

Press Release

SARBOTTAM STEELS LIMITED

July 2024

Rating

Instrument	Amount (NPR Mn)	Rating	Rating Action
Issuer Rating	NA	IRN BB- (Is)	Assigned

Infomerics Credit Rating Nepal Limited (Infomerics Nepal) has assigned the issuer rating of IRN BB- (Is) [Double B Minus (Issuer)]. Issuer with this rating is considered to have a moderate risk of default regarding timely servicing of financial obligations.

Detailed Rationale

The rating assigned to Sarbottam Steels Limited (SSL) derives strength from its experienced promoter group – Saurabh Group, supported by an experienced management team. The company's backward integration in billet production, which is a key component of steel production, brings in cost efficiencies. The rating also factors in the growth in total operating income, albeit declining profitability remains a concern.

However, these rating strengths are constrained by SSL's leveraged capital structure coupled with modest debt coverage indicators mainly due to erosion of tangible net worth amid losses, its working capital intensive nature of business, exposure to volatility in raw material prices and exposure to regulatory risk. Furthermore, SSL is exposed to foreign exchange fluctuation risk, as well as intense competition in the industry leading to low capacity utilization. Going forward, the company's ability to scale up its operations increasing its capacity utilization, while improving its profitability margins and improve its capital structure and debt coverage indicators will remain key rating sensitivities.

Detailed Description of Key Rating Drivers

Key Rating Strengths

Experienced promoter group

SSL is part of Saurabh Group, with its strength derived from promoters' strong presence in Nepal through their group entities engaged in manufacture of steel, cement, spinning mills, tea estates, etc. Operational synergies are expected, with the group's involvement in steel and cement industry (Laxmi Steels, Jagdamba Cement, and Sarbottam Cement), particularly in supply and distribution channels. SSL is managed by five-member board of directors who have wide experience in manufacturing sector. Mr. Bishnu Prasad Neupane, Chairman, has over two decades of experience in trading and manufacturing industries. Mr. Ramesh Kumar Agrawal and Mr. Utsav Neupane, Directors, possess experience in steel manufacturing business. Furthermore, the experienced and qualified pool of top management is expected to support the business going forward.

Moderate financial profile, albeit modest profitability

SSL's total operating income stood at NPR 7,753 Mn in FY23, decreased from NPR 8,934 Mn in FY22, mainly due to decrease in sales from billet, which is a raw material for production of steel. The sales of TMT rod grew by ~27% year-on-year in FY23. EBITDA margin also increased to 4.80% in FY23 from 2.54% in FY22 due to reduction in overhead costs, albeit decreased to 1.71% in 6MFY24 due to lower price realization during the off-season period. However, owing to high interest expenses, the company incurred net losses in FY22 and FY23.

Backward integration in billet production being a key component of steel production

SSL also produces billets, a vital semi-finished steel product required for manufacturing of steel. SSL

has a manufacturing plant with a total production capacity of 520,800 MTPA which includes ~51% in manufacture of billets, ~48% in manufacture of TMT, and remaining for the manufacture of wires. Vertical integration of billet production is expected to improve cost efficiencies and reduces dependence on external suppliers for this critical semi-finished steel product. This strategic initiative also strengthens the company's competitive position relative to its peers, especially during market fluctuations and supply chain disruptions.

Key Rating Weaknesses

Leveraged capital structure

SSL's capital structure stood leveraged with the overall gearing ratio of 2.49x at the end of FY23 deteriorating from 2.10x at the end of FY22, and further deteriorated to 3.38x as on mid-January 2024. This was primarily on account of losses incurred by the company that eroded the tangible net worth. Interest coverage ratio stood modest at 1.05x in FY23 vis-à-vis 1.01x in FY22, however, deteriorated to 0.20x in 6MFY24. The sharp decline of interest coverage ratio in 6 months of FY24 was due to high interest expenses on short term loan along with lower profitability. Furthermore, DSCR of the company declined to 0.86x in FY23 from 1.13x in FY22, which further deteriorated to 0.19x in 6MFY24. Total Debt to EBITDA stood at 9.78x in FY23 which improved from 14.07x in FY22 due to increase in operating profit. However, total Debt to GCA remained negative in FY23 and 6MFY24.

Working capital intensive nature of business

SSL's operating cycle remained elevated at 95 days in FY23, deteriorating from 44 days in FY22. The high operating cycle is primarily due to a longer average collection period of 51 days in FY23, vis-à-vis 19 days in FY22, reflecting extended credit terms granted to customers in the highly competitive steel industry. Additionally, the company maintained an average inventory holding of 71 days in FY23, increased from 44 days in FY22. This stems from the company's reliance on imported raw materials necessitating adequate inventory levels to ensure operational continuity and meet immediate market demands, resulting in high reliance on working capital loans for funding its operations. SSL's liquidity profile remains stretched as reflected by high working capital loan utilization at ~80% during last 12 months' period ended mid-July 2023.

Volatility in raw material price and exposure to regulatory risk

SSL primarily imports pig iron and sponge iron from India. The prices of these raw materials being linked to the market and set on a periodic basis exposes the company to price volatility that directly impacts profitability. Raw material costs have averaged about 84% of the total operating income from FY19 to FY23, making profitability highly sensitive to price changes. Additionally, SSL faces regulatory risks from policies in both Nepal and India. In the recent GoN budget for FY25, import duty on sponge iron increased from 1% to 2.5%, and scrap and pig iron now face a 1% import duty, up from Nil.

Intense competition in the industry

The iron and steel industry has numerous small and large, organized and unorganized players making it intensely competitive. The low entry barrier has limited the pricing flexibility and bargaining power of the players in the industry. The demand of iron & steel products is considered cyclical and with massive capacity enhancement of the industry due to the entry of new players as well as the substantial capacity expansion by the existing players has affected the net realization price of the iron and steel products resulting in lower operating revenue and profits.

Analytical Approach: Standalone

Applicable Criteria:

[Issuer Rating Methodology](#)

About the Company:

Sarbottam Steels Limited, a part of Saurabh Group, was incorporated in March 2017 as a private limited company and later converted to public limited company in July 2021. It has a plant situated in Birgunj, Parsa, Nepal. SSL is currently in its third year of operation involved in manufacturing of TMT Steel Bars, Billets, and wires with total installed capacity of 520,800 MTPA.

Financial Indicators (Standalone)

For the year ended* As on	FY22	FY23	6MFY24
	Audited	Audited	Unaudited
Total Operating Income (NPR Mn)	8,934	7,753	2,633
EBITDA Margin (%)	2.54	4.80	1.71
Interest Coverage Ratio (x)	1.01	1.05	0.20
Total Debt/ EBITDA (x)	14.07	9.78	51.33
Current Ratio (x)	1.08	0.96	0.94
Overall Gearing Ratio (x)	2.10	2.49	3.38

*Classification as per Infomerics Nepal standards

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About Infomerics Credit Rating Nepal Limited:

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