ICRA

January 23, 2017

Nezone Strips Limited

Instrument*	Rated Amount (in crore)	Rating Action
Fund-based Limits	97.36	[ICRA]A- (Stable) upgraded from [ICRA]BBB+(Stable)
Non-fund based Limits	82.40	[ICRA]A2+ upgraded from [ICRA]A2
Total	**179.76**	

*Instrument Details are provided in Annexure-1

Rating Action

ICRA has upgraded the long-term rating assigned to the Rs. 92.36 crore[1] (including an untied amount of Rs. 17.36 crore), and Rs. 5-crore stand-by line of credit facilities of Nezone Strips Limited (NSL)[2] from [ICRA]BBB+ (pronounced ICRA triple B plus) to **[ICRA]A-** (pronounced ICRA A minus). The outlook on the long-term rating is **stable**. ICRA also has upgraded the short-term rating assigned to the Rs. 82.40-crore (including an untied amount of Rs. 28.26 crore) non-fund based bank facilities of NSL from [ICRA]A2 (pronounced ICRA A two) to **[ICRA]A2+** (pronounced ICRA A two plus).

Detailed Rationale

ICRA has evaluated NSL's business risk profile on a consolidated basis along with Nezone Tubes Limited (NTL, rated at [ICRA]A-/Stable/[ICRA]A2+), both of which are involved in the business of manufacturing steel tubes, and share a common management. The ratings upgrade takes into account the company's improved financial risk profile during FY2016, which improved further in H1FY2017. Growth in sales volume, significant softening of raw material prices vis-à-vis realisation and decline in interest costs resulted in the company's improved net profitability at an absolute level. Despite growth in sales volume, the top-line declined in FY2016 over the previous year due to significant softening of the realisations. This coupled with reduced working capital borrowing strengthened NSL's return indicators and debt coverage metrics. ICRA also notes the company's adequate financial flexibility, given that there is no long-term debt repayment obligation vis-à-vis healthy cash accrual, low utilisation of the working capital limits in recent past and the promoters' demonstrated ability to infuse funds whenever required. The ratings continue to take into consideration the long experience of the promoters and established position of the group in the steel-tube manufacturing business. The group's scale of operations witnessed a significant growth over the years, supported by an expanding distribution network, regular capacity expansion and optimum utilisation of the same. The ratings also factor in NSL's competitive advantage arising from a diversified product profile and its ability to change the product mix as per market demand, and the company's raw material sourcing arrangement with reputed suppliers, ensuring high quality of finished products.

The ratings are, however, constrained by limited value addition and price-based competition in the steel- tube industry, as well as vulnerability of profitability to volatile raw material prices which are likely to keep the company's operating margin under check. NSL's high stocking requirement increases the working capital intensity of its operations, and also makes it vulnerable to the risks of inventory loss.

NSL's operating income is likely to grow by around 8%, while its operating and net margins are likely to remain at around 7.5% and 3.5%, respectively, in FY2017. ICRA also notes that the discontinuation of import of raw material by NSL (on the back of restrictions imposed by the Government on steel imports) and a significant increase in steel prices in the international market in the recent past, may lead to an increase in the company's working capital intensity. This is mainly because limited credit is available for domestic procurement vis-a-vis imports and consequently the working capital borrowing is also likely to increase, going forward. This may increase the company's gearing, though the capital structure is likely to remain comfortable, aided by NSL's

[1] 100 lakh = 1 crore = 10 million

[2] For complete rating scale and definitions please refer to ICRA's website www.icra.in or other ICRA Rating Publications

healthy accretion to reserves. Nevertheless, the likely increase in working capital borrowing may result in an increase in the overall interest expense. The company's ability to maintain the growth in its scale of operations, while protecting profitability and managing working capital requirements efficiently, would remain the key rating sensitivities going forward.

Key rating drivers

Credit Strengths

- Improved profitability, return indicators and debt coverage indicators in FY2016, which improved further during H1 FY2017
- Long experience of promoters and established position of the group (Nezone) in the steel- tube manufacturing business
- Diversified product profile and ability to change the product mix as per market demand, leading to competitive advantage
- Sourcing of raw materials from reputed suppliers, ensuring high quality of finished products
- Low utilisation of working capital limits in recent past, no long-term debt repayment obligation and the promoters' demonstrated ability to infuse funds strengthen financial flexibility

Credit Weaknesses

- Limited value addition in business keeps operating margin under check
- Fragmented nature of the industry leading to intense price-based competition
- Exposure to volatility in raw material prices
- Significant stocking requirement, which increases working capital intensity and also gives rise to the risks of inventory loss

Description of key rating drivers highlighted above:

The Nezone Group has been involved in the steel tube manufacturing business for more than three decades, and has a firm footprint mainly in the eastern, north-eastern and southern India through manufacturing facilities and distribution network spread across a number of states. The group has been expanding its geographical presence and distribution network over the last few years, which supported by scaling up of production, translated into a consistent growth in the overall sales volumes. NSL has a diversified product mix including mild steel pipe, galvanised pipes and precision tubes of different shapes and sizes which are used for multiple purposes. Moreover, its flexibility to change the product mix as per demand from the customers as well as a better control over the quality of the finished goods due to procurement of raw material from reputed suppliers render competitive advantage over the unorganised and smaller players. During FY2016, NSL's sales volumes increased by around 9%. Despite this, the company's top-line declined in FY2016 by around 5% because of a significant decline in the average realisations.

