Jagdamba Enterprises Private Limited

Ratings

Facilities	Amount (Rs. in Million)	Ratings[1]	Rating Action
Long Term Bank Facilities	**1,886.62**	**CARE-NP BB+ [Double B Plus]**	**Reaffirmed**
Short Term Bank Facilities	**13,920.00**	**CARE-NP A4+ [A Four Plus]**	**Reaffirmed**
Total Facilities	**15,806.62 (Fifteen Billion Eight Hundred Six Million and Six Hundred Twenty Thousand Only)**		

Details of instruments/facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has reaffirmed the ratings of 'CARE-NP BB+' assigned to the long term bank facilities and 'CARE-NP A4+' assigned to the short term bank facilities of Jagdamba Enterprises Private Limited (JEPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of JEPL continue to remain constrained by its leveraged capital structure along with modest debt service coverage indicators and moderate financial performance in FY22 (Audited, FY refers to the twelve-month period ending mid-July). Although the ratings also take cognizance of the commencement of operations of the backward integrated manufacturing facility of Steel Melting Shop (SMS) and Hot Strip Mill (HSM) in November 2022 and June 2023, respectively, the company's ability to achieve capacity utilizations at envisaged levels for a sustained period remains to be seen, particularly amid the sluggish demand scenario over the near term and other industry headwinds currently faced by the steel industry in the country. The ratings also consider JEPL's working capital intensive nature of operations, exposure to volatile interest rates, raw material price volatility risk along with foreign exchange fluctuation risk, and presence in highly fragmented and competitive nature of steel industry.

The ratings, however, continue to derive strength from long track record of operations of the company with experienced management team in the related field, established brand and marketing setup with country-wide market presence, large scale of operations of the company, diverse product range catering to wide spectrum of industries. Although near-term industry dynamics remain challenging, 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 profitably scale up its operations along with rationalization of its debt levels would be the key rating sensitivities. Also, stabilization of company's newly operational SMS and HSM plants and its ability to derive envisaged benefits from the backward integration will also be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Project stabilization risk associated with its large-size capex

The company has backward integrated its manufacturing facility by setting up Steel Melting Shop (SMS) and Hot Strip Mill (HSM), which came into operations in November 2022 and June 2023, respectively. Total cost incurred for the project was Rs. 2,246.14 Mn funded by debt to equity at 75:25. The capex is expected to reduce JEPL's dependence on use of high custom duty bearing imported billets for manufacturing TMT rods and other related products. The company will instead use lower custom duty bearing sponge iron and convert it directly into TMT bar or HR strips. This is likely to benefit JEPL in terms of cost savings which would include lower duty on imports of sponge iron, fuel saving, and a more efficient and leaner manufacturing process. With modest capacity utilizations in initial months of operations, however, the company

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

remains susceptible to risk related to stabilization and streamlining of production process from the enhanced capacity. This will remain a key monitorable aspect.

Moderate financial performance with volatile profitability

During FY22, although total operating income increased by 10.23% year on year (y-o-y) to Rs. 15,461 Mn, PBILDT margin declined to 3.19% (FY21: 10.78%). 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. 22 Mn (FY21: Rs. 961 Mn). The ability of JEPL to profitably scale up the operations for a sustained period remains to be seen.

Leveraged capital structure with modest debt service coverage indicators

Overall gearing ratio of the company remained leveraged at 2.84x at the end of FY22 (FY21: 2.74x), with further dip likely in FY23 owing to increased debt levels pertaining to the series of majorly debt-funded capex undertaken by the company in FY23. High overall debt led to modest debt service coverage indicators of the company with interest coverage ratio and total debt to Gross Cash Accruals of 1.45x and 39.16x, respectively, during FY22 (FY21: 8.30x and 5.67x).

Although the company's capex has been completed during FY23, its capital structure is likely to remain leveraged over the near-term with sequential improvement likely with repayments of the term loans coupled with accretion of profits to reserve in coming years. However, this hinges on the company's ability to achieve capacity utilization at envisaged levels, which is likely to remain challenging in the current industry dynamics. Continued pricing pressure from established market players/new entrants is likely to suppress profitability margins, particularly if demand remains sluggish. The company's ability to achieve scale and profitability as envisaged will remain critical for its business prospects and will remain critical from credit perspective.

Raw material price volatility risk and foreign exchange fluctuation risk

The major raw materials for JEPL are mostly imported from India, the prices of which are market linked and determined on a periodic basis, thus exposing the company to the volatility in input prices which has a bearing on its profitability margins. The raw material cost contributed around 90% 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 ability of the company to pass through changes in raw material prices to the finished products and managing the foreign exchange fluctuation risks related to raw materials will be the key rating sensitivities.

