A Four]	Reaffirmed
Total Facilities	3,046.64 (Decreased from 3,084.19)		

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 remain constrained by the company's highly leveraged capital structure and weak debt service coverage indicators, working capital intensive nature of operations. The ratings also factor in 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 take cognizance of decline in gross margin of the company despite steady growth in scale of operations in FY22 (Audited, FY refers to the twelve-month period ending mid-July), 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

Highly leveraged capital structure and weak debt service coverage indicators

The financial risk profile of ASPL is marked by highly leveraged capital structure with debt-equity ratio and overall gearing ratio of 3.86x and 10.80x, respectively, at the end of FY22, although improved from 6.44x and 14.12x at the end of FY21. The improvement in net worth during FY22 due to accretion of profits led to improvement in the gearing levels. Interest coverage ratio stood modest at 1.38x in FY22, which moderated from 1.96x in FY22 due to decrease in PBILDT coupled with higher interest expenses during FY22. Total Debt/ GCA of the company deteriorated to 33.47x at the end of FY22 from 16.11x at the end of FY21 due to much reduced net profit coupled with higher working capital outstanding at the end of the financial year. Limited gearing headroom limits the financial flexibility of the company. Rationalization of debt levels continues to remain critical from credit perspective.

Suppressed PBILDT margins despite steady growth in scale of operations

During FY22, although total operating income increased by over 50% year on year (y-o-y) to Rs. 6,881 Mn, PBILDT margin declined y-o-y by 294 basis points to 3.91%. PBILDT margin has generally been quite volatile over the last few years with better margins during the year when the company was able to make inventory gains. During FY22, the company was not

able to fully pass on the hike in input prices leading to subdued margins. This coupled with higher interest outgo led net profit to decline in FY22 with PAT of Rs. 9 Mn (FY21: Rs. 49 Mn). In H1FY23 (Unaudited, refers to the six-month period ended mid-January 2023), the company's total income was Rs. 3,002 Mn, with slightly improved PBILDT margin of 6.89% and interest coverage of 1.48 times. The ability of ASPL to profitably scale up the operations for a sustained period remains to be seen.

Working capital intensive nature of operations though improving operating cycle

The operations of the company are working capital intensive marked by an average operating cycle of around 61 days during FY22, albeit improved from 102 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 52 days during FY22, reduced from 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 37 days and 46 days respectively, during FY22 (FY21: 32 days and 62 days during FY21).

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 95% of the total operating income of the company in FY22 (FY21: ~91%). Furthermore, around 50% of the total raw material requirement in FY22 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

Sustained requirement for short-term working capital borrowings results in a high interest expense for ASPL. 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. Therefore, funding taken by the company remains exposed to volatile interest rate.

Highly competitive nature of industry

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.

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 long run, however muted in the near term

Demand of steel products in the country is 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. Sustained demand for steel is likely given the need of construction materials in developing public as well as private infrastructures, road, bridges and other public facilities. Furthermore, the government's continued emphasis on infrastructure development, namely development of roads, hydropower, airports and other infrastructures etc. is likely to benefit the steel manufacturers like ASPL. However, with the construction sector in Nepal impacted by slower pace of economic growth coupled with relatively lower infrastructure spending by the government, the outlook of steel industry in Nepal is challenging in the near 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 FY22 are given below:

	(Rs. Million)		
For the year ended Mid-July	FY20 (Audited)	FY21 (Audited)	FY22 (Audited)
Income from Operations	2,261	4,522	6,881
PBILDT Margin (%)	12.03	6.92	3.91
Overall Gearing (times)	-ve	14.44	10.80
Interest Coverage (times)	1.68	1.98	1.38
Current Ratio (times)	0.73	1.10	0.82
Total Debt/Gross Cash Accruals (times)	24.63	16.11	33.47

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	816.64	CARE-NP BB-
Long Term Bank Facilities	Permanent Working Capital (Proposed)	500.00	CARE-NP BB-
Short Term Bank Facilities	Fund Based Limit	260.00	CARE-NP A4
Short Term Bank Facilities	Non-Fund Based Limit	1,470.00	CARE-NP A4
Total		3,046.64	

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