During FY2016, import of raw material (HR Coil) increased to around 50% vis-à-vis around 8% in FY2015 as a result of large-scale import of HR Coil at a cheap rate following significant softening of steel prices in the international market. However, the same is not reflected in the OPM growth as the company had to pay a hefty amount of safeguard duty (@ 20%) on a few import consignments which were ordered earlier but were received post imposition of the same by the Government. In the current financial year, the volume of raw material import has declined post imposition of minimum import price (MIP) on HRC by the Government of India. The company has stopped importing HRC since October, 2016 due to a significant increase in steel prices in the international market vis-à-vis domestic prices. The recent demonitisation drive by the Government of India negatively impacted NSL's sales volumes to some extent over the last two months; however, its operation is likely to scale-up, going forward.

Although the OPM grew marginally from 6.32% in FY2015 to 6.40% in FY2016, NSL's net margin improved to 3.06% in FY2016 from 2.22% in the previous fiscal primarily because of decline in interest expenses on the back of lower working capital utilisation, as a major portion of the raw material was imported against Letter of Credit. The company's operating and net margins improved further to 9.8% and 5.61%, respectively in H1 FY2017. However, the margins may moderate to some extent in the full year of the current fiscal, given increased steel prices over the last few months. The low value addition in operation, competitive intensity in the industry and vulnerability to fluctuation in steel prices are likely to keep the profit margins under check. The company's return on capital employed improved significantly to around 18% in FY2016 and 26% in H1FY2017 from around 15% in FY2015, supported by improved profitability at an absolute level. The reduced interest cost and improved profitability strengthened NSL's debt coverage indicators during FY2016 and H1 FY2017. The company has no term-loan repayment obligation at present. Further, low utilisation of the working capital limits in the recent past and demonstrated ability of the promoters to infuse funds reflect adequate financial flexibility.

Analytical approach: Not Applicable

Links to applicable criteria
Corporate Credit Rating –A Note on Methodology

About the company:

Established in 1999, NSL manufactures precision tubes and MS pipes. The manufacturing facility is located at Dankuni in West Bengal, with an installed capacity of 96,000 MT per annum.

Besides NSL, the Nezone Group has other companies involved in the steel pipe and related businesses, including Nezone Tubes Limited (rated at [ICRA]A-/stable and [ICRA]A2+), Nezone Industries Limited (rated at [ICRA]BB/stable and [ICRA]A4), Nezone Pipes & Structures (rated at [ICRA]BBB/stable and [ICRA]A3+), NTL Steels (rated at [ICRA]BB-/Stable and [ICRA]A4), North Eastern Tubes Limited and Nezone Poles & Towers.

NSL posted a net profit of Rs. 10.28 crore (provisional) on an operating income of Rs. 183.31 crore (provisional) during H1 FY2017 (April 2016-September 2016). In FY2016, the company reported a net profit of Rs. 12.06 crore on an operating income of Rs. 393.86 crore.

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating History for last three years:
Table: Rating History

S.No	Name of Instrument	Current Rating (2016)			Chronology of Rating History for the past 3 years			
		Type	Rated amount (Rs. Crores)	Month-year & Rating	Month-year & Rating in FY2016	Month-year & Rating in FY2015	Month-year & Rating in FY2015	Month-year & Rating in FY2014
				January 2017	March 2016	January 2015	December 2014	December 2013
1	Cash Credit	Long Term	75.00	[ICRA]A- (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB (Stable)
2	Cash Credit (untied)	Long Term	17.36	[ICRA]A- (Stable)	[ICRA]BBB+ (Stable	[ICRA]BBB+ (Stable)	-	-
3	Stand-by Line of Credit	Long Term	5.00	[ICRA]A- (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB (Stable)
4	Letter of Credit	Short Term	50.00	[ICRA]A2+	[ICRA]A2	[ICRA]A2	[ICRA]A2	[ICRA]A3+
5	Letter of Credit (untied)	Short Term	25.00	[ICRA]A2+	[ICRA]A2	[ICRA]A2	-	-
6	Bank Guarantee	Short Term	3.00	[ICRA]A2+	[ICRA]A2	[ICRA]A2	[ICRA]A2	[ICRA]A3+
7	Derivative /Forward Contract	Short Term	1.14	[ICRA]A2+	[ICRA]A2	[ICRA]A2	[ICRA]A2	[ICRA]A3+
8	Derivative /Forward Contract (untied)	Short Term	1.26	[ICRA]A2+	[ICRA]A2	[ICRA]A2	-	-
9	Bank Guarantee (untied)	Short Term	2.00	[ICRA]A2+	[ICRA]A2	-	-	-

Complexity level of the rated instrument:
ICRA has classified various instruments based on their complexity as "Simple," "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1

Details of Instrument

Name of the instrument	Date of issuance	Coupon rate	Maturity Date	Size of the issue (Rs. Cr)	Current Rating and Outlook
Cash Credit	-	-	-	75.00	[ICRA]A- (Stable)
Cash Credit (untied)	-	-	-	17.36	[ICRA]A- (Stable)
Stand-by Line of Credit	-	-	-	5.00	[ICRA]A- (Stable)
Letter of Credit	-	-	-	50.00	[ICRA]A2+
Letter of Credit (untied)	-	-	-	25.00	[ICRA]A2+
Bank Guarantee	-	-	-	3.00	[ICRA]A2+
Derivative /Forward Contract	-	-	-	1.14	[ICRA]A2+
Bank Guarantee (untied)	-	-	-	2.00	[ICRA]A2+
Derivative /Forward Contract (untied)	-	-	-	1.26	[ICRA]A2+

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