

January 23, 2017

Nezone Tubes Limited

Instrument*	Rated Amount (in crore)	Rating Action
Fund-based Limits	121.56 (revised from 97.56)	[ICRA]A- (Stable) upgraded from [ICRA]BBB+(Stable)
Non-fund based Limits	107.00 (revised from 131.00)	[ICRA]A2+ upgraded from [ICRA]A2
Total	228.56	

*Instrument Details are provided in Annexure-1

Rating Action

ICRA has upgraded the long-term rating assigned to the Rs. 3.77-crore¹ (revised from Rs. 2.56 crore) term loan, Rs. 112.79-crore (including an untied amount of Rs. 22.79 crore which was not rated earlier), and Rs. 5-crore stand-by line of credit facilities of Nezone Tubes Limited (NTL)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. 107-crore (revised from Rs. 131 crore; including an untied amount of Rs. 21 crore vis-à-vis Rs. 45 crore earlier) non-fund based bank facilities of NTL from [ICRA]A2 (pronounced ICRA A two) to **[ICRA]A2+** (pronounced ICRA A two plus).

Detailed Rationale

ICRA has evaluated NTL's business risk profile on a consolidated basis along with Nezone Strips Limited (NSL, rated at [ICRA]A-/Stable/[ICRA]A2+), both of which are engaged in the business of manufacturing steel tubes, and share a common management. The rating upgrade takes into account the company's improved financial risk profile during FY2016, which sustained in H1FY2017. A sizeable growth in sales volumes supported by enhanced geographical diversification and significant softening of raw material prices vis-à-vis realisations resulted in the company's improved profitability at an absolute level. This coupled with reduced working capital borrowing strengthened NTL's return indicators and debt coverage metrics. ICRA also notes the company's adequate financial flexibility, given the limited long-term debt repayment obligation vis-à-vis healthy cash accruals, 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 and a significant growth exhibited by the company's scale of operations over the years, supported by an expanding distribution network, regular capacity expansion and optimum utilisation of the same. The ratings also factor in NTL'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 the limited value addition and the 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. NTL's high stocking requirement increases the working capital intensity of its operations, and also makes it vulnerable to the risks of inventory loss.

NTL's operating income is likely to grow by around 8%, while its operating and net margins are likely to remain at around 7% and 3%, respectively, in FY2017. ICRA also notes that the discontinuation of import of raw material by NTL, 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 due to limited credit 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 NTL's healthy

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

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 sustained during H1 FY2017
- Long experience of promoters and established position of the group (Nezone) in the steel-tube manufacturing business
- Consistent growth in the company's scale of operations over the years, aided by an expanding distribution network, regular capacity expansion and optimum utilisation of the same
- 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
- Limited long-term debt repayment obligation, low utilisation of working capital limits in recent past 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. NTL has a diversified product mix including mild steel pipe and galvanised pipe 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, NTL's sales volume increased by around 32%. Despite this, the company's top-line growth in FY2016 was limited to around 11% because of a significant drop in the average realisations. However, a steeper decline was witnessed in raw material prices as a result of large-scale import of hot-rolled coil (HRC) at a cheap rate following significant softening of steel prices in the international market. This resulted in an improvement in the company's mark-up per tonne of steel tubes sold in FY2016, which sustained in H1 FY2017. However, 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. In October, 2016, NTL has increased the steel tube manufacturing capacity of its plant at Ranipet by 40,000 tonnes per annum (TPA) which is around 28% of the company's previous capacity. The recent demonitisation drive by the Government of India negatively impacted NTL's sales volumes to some extent over the last two months. However, its operation is likely to scale up further going forward due to the recent capacity addition.

