Panchakanya Steel Private Limited

Ratings

Facility	Amount (Rs. in Million)	Rating[1]	Rating Action
Long Term Bank Facilities	113.11	CARE-NP BB [Double B]	Reaffirmed
Short Term Bank Facilities	5,030.07	CARE-NP A4 [A Four]	Reaffirmed
Total Facilities	5,143.18 (Five Thousand One Hundred Forty-Three Million and One Hundred Eighty Thousand Only)		

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

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of PSPL continue to remain constrained by leveraged capital structure with modest debt service coverage indicators and elongated operating cycle marked by high collection period at the end of FY22 (Audited, FY refers to the twelve-month period ending mid-July). The ratings also factor in 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 take cognizance of the growing scale of operations of the company over FY20-FY22, albeit with volatile profitability over the period. *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

Leveraged capital structure with modest debt service coverage indicators

PSPL's overall gearing ratio increased to 3.68x at the end of FY22 from 3.29x at the end of FY21 due to increased debt levels to cater growing scale of operations, although there was an equity infusion of Rs. 47 Mn equity share capital in FY22. Amid the need for increased working capital borrowing, particularly given the upward pressures on input prices, the company's gearing levels are expected to remain elevated over the near-term. Furthermore, interest coverage ratio of the company remained modest during FY22 at 1.38x (FY21: 1.36x). Similarly, total debt to GCA also stood high at 35.33x in FY22 although improved slightly from 37.61x in FY21 due to improved cash accruals. The company's ability to rationalize debt levels commensurate to its operations leading to improved solvency indicators will remain critical from credit perspective. As per combined financials, overall gearing ratio stood high at 3.43x at the end of FY22 which slightly deteriorated from 3.12x at the end of FY21.

Working capital intensive nature of operations

The operations of PSPL are working capital intensive in nature marked by an operating cycle of 144 days during FY22. Being presence in a highly competitive business, the company needs to extend credit period to its dealers for up to three months, whereas the company needs to make immediate payment to its suppliers. This was reflected by the company's average collection period of 97 days and average creditor period of 5 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 FY22 stood at 51 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, 2023 was around 80% of the sanctioned limits, based on quarter end figures.

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 FY22 thus any volatility in prices of the same impacts the profitability of the company. 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

Sustained requirement for short-term working capital borrowings results in a high interest expense for PSPL. The company's interest rates are based on a floating interest rate regime, where a certain premium is added to quarterly base rate and interest rate is changed accordingly on quarterly basis. Base rate 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.

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.

Increasing scale of operations over FY20-FY22, albeit with volatile profitability

During FY22, PSPL's total operating income (TOI) increased by 22% year on year (yoy) to Rs. 6,749 Mn. This was on account of increased price realizations although there was decline in quantity sold in FY22. Increase in price realizations was due to increase in cost of raw materials (billets) in the international market. In 9MFY23 (Unaudited, refers to the nine-month period ended mid-April 2023), however, PSPL's total income was Rs. 3,740 Mn, declining 29.86% yoy from 9MFY22. However, the profitability of the company has remained volatile over FY20-FY22, and relatively lower than the pre-covid levels. Amid competitive pressures and sluggish demand, the company has not been able to fully pass on increased cost of production to final price, which has resulted in lower margins as compared to historical levels. Although, in FY22, PBILDT margin of the company increased by 140 basis points (bps) year-on-year to 5.37% backed by higher price realizations. Going forward, PSPL's credit risk profile will hinge in its ability to sustain the upward trend in profitability for a sustained period leading improvement in coverage indicators. As per combined financials, TOI increased by 17% y-o-y to Rs. 10,109 Mn with PBILDT margin of 5.78% during FY22 (FY21: 5.21%).

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. 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).

Rating Approach:

CRNL has taken a combined view of Panchakanya Plast Private Limited, Panchakanya Plastic Industries Private Limited, Panchakanya Rotomould Private Limited, and Panchakanya Steel Private Limited in order to arrive at the ratings.

Brief combined financials of the above-mentioned companies 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	5,847	8,635	10,109
PBILDT Margin (%)	9.90	5.21	5.78
Overall Gearing (times)	4.05	3.12	3.43
Interest Coverage (times)	1.37	1.62	1.43
Total Debt/Gross Cash Accruals (times)	31.26	24.98	29.23

Brief standalone financials of PSPL 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	3,265	5,532	6,749
PBILDT Margin (%)	7.78	3.97	5.37
Overall Gearing (times)	5.11	3.29	3.68
Interest Coverage (times)	1.15	1.36	1.38
Current Ratio (times)	1.14	1.25	1.21
Total Debt/Gross Cash Accruals (times)	74.75	37.61	35.33

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	113.11	CARE-NP BB
Short Term Bank Facilities	Fund Based Limit	4,580.00	CARE-NP A4
Short Term Bank Facilities	Non-Fund Based Limit	450.07	CARE-NP A4
Total		**5,143.18**	

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