Laxmi Steels Limited: Ratings reaffirmed

October 3, 2023

Summary of rating action

Instrument*	Previous Rated Amount (NPR Million)	Current Rated Amount (NPR Million)	Rating Action
Long-term limits; fund based	399.0	222.5	[ICRANP] LBB (Reaffirmed)
Short-term limits; fund based	5,695.0	2,700.0	[ICRANP] A4 (Reaffirmed)
Short-term limits; non-fund based	580.0	(2,000.0) #	[ICRANP] A4 (Reaffirmed)
Total	**6,674.0**	**2,922.5**	

** Instrument details are provided in Annexure-1*
#within short-term fund-based limits

Rating action

ICRA Nepal has reaffirmed the long-term rating of Laxmi Steels Limited (LSL) at [ICRANP] LBB (pronounced ICRA NP L double B) and the company's short-term rating at [ICRANP] A4 (pronounced ICRA NP A four) for the company's bank loan limits.

Rationale

The ratings reaffirmation continues to factor in LSL's long track record in the industry and its experienced promoter group and management team. LSL has among the large 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. The ratings also positively factor in the healthy revenue growth of the company for FY2022 and FY2023 along with improvement in the financial profile of LSL from FY2022 due to the infusion of equity/ conversion of promoters' loans to equity which has improved the gearing levels and capitalisation profile of the company. LSL's established supply chain and customer base, coupled with the synergy accruing from the Saurabh Group's other units in the steel and 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 Government of Nepal (GoN) through import barriers on finished steel products. ICRA Nepal notes the location-specific advantages available to LSL, 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.

Nonetheless, the ratings remain constrained by 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 LSL's profit margin and financial indicators. The ratings also remain constrained by the weakened coverage indicators of the company for FY2023 as a result of increased interest expense for the year. The company's stretched liquidity, with limited headroom in the working capital drawing power, also continues to remain a rating concern. The ratings are also tempered by the company's limited product diversification (~94% of 11M FY2023 revenues came from TMT sales) and the inherent cyclicality associated with the steel industry, thus exposing the company to cash flow volatility. LSL is also exposed to forex risks, given the practice of financing the import of raw material (billet/sponge iron) through partially hedged US-dollars denominated import loans and sales realisation in the domestic currency.

ICRA Nepal also takes note of the LSL's contingent liability towards power charges (as demanded by the Nepal Electricity Authority-NEA) related to the load-shedding era[1]. If the liability materialises, this could, stress the liquidity position and coverage metrics of the company. This also remains a rating sensitivity.

[1] *Period of prolonged power cut in the national grid until November 2017, given the demand-supply mismatch*

Key rating drivers

Credit strengths

Strong promoter Group and established track record in the industry – LSL 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 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, LSL 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 and distribution aspects of the business.

Healthy growth in revenues in recent years - LSL has recorded ~40% growth in operating income (OI) for FY2022 and ~11% for FY2023 registering higher than pre-pandemic sales. Growing in revenue with relatively stable margins underscores good demand for LSL's product and its relatively good competitive positioning in the market. Growth of LSL had remained suppressed in FY2019 and FY2020, due to the stiff competition and demand dropdown and the effect of pandemic in FY2020.

Backward integration into billet production and duty protection through high import barriers – LSL has been continuously increasing its in-house billet production capacity; which fulfils its major billet requirement as on date. The company has backward integrated into producing billet/ingot in its own melting furnace using mainly sponge iron and scrap irons. This has helped in generating cost efficiencies, which has also supported the margins for the company and provided an edge against the players solely relying on the imported billets for TMT production.

Moreover, given the higher custom tariffs for most finished steel products (including TMT) as well as imported billet, the players like LSL are shielded from the competition arising from the cheaper imports of finished/semi-finished items.

Credit challenges

Capacity overhang in the industry and resulting competition supress profitability outlook – The TMT bar production capacity of the Nepalese steel industry increased significantly in the last three to four years, following the commissioning of new manufacturing units as well as capacity expansion by old players. 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. Following the ebbing of event-specific demand, the industry currently has a significant capacity overhang situation, with the average capacity utilisation of the industry remaining below 50% in the last 2-3 years. Without any significant changes in the industry dynamics, the supply overhang and resulting competitive pressure is likely to supress revenue growth of individual companies as well as profitability of overall industry.

Weakened coverage indicators in recent period and liquidity concerns – LSL's coverage indicators have weakened in FY2023 due to the increased interest expense amid higher interest rates prevailing in the banking sector. LSL's coverage indicators have declined in FY2023 with DSCR of ~1.6 and Interest Coverage of ~2 times from a DSCR of ~2.8 times and interest coverage of ~4 times for FY2022. Moreover, the short-term liquidity has continued to remain strained because of dividend payout and frequent capex made in last 3-4 years for enhancing the billet production capacity. The liquidity pressure is evident from low to no headroom available in the working capital drawing power, which limits LSL's ability to absorb any major liquidity shocks.

Limited product diversification – TMT bar sales accounted for ~94% of LSL's revenues in 11M FY2023 and ~88% in FY2022 with the remaining sales coming from products like ribbed wire, binding wire and others. This exposes LSL to product concentration risks, especially in view of the increased competition in the TMT bar industry.

Vulnerability to inherent cyclicality of the industry and forex risk – The cyclical nature of the steel industry is likely to keep LSL'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]

Links to previous rating rationale:
[Laxmi-Steels-Surveillance-August 2022_Rationale]

About the company

Laxmi Steels Limited (LSL) is among the large 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 multiple sectors.

LSL is a secondary steel manufacturer that produces TMT bars, ribbed wire and binding wire, all under the Laxmi Steels brand. The company also has in-house billet producing capability using sponge iron and iron scrap. LSL has an annual installed production capacity of ~2,00,000 metric tonnes for TMT bars and ribbed wire.

The major stake in the company is held jointly by Neupane Family and Agarwal Family. Neupane family (through nine members) holds ~52% of the stake while Agarwal family (through five members) holds ~45% stake. Mr. Tika Ram Neupane is the chairman of the company.

Key financial indicators:

Amount in NPR million	FY2019 (Audited)	FY2020 (Audited)	FY2021 (Audited)*	FY2022 (Audited)	FY2023 (Provisional)
Operating income (OI; NPR Million)	6,761.0	3,807.3	6,095.6	8,556.5	9,456.9
OPBDITA /OI (%)	4.20%	1.40%	5.25%	6.80%	5.49%
Total debt/Tangible net worth (TNW; times)	4.6	5.2	4.6	1.8	1.7
Total outside liabilities/TNW (times)	5.7	5.8	5.6	2.4	2.7
Total Debt/OPBDITA (times)	9.1	41.2	7.6	4.0	4.1
Interest coverage (times)	1.3	0.3	2.9	4.0	2.0
DSCR (times)	0.8	0.2	1.9	2.8	1.6
Net working capital/OI (%)	36%	39%	31%	29%	20%
Current ratio	1.3	1.2	1.1	1.1	1.1

** Restated with NFRS implementation for FY2021-FY2022.*

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	222.5	[ICRANP] LBB (Reaffirmed)
Short-term limits; fund based (overdraft, demand loan, short-term loan)	5,695.0	2,700	[ICRANP] A4 (Reaffirmed)
Short-term limits; non-fund based (LC, guarantee)	580.0	-	[ICRANP] A4 (Reaffirmed)
Short-term limits; Non-fund based (LC, guarantee; within funded limits)	(3,190.0)	(2,000)	[ICRANP] A4 (Reaffirmed)
Total	**6,674.0**	**2,922.5**	

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About ICRA Nepal Limited:

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