A steep decline in raw material prices vis-à-vis realisations during FY2016 led to a significant improvement in the company's operating margin to 7.47% in FY2016 from 4.92% in the preceding year. Moreover, the company's interest expense declined in FY2016 because of lower working capital borrowing, as a major portion of the raw material was imported through utilisation of non fund-based facility. As a result, NTL's net margin improved from 1.63% in FY2015 to 3.56% in FY2016. The improved margins coupled with top-line growth



resulted in a sizeable improvement in NTL's OPBDITA (by 68%) and PAT (by 142%) during FY2016. The company's operating and net margins improved further to 8.06% and 4.05% 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 20% in FY2016 and H1 FY2017 from around 12% in FY2015, supported by improved profitability at an absolute level. The reduced interest cost and improved profitability strengthened NTL's debt coverage indicators during FY2016 and H1 FY2017. The company has limited term loan repayment obligation compared to its current cash accrual. Further, the low utilisation of the working capital limits in the recent past and demonstrated ability of the promoters to infuse funds reflects adequate financial flexibility.

Analytical approach: Not Applicable

Links to applicable criteria

Corporate Credit Rating –A Note on Methodology

About the company:

Incorporated in 1981, Nezone Tubes Limited (NTL) manufactures mild steel black pipes and galvanised iron pipes. In the plant located at Dankuni, West Bengal the company has three tube mills having a total capacity of 85,000 TPA, along with an annual galvanising capacity of 20,000 TPA. NTL commissioned a new tube plant at Ranipet, Tamil Nadu in January 2013, consisting of two tube mills. The capacity of the tube plant at Ranipet was initially estimated at 40,000 TPA. However, the same has been reassessed at 60,000 TPA. A galvanisation facility of 20,000 TPA was also commissioned at the Ranipet plant in FY2014. However, the galvanisation plant at Ranipet was scrapped in FY2016 on account of low demand of galvanised iron pipes in the southern India. In October, 2016, NTL commissioned another tube mill (with a capacity of 40,000 TPA) in the Ranipet plant, increasing the overall capacity of the company to 185,000 TPA.

Besides NTL, the Nezone Group has other companies engaged in the steel pipe and related businesses, including Nezone Strips 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.

NTL posted a net profit of Rs. 11.39 crore (provisional) on an operating income of Rs. 281.43 crore (provisional) during H1 FY2017 (April 2016 – September 2016). In FY2016, the company reported a net profit of Rs. 20.20 crore on an operating income of Rs. 567.35 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	Term Loan	Long Term	3.77	[ICRA]A-(Stable)	[ICRA]BBB+(Stable)	[ICRA]BBB+(Stable)	[ICRA]BBB+(Stable)	[ICRA]BBB (Stable)
2	Cash Credit	Long Term	90.00	[ICRA]A-(Stable)	[ICRA]BBB+(Stable)	[ICRA]BBB+(Stable)	[ICRA]BBB+(Stable)	[ICRA]BBB (Stable)
3	Cash Credit (untied)	Long Term	22.79	[ICRA]A-(Stable)	-	[ICRA]BBB+(Stable)	-	-
4	Stand-by Line of Credit	Long Term	5.00	[ICRA]A-(Stable)	[ICRA]BBB+(Stable)	[ICRA]BBB+(Stable)	[ICRA]BBB+(Stable)	[ICRA]BBB (Stable)
5	Letter of Credit	Short Term	75.00	[ICRA]A2+	[ICRA]A2	[ICRA]A2	[ICRA]A2	[ICRA]A3+
6	Letter of Credit (untied)	Short Term	20.00	[ICRA]A2+	[ICRA]A2	[ICRA]A2	-	-
7	Bank Guarantee	Short Term	8.00	[ICRA]A2+	[ICRA]A2	[ICRA]A2	[ICRA]A2	[ICRA]A3+
8	Derivative /Forward Contract	Short Term	3.00	[ICRA]A2+	[ICRA]A2	[ICRA]A2	[ICRA]A2	[ICRA]A3+
9	Derivative /Forward Contract (untied)	Short Term	1.00	[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
Term Loan	April 17, 2012	12.7%	September 30, 2020	3.77	[ICRA]A- (Stable)
Cash Credit	-	-	-	90.00	[ICRA]A- (Stable)
Cash Credit (untied)	-	-	-	22.79	[ICRA]A- (Stable)
Stand-by Line of Credit	-	-	-	5.00	[ICRA]A- (Stable)
Letter of Credit	-	-	-	75.00	[ICRA]A2+
Letter of Credit (untied)	-	-	-	20.00	[ICRA]A2+
Bank Guarantee	-	-	-	8.00	[ICRA]A2+
Derivative /Forward Contract	-	-	-	3.00	[ICRA]A2+
Derivative /Forward Contract (untied)	-	-	-	1.00	[ICRA]A2+

