Laxmi Steels Private Limited: Ratings downgraded to [ICRANP] LBB-/A4; Rating Watch with Negative Implications removed

July 5, 2021

Summary of rated instruments

Instrument*	Previous Rated Amount (NPR Million)	Current Rated Amount (NPR Million)	Rating Action
Long-term limits; fund based	399.0	399.0	[ICRANP] LBB- (Downgraded from [ICRANP] LBB@[1]; removed from Rating Watch with Negative Implications)
Short-term limits; fund based	5,695.0	5,695.0	[ICRANP] A4 (Downgraded from [ICRANP] A4+@; removed from Rating Watch with Negative Implications)
Short-term limits; non-fund based	580.0	580.0	[ICRANP] A4 (Downgraded from [ICRANP] A4+@; removed from Rating Watch with Negative Implications)
Total	**6,674.0**	**6,674.0**	

** Instrument details are provided in Annexure-1*

Rating action

ICRA Nepal has downgraded the long-term rating of Laxmi Steels Private Limited (LSPL) to [ICRANP] LBB- (pronounced ICRA NP L double B minus) from [ICRANP] LBB@ (pronounced ICRA NP L double B). ICRA Nepal has also downgraded the short-term rating to [ICRANP] A4 (pronounced ICRA NP A four) from [ICRANP] A4+@ (pronounced ICRA NP A four plus). The ratings have been removed from Watch with Negative Implications.

Rationale

The downward revision in the ratings factors in the weak financial performance of the company in the last 12-18 months amid intense competition in the industry and the Covid-19 pandemic. The company witnessed a sharp decline in revenue and operating margins in FY2019 and FY2020. LSPL's gearing and debt burden increased significantly after the dividend pay-out in FY2018 and FY2019. All these have strained the debt coverage ratios and liquidity profile of the company considerably vis-à-vis the earlier estimates, triggering ratings downgrade. LSPL reported a revenue decline of ~45% in FY2020 with an operating margin of merely 1.4%, resulting in a net profit margin of -4.1%. The industry margins have moderated considerably after FY2018 because of capacity overhang in the industry and ensuing competition and is likely to remain supressed due to the ongoing pandemic. Falling revenues and high working capital intensity which is largely debt-funded, has strained the financial profile by increasing debt burden, creating liquidity pressure and eroding the debt coverage ratios in FY2020. Although some improvements have been reported in revenues and margins in 9M FY2021, partly supported by the pent-up demand from FY2020, its sustainability remains to be seen.

The ratings action also factors in the company's exposure to regulatory risks, which also remain a key rating sensitivity, as any reduction in the import tariff by the Government of Nepal (GoN) will have an adverse impact on LSPL's profit margin and financial indicators. The ratings are also tempered by the company's limited product diversification (~96% of FY2020 revenues came from TMT sales) and the inherent cyclicality associated with the steel industry, thus exposing the company to cash flow volatility. LSPL is also exposed to forex risks, given the practice of financing the import of raw material (billet) through partially hedged US-dollars denominated import loans and sales realisation in the domestic currency. The current debt coverage ratios are also benefitted by the lower interest rates in dollar-denominated import loans from the domestic banks and therefore any uptick in the interest rates will also remain a rating monitorable.

Nonetheless, the ratings continue to derive strength from LSPL's long track record in the industry and its experienced promoter group and management team. LSPL has one of the largest and established thermo-mechanically treated (TMT) steel manufacturing units in Nepal. The resulting economies of scale remains a positive for the company, especially in the increasingly competitive industry. LSPL's established supply chain and customer base, coupled with the synergy accruing from the Saurabh Group's other units in the steel and

1 @ Denotes rating watch with negative implications cement industry, remain rating strengths. The ratings factor in the positive demand outlook for steel products in Nepal and the duty protection accorded to the domestic steel industry by the GoN through import barriers on finished steel products. ICRA Nepal notes the location-specific advantages available to LSPL, given its proximity to the Indian border and the National (East-West) Highway, for the import of raw materials from India as well as distribution of products (TMT bars) across the country.

Key rating drivers

Credit strengths

Strong promoter Group and established track record in the industry – LSPL is promoted by the Saurabh Group, a joint venture (JV) between the Neupane and Agrawal families. Both the families are among the established business houses in the country. Apart from its long experience in the steel and cement manufacturing industry, the Group has a stake in spinning mills, tea estates, synthetic packaging bags, plastic packaging manufacturing etc. Operating since 2008, LSPL is one of the largest and established units in the Nepalese iron and steel industry. The Group's other units in the steel and cement industry (Jagadamba Cement, Sarbottam Cement, Sarbottam Steels etc) generate synergies in the production process and supply chain.

Positive demand outlook for domestic players owing to infrastructural gaps and high import barriers – Notwithstanding the decline in FY2020, partly due to the slowdown caused by the Covid-19 pandemic, the import of steel products in Nepal has grown at a healthy pace (33%, 26% and 17% growth in FY2017, FY2018 and FY2019, respectively). As per the import statistics published by Nepal Rastra Bank, the Central Bank of Nepal, billet import in 8M FY2021 surpassed the FY2020 level. This shows a robust long-term demand for steel products in Nepal. Given the country's significant infrastructural as well as household construction needs, the growth is expected to remain moderate to strong over the medium to long term. Moreover, the empowerment of local government and an increase in economic activities across the country are expected to provide an impetus to the infrastructure development. Additionally, import barriers for most finished steel products are high because of custom tariffs, which benefit domestic steel producers, including Laxmi Steels.

