Rajesh Metal Crafts Private Limited: [ICRANP] A2 (Assigned)

February 9, 2019

Summary of rated instruments:

Instrument*	Rated Amount (NPR Million)	Rating Action
Short-term loans; fund-based	5,135	[ICRANP] A2 (Assigned)
Short-term loans; non-fund based – Letter of credit	1,455	[ICRANP] A2 (Assigned)
Total	**6,590**	

* Instrument details are provided in Annexure-1

Rating action

ICRA Nepal has assigned the short-term rating of [ICRANP] A2 (pronounced ICRA NP A two) to the existing as well as proposed short-term loans (including non-fund-based limits) of Rajesh Metal Crafts Private Limited (RMC).

Rationale

The assigned rating factors in RMC's established track record (operating since 1993) and good market positioning in the steel pipe and sheet manufacturing segment. The rating also considers 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. ICRA notes that the presence of limited number of players in Nepal in the pipe and sheet segment, duty protection against imports, and a favourable growth in demand (especially for sheets) after the April 2015 earthquake has led to higher sales realisation, healthy operating margin and net profitability for the company in the last few years. The rating action also takes into consideration RMC's good capitalization levels and absence of long-term debt resulting in low gearing level. Moreover, strong profitability of RMC and moderate debt-burden has resulted in healthy debt coverage indicators for the company. RMC has retained a major portion of its internal accruals in the last four to five years, thereby reducing its reliance on external working capital financing. Absence of long-term debt and a decline in reliance over external working capital financing is likely to increase RMC's financial flexibility and enable the company to better withstand industry cyclicality associated with the steel business. The rating further takes comfort from the promoter groups' long experience in the steel industry.

The ratings, however, are constrained by the company's exposure to regulatory risk. Any reduction in import tariff by the government will have an adverse impact on the profit margin and financial indicators of RMC, and therefore remains a key rating sensitivity. ICRA notes that the pipes and sheets segment is expected to see fresh capacity creation over the medium term following the entry of new players, leading to an increase in competitive intensity, and consequently, this is likely to moderate industry margins going forward. The rating is also tempered by the company's limited product diversification (~95% revenues accounted for by sheets and pipes), and the inherent cyclicality associated with the steel industry, exposing the company to volatile cash-flows. RMC is also exposed to the forex risk, with the raw material purchases in US Dollars and sales realization in the domestic currency. This 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 from India (including semi-finished products like hot rolled coils, billet, ingots, sponge iron, etc.) registered a sharp growth in FY2017 and FY2018 (96% and 15% year-on-year respectively). Between April and October 2018, Nepal was the largest importer of steel products from India (registering an annualised growth of 64% over FY2018). This indicates a growing demand for steel products in Nepal. The growth is expected to remain strong over the medium term, supported by the reconstruction drive following the earthquake in 2015. Moreover, the recently concluded local/state election and formation of a local government are expected to provide an impetus to infrastructural development across the country. Given the higher custom tariff for most of the finished steel products (including pipes and sheets), import barriers remain high. Hence, steel producers in Nepal are expected to benefit from strong domestic demand.

Healthy operating profit margin in consolidated steel pipe and sheet segment

RMC is one of the four major players in the Nepalese domestic market, producing steel pipes and sheets. A limited number of players, duty protection against cheaper imports and good demand in the domestic market has resulted in higher sales realisations for RMC in the past two to three years, which has translated into healthy operating profit margin and overall profitability. The proportion of revenue from galvanised and colour-coated sheet in overall sales has increased in the recent years. Higher margin associated with sheets has also strengthened the operating profitability for RMC.

Healthy capitalisation, low gearing levels and promoters' financial strength increases financial flexibility

Healthy profitability and retention of major portion of profits over the years has boosted RMC's net worth and brought down its gearing level. RMC does not have any long-term debt in its capital structure and the retained profits have kept the need for external working capital financing at lower level. Given the inherent cyclicality in the steel industry, lower debt-burden and reliance on external financing remains a positive. This is also likely to increase the company's ability to withstand industry cyclicality by increasing its financial flexibility.

Established track record of the company

RMC has been in operation since 1993 and remains one of the established players in the steel pipes and sheets segment. Established brand and traction with dealers and customers over the years remains a comfort to the revenue sustainability and incremental financial indicators of RMC. Moreover, the promoters' experience in the segment and their prior experience in retail trade of construction materials also is significant.

