

Rating Rationale

Agni Cement Industries Private Limited

Rating

Facility	Amount (Rs. In Million)	Rating ¹	Rating Action
Long Term Bank Facilities	190.10	CARE-NP BB [Double B]	Assigned
Short Term Bank Facilities	690.00	CARE-NP A4 [A Four]	Assigned
Total Facilities	880.10		

Details of Facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has assigned rating of ‘CARE-NP BB’ to the long term bank facilities and ‘CARE-NP A4’ to the short term bank facilities of Agni Cement Industries Private Limited (ACPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of ACPL are constrained by moderate scale of operations, exposure to volatile interest rates, lack of backward integration and raw material price volatility risk, working capital intensive nature of operations leading to high working capital utilization. The ratings also factors presence in highly fragmented and competitive nature of cement industry and cyclicity of cement industry. The ratings, however, derives strength from established track record of operations and experienced promoters in the related field, comfortable financial risk profile and moderate debt service indicators, demand of cement products in the country expected to grow in the long term and established brand and marketing network.

Ability of the company to manage the growth in the operations & maintaining the profit margins and rationalization of its debt through efficient working capital management would be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Moderate scale of operations

At current production capacity of 900 metric tons per day (MTPD), ACPL was operated at moderate capacity utilization of ~51% during 9MFY19 ending April 14, 2019, witnessing decline in the capacity utilization from ~75% during FY18 (refers to 12 months period ended July 16, 2018). Further, during 9MFY19, ACPL reported sales revenue of Rs.1,372 Mn with

¹Complete definitions of the ratings assigned are available at www.careratingsnepal.com

113,227 metric tons of cement sold. Considering ACPL's current production capacity in comparison to the production of cement in Nepal of around 8 Million tons per annum, ACPL's scale of operation seems relatively moderate. ACPL got license dt. May 13, 2008 from Department of Industry Nepal to manufacture cement with production capacity of 90000 metric tons (MT) per annum.

Exposure to volatile interest rates

Nepalese banking sector fix interest rates on lending based on quarterly published base rate by the banks. Due to tight liquidity in the market, the interest rate has been high and volatile during the last 12 months. Therefore, project funding from Banks and Financial Institutions are exposed to volatile interest rate.

Lack of backward integration and raw material price volatility risk

ACPL is engaged in production of cement and does not possess its own clinker manufacturing unit. Hence, it is procuring its clinker requirements from other clinker manufacturers. Standalone grinding units will have cost competitive disadvantage over the clinker manufacturing units as the average manufacturing cost per MT of clinker will come around Rs.7500 and current market price of clinker is around Rs.8700 per MT. However, being the associated company, ACPL has convenient access for its clinker requirements from Shubhashree Agni Cement Udhyog Pvt. Ltd. ACPL uses clinker, flyash, gypsum etc. as the major raw materials. Around 30% of raw materials were imported from India during FY18. Raw material cost continues to be the major cost component of ACPL constituting around 87% of the total cost of sales in FY18. Hence, any adverse movement in raw material price without any corresponding movement in finished goods price is expected to affect the profitability of the company. The ability of the company to pass through of changes in raw material prices to the finished products will be the key rating sensitivities.

Working capital intensive nature of operations leading to high working capital utilization

The operations of the company are working capital intensive in nature. ACPL is involved in the manufacturing of cement by importing and locally purchased raw materials. The company has to make advance payments for the raw materials, have to keep the inventory for smooth operations and extend high credit to their dealers, which lead to high reliance on working capital limits. ACPL generally allows three to four months credit period to its customers and the company

keeps inventory for around a month. Further, due to high competition and stagnant demand in the market the company has given high credit period to their customers during 9MFY19. This leads to high reliance of the company on the bank finance for working capital needs. Maximum working capital utilization of the company remained high at above 95% for the past 12 months ending May 14, 2019.

Presence in highly fragmented and competitive nature of cement industry

ACPL is operating in a highly competitive market, dominated by the large cement manufactures with wide brand acceptability. There are more than 50 cement factories operating in the country that produce 160 Million bags (8.5 Million metric tons) of cement annually. Further many cement factories that are under construction will come into operation soon and other domestic cement factories are also expanding their production capacity which will intensify the competition. Given the fact that the entry barriers to the industry are low, the players in the industry do not have pricing power and are exposed to competition induced pressures on profitability.

