

March 02, 2023

Nezone Pipes & Structures: Ratings upgraded

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Fund-based – Cash Credit/ WCDL	18.00	55.00	[ICRA]A- (Stable), upgraded from [ICRA]BBB+ (Stable)
Long-term Fund-based – Stand by Line of Credit	2.00	-	-
Short-term Non Fund-based – Letter of Credit	2.00	-	-
Short-term Non Fund-based – Letter of Credit [§]	-	(5.00)	[ICRA]A2+, upgraded from [ICRA]A2
Short-term Non Fund-based – Bank Guarantee	7.00	-	-
Long-term/ Short-term – Non Fund-based Bank Guarantee	-	5.00	[ICRA]A- (Stable)/ [ICRA]A2+, upgraded from [ICRA]BBB+ (Stable)/ [ICRA]A2
Long-term/ Short-term – Unallocated Limits	31.00	-	-
Total	60.00	60.00	

*Instrument details are provided in Annexure-I

§ Letter of credit is the sub-limit of the Bank Guarantee

Rationale

The ratings upgrade of Nezone Pipes & Structures (NPS) takes into consideration the significant top line growth witnessed in FY2022, which is expected to continue in FY2023 also as the entity has already achieved a growth of around 39% in 9M FY2023 on a YoY basis. Besides, successful commissioning of its enhanced production capacities in December 2022 as well as stabilisation of the same would positively impact its overall operational profile, going forward. The ratings also take into account the long experience of the promoters and the established position of the firm in the steel-tube manufacturing business, aided by a strong distribution network and good brand recognition. The ratings also factor in the entity's competitive advantage arising from a diversified product profile and its ability to change the product mix as per market demand. Besides, the Group's raw material sourcing arrangement with reputed suppliers ensures high quality of finished products. ICRA notes that the firm recorded a sizeable inventory gain due to a steady rise in steel prices over the past two years, which along with improved margin on sales had a positive impact on the operating profit. However, in the current fiscal, ICRA expects the entity to incur inventory loss due to a drop in steel prices. Moreover, reduced margin on sales would adversely impact the firm's operating margin in FY2023 compared to FY2022. Nevertheless, the ratings continue to derive strength from the comfortable financial risk profile of the firm, reflected by healthy profits, a conservative capital structure and comfortable debt protection metrics.

The ratings are, however, constrained by the limited value addition and price-based competition in the steel-tube industry. Moreover, cyclical nature inherent in the steel business is likely to keep the entity's margins and cash flows vulnerable to fluctuations in raw material prices and demand of final products. The ratings are also impacted by the significant receivables and stocking requirement, which are likely to keep the working capital intensity of operations at a moderately high level. The ratings also consider the risks associated with the entity's status as a partnership firm, including the risk of capital withdrawal by the partners, as witnessed in the past years.

The Stable outlook on the long-term rating reflects ICRA's opinion that NPS will be able to maintain its business position, given its established track record of operation in the steel tube manufacturing business. Besides, the financial risk profile of the firm is likely to remain comfortable, going forward.

Key rating drivers and their description

Credit strengths

Established position of the firm in steel-tube manufacturing business – NPS has been involved in the steel-tube manufacturing business for nearly a decade and has a strong operating base in the north eastern India. The entity's established brand (Nezone) in the steel-tube industry, its strong distribution network and the promoters' long experience in the business strengthen its operational profile.

Diversified product profile and ability to change product mix as per market demand lead to competitive advantage – The firm has a diversified product mix including mild steel black pipe/ square pipe, galvanised pipe and various fabricated structural items, namely tubular pole, beam, scaffolding, metal crash barrier etc. MS black pipes/sections are mainly used for fabrication, structural purpose and scaffolding, whereas galvanised pipes are used in water pipe lines (mainly drinking water and irrigation). Till FY2021, MS black pipe had remained the key revenue driver for the firm. However, the share of revenue from GI pipe has grown significantly since FY2020 and became the highest revenue contributor for the firm in FY2022. Moreover, the firm's flexibility to change the product mix as per demand from the customers renders competitive advantage to an extent.

Sourcing of raw materials from reputed suppliers ensures high quality of finished products – The Nezone Group sources raw materials for its various entities involved in similar businesses in a centralised manner from reputed suppliers. Around 80-85% of the Group's total hot rolled coil (HRC) requirement is met from Tata Steel Limited, while 10-15% is either imported or sourced from other renowned domestic suppliers. This provides a better control over the quality of the finished goods and renders competitive advantage over the unorganised and smaller players.

