

## Siddhi Laxmi Steels Private Limited: [ICRANP] LB+/A4 (Assigned)

July 8, 2019

### Summary of rated instruments:

Instrument*	Rated Amount (NPR Million)	Rating Action
Long-term loans; fund-based	1,260	[ICRANP] LB+ (Assigned)
Short-term loans; fund-based	1,250	[ICRANP] A4 (Assigned)
Short-term loans; non-fund based	(1,800)	[ICRANP] A4 (Assigned)
<b>Total</b>	<b>2,510</b>	

\* Instrument details are provided in Annexure-1

### Rating action

ICRA Nepal has assigned a long-term rating of [ICRANP] LB+ (pronounced ICRA NP LB plus) to the NPR 1,260 million long-term loans of Siddhi Laxmi Steels Private Limited (SLS). ICRA Nepal has also assigned a short-term rating of [ICRANP] A4 (pronounced ICRA NP A four) to the existing and proposed short-term loans of NPR 1,250 million (including non-fund based limits).

### Rationale

The assigned rating factors the positive demand outlook for steel products in Nepal and duty protection accorded to the domestic steel industry by the Government of Nepal (GoN), through import barriers on finished steel products. The rating also considers SLS's promoter group's established reputation in the domestic business arena; albeit not in the steel sector. The rating further takes comfort from SLS's management team with extensive experience in the steel and cement industry. ICRA Nepal notes the locational advantage available to SLS from its proximity to the Indian border and the national (east-west) highway for raw material import from India as well as product distribution (TMT bars) across the country.

The rating is, however, constrained by the project execution risk, albeit mitigated by the advanced stage of project development. Off-take of the manufactured product remains the key risk for SLS, given the highly fragmented and competitive TMT segment, lack of established supply chain and limited experience of the promoters in this sector. Smooth off-take remains paramount for SLS's debt repayment capacity, given the high gearing of the project. Further, the company's exposure to regulatory risks also remains a key rating sensitivity, as any reduction in import tariff by the GoN will have an adverse impact on the profit margin and financial indicators of SLS. The rating is also tempered by the company's limited product diversification (100% revenues expected from TMT bars in the near term and ~90% in the medium term) and the inherent cyclical nature associated with the steel industry, thus exposing the company to cash flow volatility. SLS is also exposed to forex risks, with its raw material (billet) purchases in US Dollar terms and sales realisation in the domestic currency. This risk has also been factored into the assigned rating.

### Key rating drivers

#### Credit strengths

**Positive demand outlook for steel products in Nepal** - Nepal's import of steel products increased by 36% in FY2018 over ~33% in FY2017. During 9M FY2019, the import of steel products grew by 27% over the same period in FY2018<sup>1</sup>. This indicates a growing demand for steel products in Nepal. The growth is expected to remain strong over the medium term, given the country's large infrastructural as well as household construction needs. Moreover, improvement in political outlook and the formation of local/state governments after a long period of political transition and instability are expected to provide an impetus to infrastructure development across the country. Given the higher custom tariffs for

<sup>1</sup> Data from Trade and Export Promotion Centre Nepal

most finished steel products (including TMT bars), import barriers remain high. Hence, domestic steel producers like SLS are expected to benefit from the strong domestic demand.

**Strong promoter group** - SLS is a new venture of an established and reputed business house (Laxmi Group) in Nepal. The Group has been active in the Nepalese business arena since 1973 with an established track record in trading (automobile and electronics) and manufacturing (confectionary, plastics and packaging, dairy, etc). Although the Group's experience in manufacturing and trading construction material is limited, SLS is expected to benefit from the reputation and financial strength of its major promoters.

**Senior management with adequate industry experience** - The senior management team of SLS (head of operations, finance, sales and marketing, etc) has adequate experience in Nepal's cement and steel industry. This is expected to help in the initial off-take and market penetration.

## Credit Challenges

**High off-take risk** - The iron and steel manufacturing industry in Nepal is highly competitive and fragmented with more than 25 secondary steel producers (mostly rolling mills) in operation. Further, low entry barriers to the new players and capacity expansion by old players have intensified the competition in the segment. SLS's ability to create a market for itself remains a major challenge, given the competitive intensity and the lack of an established supply chain. SLS's ability to manage a healthy off-take will have a bearing on its profitability and financial indicators.