Credit challenges

Capacity overhang in the industry and resulting competition supress growth and profitability outlook – The TMT bar production capacity of the Nepalese steel industry increased significantly in the last two to three years, following the commissioning of new manufacturing units. At the same time, existing TMT players have undergone capacity expansion. The overall production capacity of the industry has also bolstered owing to improved power supply with a significant decline in power cuts at the industrial units in the last 2-3 years. The fresh capacity creation/expansion was driven by a 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 post-earthquake reconstruction drive approaching the end and a moderation in the pace of infrastructural development, the industry is currently witnessing a capacity overhang situation, with the average capacity utilisation of the industry remaining below 50% in the last 12-18 months. The situation has been further exacerbated by the ongoing Covid-19 pandemic and the resulting moderation in steel demand.

Limited product diversification – TMT bar sales accounted for ~96% of LSPL's revenues in FY2020 with the remaining sales mostly coming from products like ribbed wire and binding wire. This exposes LSPL to product concentration risks, especially in view of the increased competition in the TMT bar industry.

Moderation in financial profile, high gearing, declining margins and modest debt coverage indicators – LSPL's net worth and liquidity position deteriorated due to a series of dividend pay-outs by the company to its shareholders between FY2016 and FY2018. This, coupled with a net loss in FY2019 and FY2020, eroded the capital base and increased the company's gearing (~5 times as of mid-July 2020). LSPL's operating profit margin registered a continuous and a sharp decline to ~1.4% in FY2020 (from ~17% in FY2017), which, in turn, led to a deterioration in the interest coverage ratio to 0.3 times in FY2020. For FY2020, the company's DSCR stood at 0.2 times necessitating the injection of a director's loan to support debt repayments. In the current situation of diminishing margins, stretched cash cycles and high dependence upon working capital financing requirement, LSPL's liquidity is likely to remain under pressure.

Vulnerability to inherent cyclicality of the industry and forex risk – The cyclical nature of the steel industry is likely to keep LSPL's profits and cash flows volatile. The company also remains exposed to forex risks because of a significant dependence on imports for raw materials (mainly mild steel billet) procurement.

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

Laxmi Steels Private Limited (LSPL) is one of the largest and established players in the iron and steel products manufacturing industry. It was set up in 2008 as a private limited company. It is owned by the Neupane and Agrawal families under the common group name – Saurabh Group. Both the promoter groups belong to reputed business houses in Nepal with stakes in different sectors.

LSPL is a secondary steel manufacturer that produces TMT bars, ribbed wire and binding wire, all under the Laxmi Steels brand. Its raw materials, mainly iron billets, are imported from primary steel manufacturers in India. LSPL has an annual installed production capacity of ~2,00,000 metric tonnes for TMT bars and ribbed wire at present.

The company is jointly held by the Neupane and Agarwal families. The Neupane family (through Mr. Tikaram Neupane, Mr. Ankur Neupane and Mr. Bishnu Prasad Neupane) holds a ~65% stake while the Agarwal family (through Mrs. Mina Kumari Agarwal and Mrs. Neha Kumari Agrawal) holds the balance. Mr. Tikaram Neupane is the Managing Director of the company.

Key financial indicators:

Amount in NPR million	Audited			Provisional
	FY2018	FY2019	FY2020	9MFY2021
Operating Income OI (Sales; in NPR Million)	7,617	6,761	3,807.3	4,315.4
OPBDITA[2] /OI (%)	9.3%	4.2%	1.4%	4.1%
Total Debt/Tangible Net Worth-TNW (times)	2.1	4.6	5.2	6.4
Total Outside Liabilities/TNW (times)	2.8	5.7	5.8	7.9
Total Debt/OPBDITA (times)	2.9	9.1	41.2	11.5
OPBDITA/Interest (times)	3.7	1.3	0.3	2.0
DSCR (times)	2.7	0.8	0.2	1.1
NWC/OI (%)	30%	36%	39%	35%

Annexure-1: Instrument details

Instrument	Previous Rated Amount (NPR million)	Current Rated Amount (NPR million)	Rating action
Long-term limits; fund based (term loan)	399.0	399	[ICRANP] LBB- (Downgraded from [ICRANP] LBB@[3]; removed from Rating Watch with Negative Implications)
Short-term limits; fund based (overdraft, demand loan, short-term loan)	5,695.0	5,695	[ICRANP] A4 (Downgraded from [ICRANP] A4+@; removed from Rating Watch with Negative Implications)
Short-term limits; non-fund based (LC, guarantee)	580.0	580	[ICRANP] A4 (Downgraded from [ICRANP] A4+@; removed from Rating Watch with Negative Implications)
Short-term limits; Non-fund based (LC, guarantee; within funded limits)	(3,190.0)	(3,190.0)	[ICRANP] A4 (Downgraded from [ICRANP] A4+@; removed from Rating Watch with Negative Implications)
Total	**6,674.0**	**6,674.0**	

[2] *Operating profit before depreciation, interest, tax and amortisation*

3 @ Denotes rating watch with negative implications

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About ICRA Nepal Limited:

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