

Varsha Recycling Industries Private Limited: [ICRANP] A4 (reaffirmed)

February 28, 2022

Summary of rating action

Instrument*	Last rated amount (NPR million)	Current rated amount (NPR Million)	Rating Action
Fund-based short-term limits	700.00	700.00	[ICRANP] A4; Reaffirmed
Non-fund based short-term limits	150.00	150.00	
Non-fund based short-term limits (within fund-based limits)	(280.00)	(280.00)	
Total	850.00	850.00	

* Limit details are provided in [Annexure-1](#)

Rating action

ICRA Nepal has reaffirmed the short-term rating of [ICRANP] A4 (pronounced ICRA NP A four) to the NPR 700 million fund-based and NPR 430 million non-fund based limits (out of which 280 million is within fund-based limits) of Varsha Recycling Industries Private Limited (Varsha).

Rationale

The rating action continues to factor in Varsha's long operational track record in the non-ferrous metal processing industry along with the long-standing experience of its promoters. The well-diversified and complementary product portfolio of the group companies, along with the established sales channel, extensive dealer network and traction with suppliers is expected to support the growth outlook and has been factored as a positive in the rating exercise. The rating also notes the competitive advantage imparted by the company's recycling operation which has allowed for the company to procure raw materials at lower costs compared to the international market. The rating also takes comfort from the duty protection accorded to the industry, which protects domestic players from cheaper imports.

The rating is, however, constrained by Varsha's moderate financial position and its stretched liquidity, which remains a concern to its debt repayment capacity. While the company has been recording gradual improvements in its gearing as well as debt service coverage indicators, the company still has a high gearing of ~3 times as on FY2021 end (down from ~3.8 times in FY2020 end) along with moderate coverage indicators (Interest coverage and DSCR¹ stood at 2.9 times and 1.9 times respectively for FY2021). However, the improvement in debt coverage indicators in FY2021 stems from improved operating margins, primarily supported by the inventory gains amid rising prices of non-ferrous metal in the global market. Therefore, its long term sustainability remains to be seen. Rating concerns also arise from the company's stretched liquidity position as evidenced by sustained overutilisation of drawing power and weak current ratio. While improvements have also been witnessed in FY2021 on the working capital limits utilization front, the drawing power of the company remains over utilised which offers lower cushion against probable liquidity shocks. . Further, the company continues to maintain a high working capital intensity with NWC²/OI of ~70% for FY2021, partly because of high debtor days as well as seasonal nature of sales and wide product portfolio which results in high inventory days. The high working capital intensity of Varsha's business is met largely through bank financing, resulting in a high finance cost, which suppresses the company's profitability profile. The rating concerns also emanate from the unsecured debtors of Varsha, which coupled with high debtor days and high concentration among top debtors, could lead to debtor recovery issues. The fragmented industry, with several unorganised players, low entry barriers and lack of brand awareness, also remains a challenge as this could increase the competitive intensity and erode the margins across the industry going forward.

¹ Debt service coverage ratio

² Net working capital

High raw material price volatility and exchange fluctuation risks also remain a challenge for companies, such as Varsha, which maintain high inventory levels.

Going forward, Varsha's ability to increase its scale of operations, generate economies of scale and manage the working capital intensity and liquidity along with improved debtor recovery remain a key rating sensitivity.

Key rating drivers

Credit strengths

Adequate track record of operations in non-ferrous metal segment; experienced promoters and management– Varsha's promoters are seasoned professionals involved in the non-ferrous metal recycling business for more than 35years. The first company of the Group was Vinod Metal Industries Pvt Ltd, which started operations in 1981. Further, the people heading sales & marketing, production and procurement have adequate history and experience in the sector.

Synergy from sister units in related segments – The companies of the Group include Vijay Metal Industries Pvt Ltd. (rated LBB-/A4 by ICRA Nepal), Vinod Metal Industries Pvt Ltd. and Vimal Metal Industries Pvt Ltd, all involved in manufacture and distribution of circles/sheets and utensils made from copper, bronze, aluminium, brass, etc. The combined operations of these entities are expected to generate business synergies and reduce the Group's reliance on a single product segment.

Established sales channel, extensive dealer network and traction with suppliers – Varsha has a well-established supply chain across the country. The sales and marketing operations of the Group are headed by experienced professionals, who have a long standing business relationship with majority of the customers. Further, the direct involvement of the senior management in procurement and the established traction with raw material suppliers are credit positives.

Credit challenges

High working capital intensity affects liquidity and increases the need for external financing – The working capital intensity of the company remains high with Net working capital/Operating Income (NWC/OI) of ~70% for FY2021 as the company maintains high levels of inventory with inventory days of 170 days along with high debtor days of 125 days for the year. This results in an increased need for external financing, increasing the gearing levels. Varsha's liquidity position also remains stretched with the sustained overutilisation of working capital drawing power. While the level of overutilization of its drawing power has shown gradual reduction in recent years, the liquidity position continues to remain weak with increasing levels of debt.

