Hulas Wire Industries Limited: [ICRANP] LBB+/A4+ assigned

April 12, 2021

Summary of rated instruments

Instrument*	Rated Amount (NPR million)	Rating Action
Long-term loans	82.50	[ICRANP] LBB+; assigned
Short-term loans	5,196.13	[ICRANP] A4+; assigned
Total	**5,278.63**	

** Instrument details are provided in Annexure-1*

Rating action

ICRA Nepal has assigned a long-term rating of [ICRANP] LBB+ (pronounced ICRA NP L double B plus) to the long-term loans and a short-term rating of [ICRANP] A4+ (pronounced ICRA NP A four plus) to the short-term loans of Hulas Wire Industries Limited (Hulas).

Rationale

The assigned ratings factor in Hulas' long track record (since 1979), the good brand recall of 'Hulas', the established distribution network and the adequate scale of operations. The ratings also factor in the company's strong promoter profile, comprising members from the Golchha family, which is an established business house with a diversified presence in various manufacturing and trading sector entities in Nepal, and its experienced management team. The ratings also consider Hulas' adequate financial profile characterised by a comfortable gearing level (TD/TNW of 1.4 times as of mid-July 2020) and adequate debt coverage indicators (notwithstanding the moderation in FY2020 caused by the Covid-19 pandemic). The company's ability to withstand the liquidity shocks arising from the pandemic is supported by the adequate headroom in its working capital drawing power (unutilised drawing power at ~35% as of mid-December 2020), which has also been factored into the rating action. The ratings also consider Hulas' adequately diversified product portfolio (galvanised iron (GI) wires, TMT bars, brass sheet/strips, etc) and the duty protection accorded by the Government of Nepal to the domestic steel industry.

Nonetheless, the ratings are constrained by the sustained and ongoing moderation in the company's operating margins over the years (4.9% in FY2020 against 11.4% in FY2017) on account of the increasing competition. This, coupled with the increasing working capital intensity (net working capital to operating income of ~47% in FY2020 against 14% in FY2017) of the business, has led to higher requirement for working capital financing, which is largely debt-funded. This has led to a higher debt burden vis-à-vis the operating profits (total debt/OPBDITA of 8.4 times in FY2020 vs. 5.2 times in FY2019) which, in turn, has supressed its debt service indicators (debt service coverage ratio (DSCR) of 1.7 times and interest coverage of 1.8 times in FY2020 against 5.7 times and 6.5 times, respectively, in FY2017). Rating concerns also arise from raw material price fluctuation risk as well as forex risks as most of the imports are in US dollar terms. As it is a player in a duty-protected industry, Hulas is also exposed to regulatory risks as any reduction/removal of import duty will affect its financial profile significantly. Going forward, Hulas' ability to maintain its operating income amid increased competition, protect its margins and improve its debt coverage and capitalisation indicators will remain a key rating sensitivity.

Key rating drivers

Credit strengths

Long track record of operations and diverse product portfolio with good brand traction – The company has been in the business of manufacturing GI wires, TMT bars, copper wires, etc, since 1979. Over these years, it has been able to develop good traction for its products in the local as well as export markets. With good brand recall and sizeable installed capacity, Hulas remains one of the key players in the segment. Further, the presence of a diverse line of products has helped the company maintain a modest business performance over the years. In FY2020, the GI wire segment dominated the sales at ~34%, followed by TMT bars at ~31%, brass sheet/strips at 11%, black pike at ~10%, with various other product segments accounting for the rest.

Comfortable capitalisation – With generally low dividend payouts and healthy cash accruals over the years, Hulas has a sizeable net worth base of ~NPR 1,486 million (~74% in the form of accumulated profits) as of mid-July 2020. This is reflected in the comfortable capitalisation with a gearing of 1.4 times as on the same date despite a slight increase over the years (0.8 times as of mid-July 2017). Though the gearing is expected to increase slightly going forward with the proposed capex, the overall financial profile is expected to remain satisfactory.

Strong promoter profile and experienced directors/management – The company is promoted by members of the Golchha family, which has a long and established presence in various reputed manufacturing and trading entities in Nepal. The company's affiliation with the Group, along with its own established track record, provides it with adequate financial flexibility. Additionally, the company's board and management team comprises experienced individuals, which augurs well in terms of incremental business performance.

Strategic location – Hulas' factory in Biratnagar district (eastern Nepal) has locational advantage both for importing raw materials from India and for supplying final products all over Nepal and to nearby towns in India. The nearest Nepal-India border of ~16 km limits the logistics cost associated with the import of raw material and export of finished goods. Further, the factory area is close to the national East-West Highway, which supports easy supply of finished products to all parts of the country.

