

Rating Rationale

Shubhashree Agni Cement Udhyog Private Limited

Rating

Facility/ Instrument	Amount (Rs. In Million)	Rating ¹	Rating Action
Long Term Bank Facilities	2,368.69	CARE-NP BB+ [Double B Plus]	Reaffirmed
Short term Bank Facilities	2,610.00	CARE-NP A4+ [A Four Plus]	Reaffirmed
Total Facilities	4,978.69 (enhanced from 3895.40)		

Details of Facilities in Annexure 1

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

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of SSPL are continues to be constrained by leveraged capital structure, raw material price volatility risk, exposure to volatile interest rates and foreign exchange fluctuation risk. The ratings also factors presence in highly fragmented and competitive nature of cement industry, cyclicality of cement industry and impact of COVID-19 on the business of the company. The ratings, however, derive strength from experienced promoters in the cement industry, healthy profitability and its moderate debt service coverage indicators, competitive advantage over the standalone grinding units, optimum utilization of installed capacity, demand of cement products in the country expected to grow in the long term, and locational advantage of the plant site and license of limestone mines. The ability of the company to pass through of changes in raw material prices to the finished products and managing the foreign exchange fluctuation risks related to raw materials will be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Leveraged capital structure

SSPL has leveraged capital structure with debt equity ratio of 2.00x at the end of FY19 which improved from 2.51x at the end of FY18 due to the increase in total networth of the company on account of accretion of profit and infusion of equity despite increase in term loan. Further, the company is having leveraged capital structure with overall gearing ratio of 2.62x at the end of FY19 which improved from 2.91x at the end of FY18.

Exposure to volatile interest rates

Nepalese banking sectors are fixing interest rate on lending based on quarterly base rate and interest rate will be changed accordingly on quarterly basis. Due to tight liquidity in the market, the interest rate has

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

been high and volatile during the last 12 months. Therefore, funding from Bank and Financial Institutions is subject to volatile interest rate.

Foreign exchange fluctuation risk and raw material price volatility risk

SSPL currently uses coal, limestone, bauxite, red clay and iron ore as the major raw materials. Coal constitutes around 7% of raw materials consumption during clinker production. All the coal requirements are met through import from South Africa, Australia and India. Out of which around 90% import of coal are invoiced in USD, for which it is exposed to the foreign exchange fluctuation risk. SSPL has not taken any hedging mechanism to minimize the risk associated with fluctuation in foreign currency. Raw material cost continues to be the major cost component of SSPL as cost of goods sold constituting around 66% of the total sales in FY19. 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 and managing the foreign exchange fluctuation risks related to raw materials will be the key rating sensitivities.

Presence in highly fragmented and competitive nature of cement industry

SSPL is operating in a highly competitive market, dominated by the large cement manufacturers with wide brand acceptability. 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. The producers of cement are essentially price-takers in the market, which directly expose their cash flows and profitability to volatility in the prices of cement.

Cyclicality 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.

Impact of COVID-19 on the business of the company

The outbreak of Coronavirus disease 2019 (COVID-19) which was recognized as Pandemic by World Health Organization has affected Nepal as well. Government of Nepal (GoN) imposed travel restrictions and countrywide lockdown since March 24, 2020 closing most of the organizations which resulted in slowing down of the economic activities. Due to this, production and sales of whole industry including SSPL has been impacted and has impacted the revenue of the company. Further, the central bank of Nepal has provided an extension of 3 months for the repayment of loans falling due in mid-April 2020 to provide some temporary relief. However, SSPL has not availed the relaxation and has paid its debt repayments for quarter ending mid-April 2020.

Key Rating Strengths***Experienced promoters in the related field***

SSPL is promoted by individuals involved in cement industry, hospital, education sectors. The company is managed under the overall guidance of the Company's Board of Directors (BoD) who possesses wide experience in the related field. Mr. Krishna Prasad Pokharel is the Chairman and Dr. Tara Prasad Pokharel is the Managing Director of the Company. Mr. Krishna has been involved in different businesses from the last 24 years and is director in Agni Cement Industries Pvt. Ltd. [ACPL – CARE-NP BB/A4]. Dr. Tara Prasad, is also the Managing Director of ACPL. ACPL, one of the promoters of SSPL holding 10.84% paid up capital of SSPL as on July 16 2019, operates clinker grinding plant since six years.

