Rating Rationale

Nepal Ultratech Cements Private Limited

Rating

Facility/ Instrument	Amount (Rs. In Million)	Rating[1]	Rating Action
Long Term Bank Facilities	1,144.00	**CARE-NP BB [Double B]**	Assigned
Short Term Bank Facilities	725.00	**CARE-NP A4 [A Four]**	Assigned
Total facilities	**1,869.00**		

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 Nepal Ultratech Cements Private Limited (NUCPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of NUCPL are constrained by moderate financial performance during FY19 (audited, refers to 12 months period ended mid-July 2019), highly leveraged capital structure at the end of FY19 on account of escalation in project cost and time overrun, working capital intensive nature of operations and lack of backward integration leading to raw material price volatility risk. The rating also factors in nascent stage of the company's distribution channel which is yet to fully develop, presence in highly fragmented & competitive market and cyclical nature of cement industry. The ratings however, derives strength from fully automated and latest technology installed in the plant expected to provide healthy profitability and cost efficiencies and expected growth in demand of cement products in the country in the long term. The rating also factors in experienced promoters in trading field related to construction items, product diversification and locational advantage of the plant site.

Ability of the company to pass through changes in raw material prices to the finished products will be the key rating sensitivity. Also ability of the company to generate sufficient profitability and cash to bear the increased debt burden and interest cost due to escalations in project cost will be the key rating sensitivity.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Moderate financial performance during FY19, first year of operation

The company commenced its operations from December 5, 2018 and during FY19 was operational for a period of seven months. During FY19, company achieved sales of Rs 564 Mn with PBILDT of Rs. 52 Mn and PBILDT margin of 9.17%. Sales of the company was impacted due to suspension of commercial sales by the Nepal Standard Bureau over quality issues for a period of four months during the year. The company earned PAT of Rs. 3.98 Mn with PAT margin of 0.72% in FY19.

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

Highly leveraged capital structure on account of escalation in project cost and time overrun

The initial planned capacity of the cement manufacturing plant with grinding capacity was 500 Metric Tonnes Per Day (MTPD) which was later increased to 1,000 MTPD to achieve higher operational cost efficiency. Also, additional cost was incurred by the company on additional piling works due to soft soil and water logged low agricultural land which further escalated the project cost. Further, the project was estimated to start operations from July 2018, but due to non-availability of dedicated grid for supply of electricity, commencement of operation was delayed to December 2018. Accordingly, the cost of the project increased to Rs. 1,527 Mn which was financed at D/E ratio of 75:25. At the end of FY19, the debt-equity ratio of the company stood at 1.88x with moderate overall gearing of 2.80x. Interest coverage ratio of the company was low at 1.26x with high total debt/GCA of 157.22x at the end of FY19. Increased debt burden and interest cost is likely to put significant pressure on the profitability of the company and timely infusion of funds by the promoters will be critical for the smooth running of operations.

Lack of backward integration and raw material price volatility risk; presence only in clinker grinding

NUCPL is engaged in manufacturing cement and does not possess its own clinker unit. Company mainly uses clinker, flyash, slag, gypsum etc. as raw materials, majority of which is imported from India. Hence, for clinker supply, the company is dependent on other cement manufacturers. Raw material cost continues to be the major cost component of NUCPL as cost of goods sold constituted more than 80% of the total sales. 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 changes in raw material prices to finished products will be the key rating sensitivities.

Working capital intensive nature of operations

The operations of the company are working capital intensive in nature as NUCPL is involved in manufacturing of cement from imported and locally purchased raw materials. The company has to make advance payments for raw materials in order to maintain inventory for smooth operations and also extend credit to their dealers, which lead to high reliance on working capital limits. NUCPL generally allows three months credit to its dealers and maintains inventory of around two months. NUCPL had an operating cycle of around 128 days during FY19.