**High gearing and moderate cash flows in the stabilisation phase likely to result in stretched debt coverage indicators** - SLS's TMT line with an annual installed production capacity of 200,000 MT is estimated to be commissioned at the cost of ~NPR 1,350 million, to be ~76% debt-funded. However, the project is expected to operate at sub-optimal capacity utilisation in the early years until product stabilisation is achieved. At the same time, given the working capital intensive nature of business and competitive intensity of the industry, debtor days and inventory days are expected to remain high in the early years, necessitating external working capital financing. Hence, SLS is expected to operate with high gearing. Coupled with the expected sub-optimal capacity utilisation, moderate cash flows and prevailing high interest rate regime, this is likely to result in modest debt coverage indicators for the company.

**Regulatory risk**- Being a duty-protected industry, SLS remains exposed to the risk of regulatory changes to import tariffs. SLS's projected profitability and financial indicators are aided by the high import barriers on finished steel products like TMT (up to 30% of custom duty). Reduction or removal of import duty/ tariff could have a significant impact on the company's incremental revenue profile, profit margin and debt coverage indicators.

**Limited product diversification**- TMT bar sales will account for 100% of SLS's revenue in the near term. This exposes SLS to product concentration risks. Although the management plans to add wire rods and structures to its product portfolio after the stabilisation of TMT production, ~90% of its revenue is still expected to come from TMT sales. The same is expected to result in SLS's continued high product concentration risk in the mid-term as well.

**Inherent cyclicity of the industry** - The cyclical nature of the steel industry is expected to create uncertainty in the demand and cash cycles of SLS. This could have a significant impact on the capacity utilisation, revenue and profit margins of the company. Volatility in the cash flows due to the cyclicity in the cash cycle could pose challenges, especially during periods of weak demand.

**Forex risk** - SLS is exposed to forex risks because of the currency mismatch between its raw material purchase (in US Dollar) and its revenue realisation from finished goods sales (in Nepalese Rupee). The risk becomes pronounced due to the lumpiness in procuring raw material and the expected use of unhedged US Dollar loans to finance SLS's raw material imports.

**Analytical approach:** For arriving at the ratings, ICRA Nepal has applied its rating methodology as indicated below.

**Links to applicable criteria:**

[Corporate Credit Rating Methodology](#)

## About the company

Promoted by the Laxmi Group, Siddhi Laxmi Steels Private Limited was established in 2017 as a private limited company. It is a family-owned business, with Mr. Ganesh Bahadur Shrestha and his three sons, Mr. Anjan Shrestha, Mr. Nirakar Shrestha and Mr. Niranjan Shrestha, holding the entire equity stake (through Laxmi Holding Private Limited, an SPV).

SLS is setting up a rolling mill for manufacturing TMT steel bars (under the brand name, “Samriddhi Steels”) using billets that are mainly imported from India. With an annual installed production capacity of ~200K metric tonne (MT), the factory is located in the Ramgram Municipality of Nawalparasi. The estimated total project cost is ~NPR 1,642 million (~NPR 1,350 earmarked for TMT line) out of which NPR 1,260 million was debt-funded (~NPR 1,000 million earmarked for TMT line) and the rest equity funded. As of April 2019, ~90% of the project’s financial progress had been achieved. In terms of physical progress, the project is in the advanced/ final stage of completion and is expected to be operational by July 2019. SLS mainly plans to cater to the domestic demand for TMT bars.

## Annexure-1: Instrument Details

Instrument	Limit (Amount in NPR Million)	Rating Action
Long-term, Fund-based (Term loan)	1,260.00	[ICRANP] LB+
<b>Total long term, fund based (A)</b>	<b>1,260.00</b>	
<b>Short Term</b>		
Fund-based, (Overdraft /Demand loan)	1,250.00	[ICRANP] A4
Non-fund based, (Letter of credit/ Trust Receipts/Bank Guarantee)- (within funded limits)	(1,800.00)	[ICRANP] A4
<b>Total short term, fund based/non-fund based (B)</b>	<b>1,250.00</b>	
<b>Grand total (A+B)</b>	<b>2,510.00</b>	

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