Jagdamba Enterprises Private Limited

Ratings

Facilities	Amount (Rs. Million)	Rating[1]	Rating Action
Long Term Bank Facilities	1,886.62 (Increased from Rs. 277.96 Mn)	**CARE-NP BB+ [Double B Plus]**	Reaffirmed
Short Term Bank Facilities- Fund based and non-fund based	13,920.00 (Decreased from 15,016)	**CARE-NP A4+ [A Four Plus]**	Reaffirmed
Total	**15,806.62**		

Annexure-1 Details of Facilities/Instruments to be rated

CARE Ratings Nepal Limited (CRNL) has reaffirmed the rating of `CARE-NP BB+' assigned to the long term bank facilities and 'CARE-NP A4+' assigned to the short term bank facilities of Jagdamba Enterprises Private Limited (JEPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of JEPL are constrained by moderate financial performance in H1FY22 (Unaudited, refers to the six-month period ended mid-Jan 2022) amid higher import duty on billets (major component of raw material) resulting in increased input price leading to squeezed profitability margins. The ratings also factor in the residual project implementation risk associated with the ongoing debt funded brownfield capex and stabilization risk thereafter. The ratings also consider JEPL's working capital intensive nature of operations, exposure to volatile interest rates, raw material price volatility risk along with foreign exchange fluctuation risk, and presence in highly fragmented and competitive nature of steel industry. Although the ratings take cognizance of rebound of operating performance leading to improved capital structure and debt service coverage indicators during FY21 (audited, refers to the twelve-month period ended mid-July 2021), sustainability of the same remains to be seen, particularly once the ongoing capex is completed.

The ratings, however, continue to derive strength from long track record of operations of the company with experienced management team in the related field, established brand and marketing setup with country-wide market presence, large scale of operations of the company, diverse product range catering to wide spectrum of industries and stable demand outlook for steels products in the country over the medium term.

Going forward, successful implementation and swift stabilization of the expansion project within the expected time and cost leading to capacity utilization and improvement in profitability margins as envisaged will be the key rating sensitivities. The ability of the company to manage growth in operations, coupled with its ability to rationalize its debt levels and improve the capital structure would also be key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Moderate financial performance amid challenging operating environment

JEPL generates its revenue from wide range of steel products, around 50% from Thermo Mechanically Treated (TMT) bars which includes imported billets as raw materials. As Government of Nepal (GoN) during FY22 has kept the duty on imported billets at 5% while reducing that on sponge iron, making it less profitable to make steel products through imported billets. Financial performance of the company has been lower than expected in H1FY22 amid increased input prices. Although sales are likely to grow on a year on year basis, the profitability margins of the company is likely to decline sharply in FY22 due to competitive pricing, particularly on account of increased competition from domestic players who manufacturer their own billets. To this effect, the company is in the process of setting up its own steel melting shop and hot strip mill, which is likely to reduce its dependency

[1]Complete definition of the ratings assigned are available at www.careratingsnepal.com and other CARE publications

on imported billets and make it more self-reliant on making various steel products from sponge iron. Earlier in FY21, Total Operating Income (TOI) of the company had decreased by 6.38% yoy, to Rs. 14,026 Mn with average price realization of Rs. 84,529 per MT on account of company tightening its credit terms losing some of its customer. However, PBILDT margin of the company improved to 10.78% boosted by favorable change in sales mix.

Leveraged capital structure with satisfactory debt service coverage indicators

Overall gearing ratio of the company remained leveraged at 2.74x at the end of FY21, albeit improved from 4.11x at the end of FY20, backed by lower utilization of working capital loans at the end of FY21 and scheduled repayment of term loan and increase in net worth base due to accretion of profits. Consequently, debt service coverage indicators of the company aided by lower interest outgo. Interest coverage ratio stood at 8.30x in FY21 compared to 1.34x in FY20. Similarly, Total debt/ GCA improved to 5.67x in FY21, albeit still at high level, from 45.65x in FY20. However, amid the requirement of increased debt to fund the ongoing capex, the company's gearing levels are expected to moderate over the near-term, with sequential improvement likely after the commissioning of the project.

Project implementation and stabilization risk associated with the debt funded brownfield investment

JEPL is currently undertaking brownfield expansion of setting up its own steel melting shop and hot strip Mill- backward integration of HR Strips/TMT ROD. The capex is expected to reduce JEPL's dependence on use of imported billets for manufacturing TMT ROD, and other related products. After the expansion, the company will instead use sponge iron and convert it directly into TMT bar or HR strips. The capex is likely to benefit JEPL in terms of cost savings which would include lower duty on imports of sponge iron, fuel saving, and a more efficient and leaner manufacturing process. Total envisaged cost of the project is around Rs. 2,250 Mn to be funded via additional debt maintaining DE ratio of 75:25. The debt of the project has been tied up . The expected Commercial Operation Date of the project is mid-November, 2022. Being significant capex, company currently remains susceptible to risk related with implementation and stabilization of the project. Any delays in the implementation may impact the company's financial risk profile and is also crucial from credit prospective. The debt funded project is expected to moderate the gearing levels in the medium term.