Contact Details
Analyst Contacts

Jayanta Roy
+91 33 7150 1120
jayanta@icraindia.com

Sumit Jhunjunwala
+91 33 7150 1111
sumit.jhunjunwala@icraindia.com

Sujoy Saha

+91 33 7150 1184
Sujoy.saha@icraindia.com

Relationship Contact

Jayanta Chatterjee
+91 33 7150 1100
jayantac@icraindia.com

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**Registered Office****ICRA Limited**

1105, Kailash Building, 11th Floor, 26, Kasturba Gandhi Marg, New Delhi 110001
Tel: +91-11-23357940-50, Fax: +91-11-23357014

Corporate Office**Mr. Vivek Mathur**

Mobile: +91 9871221122

Email: vivek@icraindia.com

Building No. 8, 2nd Floor, Tower A, DLF Cyber City, Phase II, Gurgaon 122002
Ph: +91-124-4545310 (D), 4545300 / 4545800 (B) Fax; +91- 124-4050424

Mumbai**Mr. L. Shivakumar**

Mobile: +91 9821086490

Email: shivakumar@icraindia.com

3rd Floor, Electric Mansion
Appasaheb Marathe Marg, Prabhadevi
Mumbai—400025,
Board : +91-22-61796300; Fax: +91-22-24331390

Kolkata**Mr. Jayanta Roy**

Mobile: +91 9903394664

Email: jayanta@icraindia.com

A-10 & 11, 3rd Floor, FMC Fortuna
234/3A, A.J.C. Bose Road
Kolkata—700020
Tel +91-33-22876617/8839 22800008/22831411,
Fax +91-33-22870728

Chennai**Mr. Jayanta Chatterjee**

Mobile: +91 9845022459

Email: jayantac@icraindia.com

5th Floor, Karumuttu Centre
634 Anna Salai, Nandanam
Chennai—600035
Tel: +91-44-45964300; Fax: +91-44 24343663

Bangalore**Mr. Jayanta Chatterjee**

Mobile: +91 9845022459

Email: jayantac@icraindia.com

'The Millenia'
Tower B, Unit No. 1004, 10th Floor, Level 2 12-14, 1 & 2,
Murphy Road, Bangalore 560 008
Tel: +91-80-43326400; Fax: +91-80-43326409

Ahmedabad**Mr. L. Shivakumar**

Mobile: +91 9821086490

Email: shivakumar@icraindia.com

907 & 908 Sakar -II, Ellisbridge,
Ahmedabad- 380006
Tel: +91-79-26585049, 26585494, 26584924; Fax:
+91-79-25569231

Pune**Mr. L. Shivakumar**

Mobile: +91 9821086490

Email: shivakumar@icraindia.com

5A, 5th Floor, Symphony, S.No. 210, CTS 3202, Range
Hills Road, Shivajinagar, Pune-411 020
Tel: + 91-20-25561194-25560196; Fax: +91-20-
25561231

Hyderabad**Mr. Jayanta Chatterjee**

Mobile: +91 9845022459

Email: jayantac@icraindia.com

4th Floor, Shobhan, 6-3-927/A&B. Somajiguda, Raj
Bhavan Road, Hyderabad—500083
Tel:- +91-40-40676500