

Real Steels Private Limited

Ratings

| Facility* | Amount (Rs. in Million) | Ratings ¹ | Rating Action |
|----------------------------|---|---------------------------------------|-------------------------------------|
| Long Term Bank Facilities | 431.93 | CARE-NP B+ [Single B Plus] | Revised from CARE-NP BB- |
| Short Term Bank Facilities | 1,075.00 | CARE-NP A4 [A Four] | Reaffirmed |
| Total Facilities | 1,506.93 (Fifteen Hundred Six Million and Nine Hundred Thirty Thousand Only) | | |

*Details of Facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has revised the rating assigned to the long term bank facilities of Real Steels Private Limited (RSPL) to 'CARE-NP B+' from 'CARE-NP BB-' and has reaffirmed the rating of 'CARE-NP A4' assigned to the short term bank facilities of RSPL.

Detailed Rationale & Key Rating Drivers

The revision in the ratings assigned to the bank facilities of RSPL factors in the decline in operational performance of the company in FY23 (Unaudited, FY refers to the twelve-month period ending mid-July) amid sluggish demand and stiff competition leading to suppressed profitability and weak debt service coverage indicators. The ratings continue to be constrained by RSPL's highly leveraged capital structure, working capital intensive nature of operations, raw material price volatility risk, foreign exchange fluctuation risk and exposure to volatile interest rates.

The ratings, however, continue to derive strength from the experienced promoters and management in the related field, locational advantage.

Going forward, the ability of the company to profitably scale up the operations with sustained improvement in capacity utilization, manage foreign exchange fluctuation risks related to raw materials 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

Declined operational and financial performance in FY23

Total operating income of the company declined by ~10% to Rs. 1,231 Mn in FY23 from Rs. 1,375 Mn in FY22 on account of muted demand as economic activities remained subdued. More concerning, the company reported PBIDLT level losses in FY23 on account of substantial increase in raw material costs which the company was unable to pass on to its customers. This resulted in substantial inventory losses for the company as cost of sales amounted to ~105% of TOI. Amid declined operating efficiency coupled with increased finance expenses, the company reported net losses of Rs. 236 Mn in FY23. Part of the operating losses were covered through additional equity infusion in FY23. Furthermore, continued financial support from promoters is expected, if needed, going forward as well.

Total gearing ratio of the company was highly leveraged at 25.42x at the end of FY23 which deteriorated from 3.95x at the end of FY22. This was majorly due deterioration in net worth of the company on account of losses during FY23. Attributed to losses at PBIDLT levels, RSPL had negative interest coverage ratio in FY23. Total debt to gross cash accruals of the company was also negative in FY23 owing to negative cash accruals. The company's ability to turnaround operating performance leading to improved cash generation from operations will be critical from credit perspective.

Elongated operating cycle with working capital-intensive nature of operations

RSPL is involved in manufacturing of wide range of steel products by majorly importing raw materials. RSPL 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 156 days in FY23 with average collection period from customers of 81 days and average inventory holding period of 88 days in FY23. 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 sanctioned limit was around 59% during last 12 months' period ending mid-July, 2023 and below unity current ratio as on FY23 reflects working capital intensive nature of operations.

Raw material price volatility risk and foreign exchange fluctuation risk

Hot rolled (HR)/ Cold rolled (CR) Coils are the major raw materials for RSPL and are majorly imported from India. The prices of RSPL'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. 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

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. Higher interest rates than envisaged could result in squeezed margins of the company. Hence, funding taken by the company is exposed 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**

RSPL is promoted by traders and businessmen from Birgunj City of Nepal who have wide experience in manufacturing steel and other businesses for more than two decades. RSPL is managed under the overall guidance of the Company's Board of Directors (BoD) who possesses wide experience in the industry. Mr. Prem Kumar Jatiya is the Chairman and Managing Director of the company. Mr. Jatiya, has been involved in different business for more than 20 years. Mr. Dipal Khanna, Executive Director, is Chartered Accountant by qualification and is also engaged in the trading of TMT bars, MS Pipes and other hardware items.

Locational Advantage and Product diversification

RSPL manufactures MS Pipe that has great usage in construction, automobile, chemical and oil industries including residential housing, shed construction. The company also offers its customers shutter profiles along with cutting Hot Rolled Coil (HRC) and Cold Rolled Coil (CRC) in different sizes. Also, the company has added new segment Shutter Spring, Lock Plate and Kaan Plate segment from FY22. The company has been focusing on supply of Prefabricated Trust Shed (PEB) and providing site installation services from last year onwards. Diversification allows for more variety and options for the customers and consequently provides a tremendous boost to product marketing. Also, being in close proximity with the Indian border, RSPL has potential for export sales in adjacent Indian states.

Industry prospects

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 RSPL in the long term.

About the Company

Real Steels Private Limited (RSPL) is a private limited company and was incorporated in March 2018. The manufacturing is located at Birgunj, Nepal and the company started its commercial operation since January, 2020. The company manufactures MS Pipes, Shutter Patti, Shutter Guide and other related products with total annual production capacity of 49,800 MT per annum for MS Pipes, Shutter Patti, Shutter Guide, Hot Rolled (HR) Coil/ Sheet, Cold Rolled (CR) Coil/ Sheet, Lock Plate, Kaan Plate and Shutter Spring as on mid-July 2023.

Brief financials of RSPL for the past three years ended FY23 are given below:

| For the year ended Mid-July | FY21 | FY22 | FY23 |
|--|-----------|-----------|---------------|
| | (Audited) | (Audited) | (Provisional) |
| Income from Operations | 1,158 | 1,375 | 1,231 |
| PBILDT Margin (%) | 10.85 | 9.47 | Negative |
| Overall Gearing (times) | 4.06 | 3.95 | 25.42 |
| Interest Coverage (times) | 4.33 | 1.50 | Negative |
| Current Ratio (times) | 0.93 | 1.18 | 0.85 |
| Total Debt/Gross Cash Accruals (times) | 10.58 | 27.85 | Negative |

(Rs. Million)

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 | 431.93 | CARE-NP B+ |
| Short Term Bank Facilities | Fund/Non-Fund Based Limit | 1,075 | CARE-NP A4 |
| Total | | 1,506.93 | |

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