Raw material price volatility risk and foreign exchange fluctuation risk

The major raw materials for JEPL are mostly imported from India, the prices of which are market linked and determined on a periodic basis, thus exposing the company to the volatility in input prices which has a bearing on its profitability margins. The raw material cost contributed around 79% of the total operating income of the company during FY21, thus, any volatility in prices of the same impacts the profitability of the company. Also, the company is exposed to foreign exchange fluctuation risk as the prices of imported raw materials are linked to USD. The ability of the company to pass through changes in raw material prices to the finished products and managing the foreign exchange fluctuation risks related to raw materials will be the key rating sensitivities.

Working Capital Intensive Nature of Operations

The operations of the company are working capital intensive in nature. JEPL is involved in manufacturing wide range of steel products and is required to maintain adequate inventory of raw material for smooth running of its production processes and meet immediate demand of customers. Also, being a highly competitive business, the company has to extend credit period to its dealers which is up to 90 days whereas company has to make immediate payment to its suppliers. Net-Operating cycle of the company was high at 215 days at the end of FY21 on account of high inventory holding period and high debtors. Furthermore, being a manufacturer, it is critical for the company to maintain minimum inventory levels to meet immediate demand of its customers; all this led to high working capital requirements which were largely met through bank borrowings.

Key Rating Strengths

Established and long track record of operations with experienced management team in the related field

JEPL has an operational track record of around two decades in manufacturing of various steel products. JEPL is promoted by industrialists and traders of Nepal, who are involved in manufacturing of cement, trading of construction materials, hospitality business among others. The company is managed under the overall guidance of its three member Board of Directors (BoD) which includes eminent businessmen/industrialists with wide experience in the manufacturing sectors. The day to day operations of the company is looked after by Mr. Anil Kumar Rungta and Mr. Vishal Patwari, Directors, both having experience of two decades in the steel industry and handle marketing, purchase of material and production planning of the company.

Established brand with country wide market presence

JEPL has successfully established "Jagdamba" and "Jag Shakti" as a brand name in different type of iron and steel products in the domestic market. Established brand image ensures customer loyalty and aid in the differentiation of products with the competitors. Additionally, the company markets and sells its entire range of products through a well-established network. JEPL has a strong dealer base across all major cities in the country which provides a ready market for its products.

Diverse product range catering to wide spectrum of industries

JEPL manufactures variety of steel products of different sizes which includes TMT bars, MS Black Pipes, Galvanized Iron pipes, Hot Rolled Strips, shutter profiles, shutter Guide, Shutter Spring, Lock Plate, Prefabricated building components, W-Beams and different steel poles which finds application in varied industries including construction, automobile, chemical and oil industries etc. The wide application not only diffuses the risk of dependency on a single industry but also allows the company to cater to a larger market with a broad customer base.

Locational advantage

The plant site is located in Parsa, around 15 Kms from Indo-Nepal borders and Birgunj dry-port. Since majority of raw materials used by JEPL are imported from India, the factory's proximity to the border remains a positive point leading to saving in freight cost.

Stable demand outlook for steels products in the country

Nepalese economy is developing and is in the phase of investment and growth in infrastructure, power sector and tourism sector, notwithstanding the lingering impact of the covid-19 pandemic. In the recent budget presented by finance minister of Nepal for FY23, Rs. 161.56 Bn has been allocated for infrastructure development along with an estimated GDP growth of 5.20%. Government's continued high emphasis on infrastructure development, namely development of roads, hydropower, airports and other infrastructures augurs well for the business prospects of iron and steel manufacturers like PSPL over the medium term.

About the Company

Jagdamba Enterprises Private Limited (JEPL) is a private limited company which was incorporated on March 29, 2001 for setting up M.S. Black & Galvanized pipe manufacturing plant in Jeetpur, Parsa district of Nepal. The company is operating from more than 20 years, manufacturing wide range of steel products with total installed plant capacity of 362,460 Metric Tons Per Annum (MTPA) as on mid-July 2021.

Brief financials of JEPL for last three years ending FY21 are given below:

(Rs. in Million)

Particulars	FY19 Audited	FY20 Audited	FY21 Audited
Income from Operations	19,661	14,981	14,026
PBILDT Margin	3.91	4.35	10.78
Overall Gearing (times)	4.79	4.11	2.74
Interest coverage (times)	1.09	1.34	8.30
Current ratio (times)	1.13	1.14	1.21
Total Debt/Gross Cash Accurals	59.39	45.65	5.67

Annexure-1 Details of Facilities/Instruments to be rated

Name of Instrument	Type of Facility	Amount(Rs in Million)	Rating
Long Term Bank Facilities	Term Loan	1,886.62	CARE-NP BB+
Short Term Bank Facilities	Working Capital Loans	3,470.00	CARE-NP A4+
Short Term Bank Facilities	Non–Fund Based Loans	10,450.00	CARE-NP A4+
Total		**15,806.62**	

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