March 07, 2024

Nezone Pipes & Structures: Ratings reaffirmed; rated amount enhanced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Fund-based – Cash Credit/ WCDL	55.00	80.00	[ICRA]A- (Stable), reaffirmed/ assigned
Short-term Non Fund-based – Letter of Credit$	(5.00)	(10.00)	[ICRA]A2+, reaffirmed/ assigned
Long-term/ Short-term Non Fund-based – Bank Guarantee	5.00	10.00	[ICRA]A- (Stable)/ [ICRA]A2+, reaffirmed/ assigned
Total	**60.00**	**90.00**	

** Instrument details are provided in Annexure – I*

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

Rationale

The reaffirmation of the ratings considers 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. The top line of the firm witnessed significant growth over the past three years, primarily driven by increased volume of sales. In the current fiscal, ICRA expects the growth momentum to moderate on a YoY basis. The firm recorded inventory losses in FY2023 due to a decline in steel prices over the previous fiscal, as a result of which the operating margin fell by ~100 bps on a YoY basis to 10.6%. ICRA expects the profitability of the firm to decline in the current fiscal as well, in view of reduced margin on sales and increased overheads. Nevertheless, the ratings continue to derive strength from the comfortable financial risk profile of the entity, reflected by healthy profits, a conservative capital structure and comfortable debt protection metrics.

The ratings are, however, constrained by limited value addition and price-based competition in the steel-tube industry. Moreover, cyclicality 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 significant receivables and stocking requirement, which are likely to keep the working capital intensity of operations at a 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 entity is likely to remain comfortable, going forward, along with adequate cash flows relative to its debt service obligations.

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 part of 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 FY2023. Moreover, NPS'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% of the Group's total hot-rolled coil (HRC) requirement is met from Tata Steel, while 10-15% is imported from Japan/ South Korea/ Vietnam and the balance from other renowned domestic suppliers, namely SAIL, JSPL and JSW Steel. 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 the top line witnessed in the past few years – The turnover of the firm witnessed a significant growth over the past three years, primarily driven by increased volume of sales. Despite a decline in the realisation, a steep rise in the overall volume of sales along with sizeable revenue generated from trading activities resulted in around 49% growth in the entity's turnover in FY2023 on a YoY basis. The firm reported a top line of around Rs. 584 crore in 9M FY2024 vis-à-vis Rs. 458 crore in 9M FY2023. ICRA notes that although the realisation is likely to moderate marginally in FY2024 compared to the last fiscal, an increase in the overall volume of sales is estimated to increase its top line by around 8% 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 0.7 times and 0.9 times, respectively as on March 31, 2023. The debt protection metrics have remained comfortable over the past years owing to healthy profits as well as cash accruals and low debt level. In view of adequate cash flow from operations, the overall debt level of the entity is likely to come down in the current fiscal. The coverage indicators of the firm would also continue to remain at a comfortable level in the near-to-medium term on the back of healthy profits and cash accruals.

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.

Moderation in profitability over the past two years; likely to continue in the current fiscal as well – The firm recorded inventory losses due to a decline in steel prices in the last fiscal on a YoY basis, which had a negative impact on the operating margin in FY2023. The operating margin of the firm declined to 10.6% in FY2023 from 11.7% in FY2021. The profitability of the firm is likely to decline in the current fiscal as well, in view of reduced margin on sales and increased overheads. The firm reported an operating margin of 9.3% in 9M FY2023. ICRA expects the net margin of the firm to remain at 6-7% in the current fiscal. The RoCE of the firm is also estimated to moderate in FY2024 compared to the previous year though the same would continue to 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 FY2022, the net working capital relative to the operating income stood at 18%. However, the same sharply rose to 31% in FY2023 mainly due to an increase in the receivables position along with a decline in advances from the customers, primarily comprising various Government departments. The firm's working capital intensity of operations is likely to remain at a 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 FY2024, the partners withdrew capital of around Rs. 3 crore from the business.

Liquidity position: Adequate

The firm is likely to generate positive cash flow from operations during the current year. The entity has also demonstrated need-based funding in the form of unsecured loan from the promoters and body corporates. The overall fund-based working capital utilisation of the firm stood at a moderate level of around 56% during the last 15 months, ended in December 2023. In view of adequate cash flow from operations, 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 moderate 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 4.0 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Iron and Steel
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 (audited)

NPS Standalone	FY2022	FY2023	9M FY2024*	9M FY2023*
Operating income	483.2	672.8	583.9	457.8
PAT	37.2	56.1	38.5	24.0
OPBDIT/OI	11.5%	10.6%	9.3%	8.4%
PAT/OI	7.7%	8.3%	6.6%	5.2%
Total outside liabilities/Tangible net worth (times)	1.0	0.9	0.8	1.3
Total debt/OPBDIT (times)	0.2	1.4	1.2	2.2
Interest coverage (times)	8.7	7.9	4.8	5.8

*Source: Nezone Pipes & Structures, ICRA Research; * Provisional numbers; All ratios as per ICRA's calculations; Amount in Rs. crore*

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2024)				Chronology of rating history for the past 3 years		
		Type	Amount rated (Rs. crore)	Amount outstanding as of Dec 31, 2023 (Rs. crore)	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021
					Mar 7, 2024	Mar 2, 2023	Mar 17, 2022	Apr 23, 2020
1	Cash Credit/ WCDL	Long Term	80.00	15.03	**[ICRA]A- (Stable)**	[ICRA]A- (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB (Stable) Withdrawn
2	Standby Line of Credit	Long Term	-	-	-	-	[ICRA]BBB+ (Stable)	[ICRA]BBB (Stable) Withdrawn
3	Letter of Credit	Short Term	-	-	-	-	[ICRA]A2	[ICRA]A3+ Withdrawn
4	Bank Guarantee	Short Term	-	-	-	-	[ICRA]A2	[ICRA]A3+ Withdrawn
5	Letter of Credit$	Short Term	(10.00)	-	**[ICRA]A2+**	[ICRA]A2+	-	-
6	Bank Guarantee	Long Term/ Short Term	10.00	-	**[ICRA]A- (Stable)/ [ICRA]A2+**	[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	-	-	-	80.00	[ICRA]A- (Stable)
NA	Letter of Credit$	-	-	-	(10.00)	[ICRA]A2+
NA	Bank Guarantee	-	-	-	10.00	[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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About ICRA Limited:

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