Working Capital Intensive Nature of Operations

The operations of the company are working capital intensive in nature. JEPL is involved in manufacturing wide range of steel products and is required to maintain adequate inventory of raw material for smooth running of its production processes and meet immediate demand of customers. Also, being a highly competitive business, the company has to extend credit period to its dealers which is up to 90 days whereas company has to make immediate payment to its suppliers. Net-Operating cycle of the company was high at 168 days at the end of FY22 on account of high inventory holding period and high debtors. Furthermore, being a manufacturer, it is critical for the company to maintain minimum inventory levels to meet immediate demand of its customers; all this led to high working capital requirements which were largely met through bank borrowings.

Key Rating Strengths

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

JEPL has an operational track record of around two decades in manufacturing of various steel products. JEPL is promoted by industrialists and traders of Nepal, who are involved in manufacturing of cement, trading of construction materials, hospitality business among others. The company is managed under the overall guidance of its three-member Board of Directors (BoD) which includes eminent businessmen/industrialists with wide experience in the manufacturing sectors. The day-to-day operations of the company is looked after by Mr. Anil Kumar Rungta and Mr. Vishal Patwari, Directors, both having experience of two decades in the steel industry and handle marketing, purchase of material and production planning of the company.

Established brand with country wide market presence

JEPL has successfully established "Jagdamba" and "Jag Shakti" as a brand name in different type of iron and steel products in the domestic market. Established brand image ensures customer loyalty and aid in the differentiation of products with the competitors. Additionally, the company markets and sells its entire range of products through a well-established network. JEPL has a strong dealer base across all major cities in the country which provides a ready market for its products.

Diverse product range catering to wide spectrum of industries

JEPL manufactures variety of steel products of different sizes which includes TMT bars, MS Black Pipes, Galvanized Iron pipes, hot rolled strips, shutter profiles, shutter guide, shutter spring, lock plate, prefabricated building components, W-beams and different steel poles which finds application in varied industries including construction, automobile, chemical and oil industries etc. The wide application not only diffuses the risk of dependency on a single industry but also allows the company to cater to a larger market with a broad customer base.

Locational advantage

The plant site is located in Parsa, around 15 Kms from Indo-Nepal borders and Birgunj dry-port. Since majority of raw materials used by JEPL are imported from India, the factory's proximity to the border remains a positive point leading to saving in freight cost.

Stable long-term demand outlook of steel products in the country, however muted over the short 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. Hence, demand of steel products in the country is expected to grow over the long term. However, with the construction sector in Nepal currently impacted by slower pace of economic growth coupled with relatively lower infrastructure spending by the government, the outlook of steel industry in Nepal remains challenging over the near term. The government's long term emphasis on infrastructure development, namely development of roads, hydropower, airports and other infrastructures is likely to benefit steel product manufacturers like JEPL in the long term.

About the Company

Jagdamba Enterprises Private Limited (JEPL) is a private limited company which was incorporated on March 29, 2001 for setting up M.S. Black & Galvanized pipe manufacturing plant in Jeetpur, Parsa district of Nepal. The company is operating from more than 20 years, manufacturing wide range of steel products with total installed plant capacity of 920,600 Metric Tons Per Annum (MTPA) as on mid-July 2023.

Brief financials of JEPL for last three years ending FY22 are given below:

Financial Performance

(Rs. Million)

For the year ended mid-July	FY20 (A)	FY21 (A)	FY22 (A)
Income from Operations	14,981	14,026	15,461
PBILDT Margin (%)	4.35	10.78	3.19
Overall Gearing (times)	4.11	2.74	2.84
Total Outstanding Liabilities/Tangible Net worth (times)	4.31	3.10	3.05
Interest Coverage (times)	1.34	8.30	1.45
Current Ratio (times)	1.14	1.21	1.06
Total Debt/Gross Cash Accruals (times)	45.65	5.67	39.16

A: Audited

Annexure 1: Details of the Facilities Rated

Nature of the Facility	Type of the facility	Amount (Rs. In Million)	Ratings
Long Term Bank Facilities	Term Loan/Bridge Gap Loan	1,886.62	CARE-NP BB+
Short Term Bank Facilities	Fund Based Limits	3,470.00	CARE-NP A4+
Short Term Bank Facilities	Non–Fund Based Limits	10,450.00	CARE-NP A4+
Total		15,806.62	

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About CARE Ratings Nepal Limited:

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