Steady growth in top line over the past two years; successful commissioning of enhanced production facilities likely to increase its turnover, going ahead – The turnover of the firm witnessed a steady growth over the past two years. Despite a decline in the overall volume of sales, a steep rise in realisation along with sizeable revenue generated from trading activities resulted in a growth in the entity's turnover over the past two years. The firm reported an operating income of around Rs. 458 crore in 9M FY2023 vis-à-vis Rs. 330 crore in FY2022. In December 2022, the firm has successfully commissioned its new tube mills and galvanising unit to increase its overall production capacities. ICRA notes that although the realisation is likely to moderate in FY2023 compared to the last fiscal, a sizeable increase in the volume of sales is estimated to increase its top line by around 34% on a YoY basis.

Favourable financial risk profile characterised by a conservative capital structure and comfortable debt protection metrics – The capital structure of the firm remained conservative on account of a healthy net worth and limited reliance on external liabilities. The gearing and TOL/TNW stood at 0.1 times and 1.0 times, respectively as on March 31, 2022. In the current fiscal, capital expenditure towards increasing the production capacity and enhanced borrowings to meet working capital requirement, to support the increased scale of operations, would negatively impact the overall capital structure of the entity as on March 31, 2023. Nevertheless, the same would still continue to remain at a conservative level. The debt protection metrics have remained comfortable over the past years owing to healthy profits as well as cash accruals and low debt level. Despite some moderation expected due to enhanced borrowings, the coverage indicators of the firm would also continue to remain at a comfortable level in the near-to-medium term.

Credit challenges

Limited value addition and price-based competition likely to keep operating margin under check – The steel-tube industry is characterised by the presence of many unorganised players in addition to a few large companies. Intense price-based competition due to the fragmented nature of the industry exerts pressure on margins. The raw material cost accounted for

around 80% of the entity's turnover over the last few years, reflecting a highly raw-material intensive nature of operations. This, along with limited value addition, is likely to keep the operating margin under check.

Exposed to volatility in raw material prices – Hot rolled coil (HRC) is the key raw material used for producing MS black pipe. Zinc is required in small quantity for the galvanisation process to convert MS black pipe into galvanised iron (GI) pipe. The firm remains exposed to significant volatility in prices of key raw materials like HRC and zinc as adequate raw material inventory needs to be maintained. The firm is likely to suffer sizeable inventory losses in the current fiscal due to a sharp moderation in steel prices, which in turn is estimated to affect its margins.

Likely deterioration in profitability in the current fiscal owing to declining realisations – The firm recorded a sizeable inventory gain due to a steady rise in steel prices over the past two years, which along with improved margin on sales led to a steady increase in the operating profits. However, in FY2023, ICRA expects the entity to incur inventory loss due to a drop in steel prices. Moreover, reduced margin on sales would also adversely impact the OPM of the firm in FY2023. The firm reported an OPM of 8.4% in 9M FY2023. However, the same is likely to increase in the full year, to an extent, given the better performance expected in Q4 FY2023 on the back of relatively stable steel price as well as margin on sales. ICRA expects the net margin of the firm to remain at around 5-6% in the current fiscal. The RoCE of the firm is also estimated to moderate in FY2023 compared to the previous year though the same would remain at a comfortable level.

Significant receivables and inventory holding likely to keep the working capital intensity high – Significant receivables and stocking requirements keep the entity's working capital intensity of operations at a high level. In FY2021, the net working capital relative to the operating income stood at 20%. However, the same reduced to 18% in FY2022 mainly due to a decline in the receivables position along with an increase in advances from the customers, which are primarily various Government departments. The firm's working capital intensity of operations is likely to remain at a moderately high level, going forward.

Risks associated with the entity's status as a partnership firm, including the risk of capital withdrawal by partners – The ratings also consider the risks associated with the entity's status as a partnership firm, including the risk of capital withdrawal by the partners, as witnessed in the past years. In 9M FY2023, the partners withdrew capital of around Rs. 8 crore from the business.

Liquidity position: Adequate

The firm has generated positive cash flow from operations over the past few years, however, an increase in the scale of operations and working capital intensity is likely to lead to a negative cash flow from operations during the current year. The firm has also demonstrated need-based funding in the form of unsecured loan from the promoters and body corporate. The overall fund-based working capital utilisation of the firm stood at a relatively lower level of around 44% during the last 15 months, ended in January 2023. In view of adequate undrawn working capital limits, absence of any scheduled long-term debt service obligations and demonstrated track record of funding from the promoters/ Group entities, ICRA expects the overall liquidity position of the firm to remain adequate in the near-to-medium term. As the entity's business is expected to record a sizeable growth in the medium term, efficient management of working capital requirement would remain crucial, going forward.