Healthy profitability and moderate debt coverage indicators

SSPL reported the increase in total sales by 67% during FY19 over FY18 due to increase in total quantity sold of the clinker. PBILDT of the company increased by 69% to Rs.716 Mn during FY19 over FY18 with PBILDT margin of 30.73%. The increase in PBILDT is mainly driven by increase in sales with the increase in the price realization coupled with the decrease in the cost of the raw material. Further, SSPL started incurring selling and distribution expense during FY19 on account of appointment of dealers for sale of cement. PAT of the company increased by 204% during FY19 over FY18 on account of increased PBILDT despite increase in interest expenses due to the high utilization of working capital loans and increase in term loan for setting up of grinding unit. SSPL has moderate interest coverage at 2.81x during FY19 due to increase in PBILDT of the company. The total debt to Gross Accruals Ratio of the company improved to 8.80x during FY19 from 12.02x during FY18 due to the increment in the Gross Cash accruals of the company.

Competitive advantage over the standalone grinding units

SSPL possess two limestone mines in its name, for which it has obtained extraction license from Department of Mines and Geology. It is estimated that mine located at Pyuthan district has ~8.6 million tons and mine located at Dang district has ~4.3 million tons of limestone, which is sufficient to run 1200 MTPD grinding unit for 46 years. Now Nepal is manufacturing its own clinker and dependence upon the imports of the clinker are reduced substantially over the period. As per Department of Customs on Nepal, import of clinkers have declined by ~77% during 7MFY20 to Rs. 2,217 Mn compared to Rs. 9,713 Mn during 7MFY19. Clinker manufacturing units will have added cost competitive advantage over the standalone grinding units.

Optimum utilization of installed capacity

SSPL started commercial operation of clinker unit from December 01, 2017 with installed capacity of 700 MTPD. Although the stated installed capacity is 700 MTPD, with some modification in the plant, SSPL reported optimum utilization of installed capacity. During FY19, SSPL produced 2,60,727 MT of clinker

which was ~106% of total installed capacity. Further, SSPL started commercial operation of grinding unit from July 2019.

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

Nepalese economy is developing and growing, and is in phase of investment in infrastructure sectors, power sector and tourism sector. It is highly probable that the national economy will be in need of construction materials in developing public as well as private infrastructures, road, bridges and other public facilities. In the recent budget presented by finance minister of Nepal for FY21, government has allocated Rs. 55 Bn towards post-earthquake reconstruction of private housing, archaeological heritage, school building, and government building. Further, government has majorly focused towards development of health sectors, tourism sectors, agriculture and other infrastructure development. Cement being fundamental requirement for any construction activity is therefore going to be in regular demand. Further, the government’s high emphasis on infrastructure development, namely development of roads, hydropower, airports and other infrastructures and estimated GDP growth of 7.00% as included in the budget for FY20-21 is likely to benefit the cement manufacturers like SSPL.

Locational advantage of the project site and license of Limestone mines

The plant is located at mid-western part of Nepal. Ghorahi, Tulsipur, Kohalpur, Nepalgunj, Butwal, Bhairahawa etc. are the big cities nearby and are the major local market for the SSPL’s product. SSPL imports coal from South Africa, Australia and India via Barhni border (60 kms from plant) and Sunauli border (90 kms from plant). The company is extracting limestone from two mines, which are within the territory of 70 kms from the plant site. There are numerous large and small grinding plant nearby SSPL’s site to whom SSPL is selling clinker.

About the Company

Shubhashree Agni Cement Udhyog Private Limited (SSPL) is a private company, established in 2013, for setting up clinker and cement grinding plant at Arghakhanchi District of Nepal. It is promoted by Agni Cement Industries Pvt. Ltd. and other individuals involved in cement industry, construction, hospital, education and trading business. Presently SSPL is engaged in producing clinker by extracting limestone with installed capacity of 700 metric ton per day (MTPD). SSPL has grinding unit of 1200 MTPD capacity which came into operation from July 2019.

Brief Financial Performance during the last 2 years is as follows:

(Rs. In Million)

For the year ended Mid July,	FY18 (A) (7.5 months)	FY19 (A) (12 months)
Income from Operations	1,393	2,329
PBILDT	423	716
PAT	53	162

Overall Gearing (times)	2.91	2.62
Interest coverage (times)	2.71	2.81

**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	2,368.69	CARE-NP BB+
Short Term Bank Facilities	Working Capital Loan	1,950.00	CARE-NP A4+
Short Term Bank Facilities	Letter of Credit	660.00	CARE-NP A4+
Total		4,978.69	