Credit challenges

Declining operating margins and reducing export sales – With increasing price competition, Hulas' operating margins declined gradually over the years to ~5% in FY2020 from ~11% in FY2017. Additionally, the company's operating revenues witnessed a sharp decline of ~36% in FY2020, which remains a major concern. Though a part of the revenue decline can be attributed to the Covid-19-related lockdowns in the last four months of the year, revenues were already in a declining trend of ~24% even in the pre-Covid period (i.e. 8M FY2020). This was mainly on account of declining export revenues (~70% decline in FY2020), which used to contribute ~35% to the annual revenues till FY2019. Exports were less prioritised with the company being unable to get a bonded warehouse facility after the introduction of 50% export requirements to avail the same. Hulas' debt service indicators also declined over the years, while remaining adequate with a DSCR of 1.7 times in FY2020. ICRA Nepal expects the debt service indicators to remain at similar levels over the medium term, primarily on the expectation of a gradual improvement in the scalability to pre-Covid levels.

High working capital intensity – Hulas' working capital intensity (NWC/OI) has gradually increased over the years with a further increase in FY2020 to ~47% (~38% in FY2019). This was mainly on account of the high inventory and debtor days, which have been increasing over the last few years. These stood at 99 and 77 days, respectively, as of mid-July 2020 (54 and 50 days, respectively, as of mid-July 2018). However, the company's dependence on bank borrowings to finance its working capital requirements is generally moderate, wherein its short-term borrowings were ~65% of its drawing power as of mid-December 2020. This provides it with adequate financial flexibility and hence remains a comfort.

Intense competition – The TMT bar production capacity of the Nepalese steel industry witnessed a significant increase in the last two to three years, following the commissioning of new manufacturing units and capacity expansion by existing TMT players. Fresh capacity creation/expansion was driven by the healthy growth seen in the steel segment between FY2016 and FY2018, wherein demand was boosted by the post-earthquake reconstruction drive and commencement of a few large infrastructure projects. With the event-induced demand moderating, the industry is currently witnessing a capacity overhang situation. Amid moderation in demand and increasing competition, realisations have softened, negatively impacting the operating margins. The Covid-induced slowdown in business activities could further weaken the demand and margin outlook for Hulas over the near term.

Vulnerability to inherent cyclicality of the industry and forex risk – The cyclical nature of the steel industry is likely to keep Hulas' profits and cash flows volatile. Raw material prices (mostly imported in US dollar terms) are prone to volatility, given the fluctuation in global prices and the volatility in the US dollar exchange rate. The risk becomes pronounced due to the lumpiness in the procurement of raw materials. Hulas is also exposed to forex risk because of the mismatch in the currency used for the purchase of raw material (US dollar) and the currency used for revenue realisation from the sale of finished goods (Nepalese rupees), amid its partial hedging practices.

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

Hulas Wire Industries Limited (Hulas) is one of the oldest players in the wire and steel product manufacturing industry. It was incorporated in 1979 as a private limited company and was later converted to a public limited company in 2006. The company is promoted by the members of the Golchha family with most of the shares held by Mr. Ishan Golchha (~29%) and Miss Rajlaxmi Golchha (~17%); the remaining ~54% is held by 22 other individuals (mostly from the Golchha family).

Hulas manufactures and sells GI wires, TMT bars, brass sheets and other metal and steel-based products. It mostly caters to the domestic market though a chunk of its products is also exported to India. It has an overall annual installed production capacity of 55,000 metric tonnes (MT) for GI wires, 60,000 MT for TMT bars/angels/strips and channels, 75,000 MT for M.S. billets, M.S. black pipes, and M.S. GI pipes, 14,400 MT for gabion boxes and ~31,950 MT for other ancillary products such as ribbed wires, copper nails, brass products, galvanising steel strips, etc.

Key financial indicators

	FY2017 (Audited)	FY2018 (Audited)	FY2019 (Audited)	FY2020 (Audited)
Operating income (OI; NPR million)	6,964	7,519	7,901	5,075
OPBITDA/OI (%)	11.4%	6.9%	6.6%	4.9%
Total debt/Tangible net worth (TNW; times)	0.8	1.2	1.7	1.4
Total outside liabilities/TNW (times)	2.0	1.8	1.9	1.7
Total debt/OPBITDA (times)	1.0	3.0	5.2	8.4
Interest coverage (times)	6.5	5.8	4.2	1.8
DSCR (times)	5.7	5.4	3.5	1.7
Net working capital/OI (%)	14%	22%	38%	47%

Source: Company data

Annexure-1: Instrument details

Instrument	Rated Amount (NPR million)	Rating Action
Long-term limits (A)	**82.50**	[ICRANP] LBB+ (Assigned)
Fund-based limits (term loan - existing)	82.50	
Short-term limits (B)	**5,196.13**	[ICRANP] A4+ (Assigned)
Fund-based and non-fund based limits (working capital loans)	5,196.13	
Total (A+B)	**5,278.63**	

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About ICRA Nepal Limited

ICRA Nepal Limited, the first credit rating agency of Nepal, is a subsidiary of ICRA Limited (ICRA) of India. It was licenced by the Securities Board of Nepal (SEBON) on October 3, 2012. ICRA Nepal is supported by ICRA Limited through a technical support services agreement, which envisages ICRA helping ICRA Nepal in areas such as rating process and methodologies, analytical software, research, training, and technical and analytical skill augmentation.

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For more information, visit www.icranepal.com

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