Rating sensitivities

Positive factors – ICRA may upgrade NPS' ratings if there is a significant increase in its revenue, profits and cash accruals, strengthening its net worth on a sustained basis.

Negative factors – ICRA may downgrade NPS' ratings if weakening in steel prices results in a significant deterioration in the entity's profitability. Besides, a deterioration in the liquidity position may also result in ratings downgrade. Specific credit metric that may trigger ratings downgrade include an interest coverage of less than 5.0 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating Methodology for Ferrous Metal Entities
Parent/Group support	Not Applicable
Consolidation/Standalone	The ratings are based on the standalone financial statements of the entity

About the company

Established in 2010 as a partnership firm, Nezone Pipes & Structures (NPS) manufactures mild steel black pipe and galvanised iron pipe. The firm started its operations with two tube mills, having a total production capacity of 60,000 metric tonnes per annum (MTPA) at its plant located at Birnyhat, Meghalaya, along with a galvanising capacity of 24,000 MTPA. In December 2022, the firm commissioned another two tube mills with a total production capacity of 60,000 MTPA and a galvanising unit with a capacity of 24,000 MTPA. Besides, the firm manufactures various fabricated steel structures namely, pole, beam, scaffolding, metal crash barrier etc. The entire range of products are sold under the brand – Nezone, catering only to the North-Eastern markets.

The firm is a part of the Nezone Group, which has been involved in the steel tube manufacturing business for more than three decades. However, the operations of NPS are independently managed by the promoters.

Key financial indicators

NPS, Standalone	FY2021 (Audited)	FY2022 (Audited)	9M FY2023 (Provisional)
Operating income	344.3	483.2	457.8
PAT	27.2	37.2	24.0
OPBDIT/OI	11.7%	11.5%	8.4%
PAT/OI	7.9%	7.7%	5.2%
Total outside liabilities/Tangible net worth (times)	0.7	1.0	1.3
Total debt/OPBDIT (times)	0.2	0.2	2.2
Interest coverage (times)	9.4	8.7	5.8

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs. crore

Source: Nezone Pipes & Structures, ICRA Research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument	Type	Current rating (FY2023)		Chronology of rating history for the past 3 years			
		Amount rated (Rs. crore)	Amount outstanding as on Dec 31, 2022 (Rs. crore)	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021	Date & rating in FY2020
				Mar 2, 2023	Mar 17, 2022	Apr 23, 2020	Oct 1, 2019
1 Cash Credit/ WCDL	Long Term	55.00	43.53	[ICRA]A-(Stable)	[ICRA]BBB+(Stable)	[ICRA]BBB (Stable) Withdrawn	[ICRA]BBB (Stable)
2 Standby Line of Credit	Long Term	-	-	-	[ICRA]BBB+(Stable)	[ICRA]BBB (Stable) Withdrawn	[ICRA]BBB (Stable)
3 Letter of Credit	Short Term	-	-	-	[ICRA]A2	[ICRA]A3+ Withdrawn	[ICRA]A3+
4 Bank Guarantee	Short Term	-	-	-	[ICRA]A2	[ICRA]A3+ Withdrawn	[ICRA]A3+
5 Letter of Credit [§]	Short Term	(5.00)	-	[ICRA]A2+	-	-	-
6 Bank Guarantee	Long Term/ Short Term	5.00	-	[ICRA]A-(Stable)/ [ICRA]A2+	-	-	-
7 Unallocated Limits	Long Term/ Short Term	-	NA	-	[ICRA]BBB+(Stable)/ [ICRA]A2	-	-

[§] Letter of credit is the sub-limit of the Bank Guarantee

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term fund-based – Cash Credit/ WCDL	Simple
Short-term non fund-based – Letter of Credit	Very Simple
Long-term/ Short-term non fund-based – Bank Guarantee	Very Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: [Click Here](#)

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Cash Credit/ WCDL	-	-	-	55.00	[ICRA]A- (Stable)
NA	Letter of Credit ^{\$}	-	-	-	(5.00)	[ICRA]A2+
NA	Bank Guarantee	-	-	-	5.00	[ICRA]A- (Stable)/ [ICRA]A2+

Source: Nezone Pipes & Structures

^{\$} Letter of credit is the sub-limit of the Bank Guarantee

[Please click here to view details of lender-wise facilities rated by ICRA](#)

Annexure II: List of entities considered for consolidated analysis

Not applicable

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Branches



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