Credit Challenges

Regulatory risk

Being a duty-protected industry, RMC remains exposed to the risk arising from change in regulations related to import tariffs. RMC's healthy profitability and financial indicators are aided by the high import barriers on finished steel products like sheets and pipes (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

During FY2017 and FY2018, ~95% of the total revenue for RMC was accounted for by pipes and sheets. This creates a product concentration risk. Within the pipe segment, although the black pipes sales remain strong, the sales of galvanised pipes have come down over the years, being substituted by cheaper polyvinyl chloride (PVC) pipes. RMC's recent growth in sales is heavily supported by the sheets (galvanised and colour-coated), which is mostly used for roofing purposes. Any change in consumer preferences for roofing or availability of cheaper roofing alternatives could affect RMC's financial indicators.

Inherent cyclicality of the industry

Cyclical nature of the steel industry creates uncertainty about the demand and cash cycles for RMC. This could have an impact on the capacity utilisation, revenue and profit margins of the company. Volatility in the cash flow due to cyclicality in the cash cycle could pose challenges, especially during the period of weak demands.

Forex risk

RMC is exposed to forex risk because of the mismatch in the currency for purchase of raw materials (US dollar) and that of revenue realisation from sales of finished goods (Nepalese rupees). The risk becomes pronounced due to the lumpiness in procurement of raw material and use of generally unhedged US dollar loans by RMC to finance the raw material imports in the last one to two years.

High working capital intensity and tight liquidity in banking sector
RMC's business is highly working capital intensive as reflected in the net working capital to operating income (NWC/OI) ratio of ~54% in FY2018 (relatively higher due to higher inventory level maintained towards year-end). RMC's working capital cycle elongates during the period when high inventory levels are maintained or when the demand for products is low. Going forward, increased competition could have an impact on debtor realisation days, and accordingly increase the working capital cycle. Given the volatility in the banking sector liquidity, RMC's ability to secure necessary working capital funding during the period of stretched working capital cycle also remains a challenge.

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

Rajesh Metal Craft Private Limited was established in 1993 as a public limited company by Mr. Shrawan K. Agrawal. The company was subsequently converted into a private limited company on July 11, 2016. RMC is a family-owned business wherein Mr. Shrawan Agrawal and his two sons (viz Rajesh K. Agrawal & Mr. Vishnu K. Agrawal) hold the entire equity stake.

RMC is a secondary steel producer, involved in manufacturing steel pipes and sheets (galvanised and colour coated) among other products. RMC imports hot rolled coils (HRCs) as primary raw material, processes it into cold rolled coils (CRCs) in its cold-rolling mill and manufactures finished goods. The HRCs are imported from primary steel producers in India. RMC mainly caters to the domestic market which accounted for ~99% of company's sales in FY2018, with negligible portion of sales as exports to neighbouring Indian states across the Indo-Nepal boarder.

RMC has an annual installed capacity of ~212,750 metric tonne, including ~57000 metric tonne capacity each for pipes (black and galvanised), ~57,000 MT of sheets (plain and corrugated), ~55,000 metric tonne of colour sheets and ~18,000 metric tonne of cut-to-length HR/CR sheets. Pipes and sheets account for ~88% of the installed capacity of RMC. Also, pipe and sheet products accounted for ~95% sales in FY2017 and FY2018. Other smaller product lines of RMC include rolling shutters profiles, tubular and telescopic poles and other fabricated steel structures.

RMC's customer base mostly includes individual end-users across the country, and it uses independent dealership outlets across the country to sell its products.

Key financial indicators of RMC:

	FY2016 (Audited)	FY2017 (Audited)	FY2018 (Audited)
Operating Income-OI (NPR Million)	4,676	5,336	7,160
Profit After Tax (NPR Million)	680	652	1,020
OPBDITA/OI (%)	21.90%	18.78%	19.87%
Total Debt/Tangible-net-worth TNW (times)	0.66	0.00*	0.76
Total Outside Liabilities/ TNW (times)	1.28	0.83	0.98
Total Debt/OPBDITA (times)	0.89	0.00	1.52
Interest Coverage (times)	17.34	16.41	54.64
DSCR (times)	8.60	13.52	44.63
Net-working capital/OI (%)	26.47%	10.54%	54.16%

Source: Company data
**working capital bank financing replaced by usance LC from creditors*

Annexure-1: Instrument Details

Instrument	Limit (Amount in NPR Million)	Rating Action
Fund-based, Short-term (Demand loan/Trust receipt loan/Overdraft/ short term loan)	5,135	[ICRANP] A2
Non-fund based, Short-term (Letter of credit/ Bank Guarantee)	1,455	[ICRANP] A2
Total	**6,590**	

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About ICRA Nepal Limited:

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