Cyclical nature of cement industry

Cement industry is highly cyclical in nature and depends largely on the economic growth of the country. There is a high degree of correlation between the GDP growth and the growth in cement consumption. Cement being a cyclical industry goes through phases of ups and downs, and accordingly impacts the unit realizations.

Key Rating Strengths

Established track record of operations and experienced promoters in the related field

ACPL has an operational track record of around ten years in the cement manufacturing by grinding of clinker. ACPL is promoted by individuals, who have been involved in construction, hospital, education and trading business for a long time. The company is managed under the overall guidance of Company's Board of Directors (BoD) who possesses wide experience in the related field. Mr. Krishna Prasad Pokharel is the Chairman and Dr. Er. Tara Prasad Pokharel is the Managing Director of the Company. Mr. Krishna has been involved in different businesses from the last 24 years. He is also the director of Subhashree Agni Cement Udhog P. Ltd. (SSPL). Dr. Tara Prasad, holds Doctor of Philosophy (PHD) in Civil Engineering, is also the Managing Director of SSPL.

Comfortable financial risk profile and moderate debt service Indicators

ACPL's total revenue has been increased by ~92% during FY17 to Rs.1630 Mn over FY16, and further increased by ~21% to Rs.1974 during FY18 due to increased volume of cement sales. Further, PBILDT has been increased by ~13% during FY18 to Rs.169 Mn over FY17 with PBILDT margin of 8.55%, which experienced decline over FY17 of 9.15% due to increased selling & distribution expenses and administrative expenses. ACPL availed term loans during FY18 and 9MFY19 for the expansion of grinding capacity to 900 MTPD and to purchase land in Kathmandu. Increase in term loans leads to increase in debt equity ratio of the company to 0.72x as on July16, 2018 (0.55x at the end of FY17) and the overall gearing was at moderate level of 1.91x as on July 16, 2018. ACPL has moderate interest coverage ratio and total debt to GCA of 3.08x and 8.27x as on July 16, 2018 respectively.

Demand of cement products in the country expected to grow in the long term

It is expected that the demand of cement in Nepal to exceed 10 Mn tons per year by 2023. Expected stabilizing political environment, federal and provincial governments' huge budget allocation towards capital expenditure i.e. Rs.546 Bn in total for FY20 with targeted GDP growth of 8.50% will accelerate towards upward trend in domestic cement consumption. Nepalese economy has gone through several highs and lows, having been impacted by natural disasters, political instability and protests. However, the government's continued thrust on the construction, infrastructure development and power sector and targeted GDP growth is likely to benefit the cement manufacturers like ACPL.

Established brand and marketing network

ACPL is manufacturing Portland Pozzolana Cement (PPC) under three brands (Agni, Orient and Tridev), which has great usage for brick masonry, plastering, tiling and waterproofing works. Ordinary Portland Cement (OPC) is manufactured under one brand namely Alpha, which has great usage for Structural Concrete or Reinforced Concrete Works (like Columns, Beams, Slab etc.). Currently ACPL focus its sales in the territory of nine zones only (out of 14 zones of Nepal) covering 31 districts (out of 77) of Nepal.

About the Company

Agni Cement Industries Private Limited (ACPL) is a private limited company, established in 2007, promoted by the individuals involved in construction, hospital, education and trading

business for setting up clinker grinding plant to manufacture cement at Rupendehi District of Nepal. Presently ACPL is engaged in producing cement by grinding clinker with installed capacity of 900 metric ton per day. ACPL principally manufactures Portland Pozzolana Cement (PPC) and Ordinary Portland Cement (OPC) cement under four brands.

Brief Financial Performance during last 3 years:

(Rs. In Million)

For the year ended Mid July,	FY16 (A)	FY17 (A)	FY18 (A)
Income from Operations	849	1,630	1,974
PBILDT	92	149	169
PAT	24	53	64
Overall Gearing (times)	1.58	2.04	1.91
Interest coverage (times)	3.07	3.28	3.08

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Annexure 1: Details of the Facilities rated

Nature of the Facility	Type of the Facility	Amount (Rs. Million)	Rating
Long Term Bank Facilities	Term Loan	190.10	CARE-NP BB
Short Term Bank Facilities	Overdraft	200.00	CARE-NP A4
Short Term Bank Facilities	Working Capital Loan	440.00	CARE-NP A4
Short Term Bank Facilities	Letter of Credit/ Bank Guarantee	50.00	CARE-NP A4
Total		880.10	