High gearing combined with moderate profitability profile and relatively small scale of operations results in weak coverage indicators– The high gearing levels of the company along with high debt levels relative to the scale of operations with TD/OPBDITA of ~5.4 times for FY2021 leads to relatively weak coverage indicators for the company. Debt service indicators for the company has remained weak over the years. The improved coverage indicators in FY2021 (with Interest coverage of ~2.9 times and DSCR of ~1.9 times) is partly aided by inventory gains amid rising prices of non-ferrous metal in the market , whose sustainability remains to be seen.

High debtor days and unsecured debtors increase near-term recovery risks– Varsha's debtors are concentrated and largely unsecured, which creates a risk of bad debts during the difficult economic conditions. The company reported high debtor days (125 days) in FY2021 end. While the company's long-established relationship with its debtors remains a comfort, the absence of a debtor security mechanism (bank guarantees, advance payments, etc) also remains a rating concern.

Fragmented industry with multiple unorganised players– The non-ferrous metal industry in Nepal comprises many unorganised players operating albeit on a small scale, increasing the competitive intensity for Varsha. The abundance of these players in the industry and the lack of brand awareness in the sector have created margin pressure and impeded the growth and profitability of the larger players.

Risks associated with raw material price volatility, currency fluctuation and high inventory days – Varsha sources majority of its raw materials requirements from local markets and other countries besides India. Procurement from other countries is made through sight LC, subsequently converted into US Dollar denominated Trust Receipt (TR) loan with an average tenure of 120-180 days. This exposes the company to risk arising from forex volatility, although partly offset by discretionary hedging practices adopted by the management. Given the high inventory days, any change in the raw material prices could also expose Varsha to risks such as inventory write down.

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

Links to applicable criteria:

[Corporate Credit Rating Methodology](#)

About the company

Varsha Recycling Industries Pvt Ltd, operating since 2014, is a manufacturer of aluminium and copper circles/sheets and utensils. The company’s product range includes traditional aluminium utensils, pressure cookers, copper utensils, metal handicraft as well as other kitchen wares. It is also involved in the trading of copper, brass & bronze sheets/circles, and utensils (which it sources out from Vijay Metal Industries).

The company is a part of VMI group, which has a long track record in the non-ferrous metal recycling industry of Nepal and is one of the few large and organised players in the sector. Varsha is a family owned business, where Mr. Vimal Siddhartha Baid and his mother, Mrs. Sharda Baid, hold 75% and 25% stake, respectively. The company markets its products under the brand names Shalimar, Presto and VMI. The annual licensed production capacity of Varsha’s manufacturing facility is 2320 MT.

Key financial indicators

	FY2017 (Audited)	FY2018 (Audited)	FY2019 (Audited)	FY2020 (Audited)	FY2021 (Audited)
Operating income (OI; NPR million)	694	1,010	836	721	825
OPBDITA ³ /OI (%)	11.1%	9.7%	10.9%	8.1%	11.8%
Total debt/Tangible net worth (TNW; times)	6.7	5.1	4.6	3.8	3.0
Total outside liabilities/TNW (times)	7.5	5.6	4.9	4.0	3.3
Total debt/OPBDITA (times)	6.2	5.2	6.2	8.4	5.4
Interest coverage (times)	2.4	2.0	1.7	1.3	2.9
DSCR ⁴ (times)	2.3	1.7	1.5	0.8	1.9
Net working capital/OI (%)	63%	49%	68%	70%	70%
Current ratio	0.9	1.0	1.0	1.0	1.1

³ Operating profit before depreciation, interest, tax and amortization

⁴ Debt service coverage ratio

Annexure-1: Rated limits

Instrument	Last rated amount (NPR million)	Current rated Amount (NPR Million)	Rating Action
Short-term loans; fund based (existing – overdraft, demand loan, trust receipt, short-term loan)	700.00	700.00	[ICRANP] A4; Reaffirmed
Short-term loans; non-fund based (existing – letter of credit-LC, bank guarantee-BG)	150.00	150.00	
Short-term loans; non-fund based (within fund based limits, existing – letter of credit-LC, bank guarantee-BG)	(280.00)	(280.00)	
Total	850.00	850.00	

Analyst Contacts:

Mr. Sailesh Subedi (Tel No. +977-1-4419910/20)
sailesh@icranepal.com

Mr. Devendra Dongol (Tel No. +977-1-4419910/20)
devendra@icranepal.com

Relationship Contacts:

Ms. Barsha Shrestha (Tel No. +977-1-4419910/20)
barsha@icranepal.com

About ICRA Nepal Limited:

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For more information, visit www.icranepal.com

ICRA Nepal Limited,

Sunrise Bizz Park, 6th Floor, Dillibazar, Kathmandu, Nepal.

Phone: +977 1 4419910/20

Email: info@icranepal.com

Web: www.icranepal.com

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