Distribution channel of the company is currently in nascent stage and yet to fully develop

NUCPL commenced its operation only in December 2018 and its brand "Bandhan" is new in the market. NUCPL is exposed to competition from existing brands in the market which have wide acceptability. Also, distribution channel of the company is currently in nascent stage and yet to fully develop and cover the target markets.

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, funding from Banks and Financial Institutions are exposed to volatile interest rate.

Presence in highly fragmented &competitive market and cyclical nature of cement industry

NUCPL is operating in a highly competitive market, dominated by the large cement manufactures with wide brand acceptability. There are 53 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. 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. The demand of cement industry is considered cyclical as it depends upon the capital expenditure plan of major players in the end-user industry.

Key Rating Strengths

Experienced promoters in trading field related to construction items

NUCPL is promoted by industrialists and traders from different district of Nepal, who are involved in various trading and manufacturing business. It is managed under the overall guidance of the Company's Board of Directors (BoD) who possesses wide experience in related field. Mr. Manish Kumar Maru, Chairman & Managing Director of the Company is also involved in trading of hardware material including cement from last 10 years.

Fully automated and latest technology likely to provide better profitability and cost efficiencies in future

NUCPL started commercial operation of 1,000 MTPD of grinding plant on December 5, 2018. Further, the company obtained Nepal Standard Council (NSC) final approval to commence sales only on March 3, 2019 and till then, it was eligible to make only limited sales on the basis of Provisional approval. The plant is fully automated with minimum labour involvement on account of automated material handling and feeding system. All these factors are expected to contribute in reducing cost of production.

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

Demand of cement in Nepal is expected to exceed 10 Mn tons per year by 2023. Expected stabilizing political environment, coupled with pressure from the population to complete vital construction projects in the aftermath of the 2015 earthquake, as well as transportation and energy infrastructure, will further accelerate this upward trend in domestic cement consumption. Apparent cement consumption in Nepal is estimated to be around 8 Million tons and clinker consumption is estimated to be around 6 Million tons during FY18. The 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 of 7.01% is likely to benefit the cement manufacturers like NUCPL.

Product Diversification

NUCPL has been manufacturing OPC and PSC cement and the PPC plant of the company is expected to come into operation from April 2020 onwards. The cements manufactured are being sold under the "Bandhan Brand". Currently, NUCPL is focused in selling cement in the nearby areas and increase its market presence and improve brand image.

Locational advantage of the plant site

The plant is located at eastern part of Nepal where concentration of cement factories is relatively less than the western part of the country. Bhadrapur, Birtamod, Biratnagar, Itahari etc. are the big cities nearby which is the major local market for the NUCPL's product. As NUCPL imports around 80% of clinker from India its proximity to Indian border reduces the logistic cost. NUCPL imports raw material from its suppliers in India till Bathnaha railway station (Bihar) which is approximately 5 kms from Biratnagar. It is then transferred via road to the plant site in Morang District which is 15 Kms from Biratnagar custom point. This connectivity enables NUCPL to get raw materials at lower logistic cost.

About the Company

Nepal Ultratech Cement Private Limited (NUCPL) was incorporated in August 27, 2015 and is promoted by individuals involved in various trading and manufacturing business. The clinker grinding plant is located in Hattimuda- 9, Morang District of Nepal with total grinding capacity of 300,000 MTPA. COD of the plant was achieved on December 5, 2018.

Brief Financial Performance during FY19 is as follows:

(Rs. In Million)

For the year ended Mid July	FY19 (A)*
Income from Operations	564
PBILDT	52
PAT	4
Overall Gearing (times)	2.80
Interest coverage (times)	1.26

**Audited*

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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	1,144.00	**CARE- NP BB**
Short Term Bank Facilities	Working Capital Loan	400.00	**CARE-NP A4**
Short Term Bank Facilities	Overdraft Loan	200.00	**CARE-NP A4**
Short Term Bank Facilities	Letter of Credit	100.00	**CARE-NP A4**
Short Term Bank Facilities	Bank Guarantee	25.00	**CARE-NP A4**
Total		**1,869.00**	