Samrat Cement Company Private Limited

Ratings

Facility	Amount (Rs. in Million)	Ratings[1]	Rating Action
Long Term Bank Facilities	10,144.79 (Decreased from 10,154.77)	CARE-NP BB- [Double B Minus]	Revised from CARE-NP BB+
Short Term Bank Facilities	2,350.98 (Decreased from 2,490.98)	CARE-NP A4 [A Four]	Revised from CARE-NP A4+
Total Facilities	12,495.77 (Twelve Billion Four Hundred Ninety-Five Million and Seven Hundred Seventy Thousand Only)		

Details of Facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has revised the rating assigned to the long term bank facilities of Samrat Cement Company Private Limited (SCPL) to 'CARE-NP BB-' from 'CARE-NP BB+'. CRNL has also revised the rating assigned to its short term bank facilities to 'CARE-NP A4' from 'CARE-NP A4+'.

Detailed Rationale & Key Rating Drivers

The revision in ratings assigned to the bank facilities of SCPL takes into account its declining operating and financial performance in FY23 (FY refers to the twelve-month period ending mid-July) resulting in higher-than-expected deterioration in its capital structure and weak debt service coverage indicators amid negative cash accruals. Despite sharp fall in operating income in FY23, SCPL reported spike in debt levels, resulting in a highly leveraged capital structure with substantial surge in gearing levels, which was also impacted by the company's diluted tangible net worth owing to net losses during FY23. Amid low demand and higher input prices, plunging margins exacerbated further by stiff competition, SCPL's income prospects would likely to remain checked over the near-term. The ratings also remain constrained by operations stabilization and salability risk associated with the brownfield expansion unit, raw material price volatility risk, working capital intensive nature of operations and presence in highly competitive nature of cement industry. The company's ability to achieve capacity utilizations at envisaged levels for a sustained period remains to be seen, particularly amid the sluggish demand scenario over the near-term and other industry headwinds currently faced by the cement industry.

The ratings, however, continue to derive strengths from experienced promoters and competitive advantage over the standalone grinding units. The ratings further derive strength from locational advantage of the project site, accessibility to limestone mines, established brand presence and stable demand outlook for cement products in the country over the medium-term.

Going forward, the ability of the company to profitably scale up its operations along with rationalization of its debt levels would be the key rating sensitivities. Furthermore, stabilization of the expansion project with capacity utilization levels thereafter to generate sufficient cash flows as envisaged will be the key rating sensitivity.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Weak operating performance with sustained pressure on margins in FY23 amid industry headwinds

During FY23, SCPL reported decrease in total operating income (TOI) by ~31% y-o-y to Rs. 3,375 Mn (FY22: Rs. 4,875 Mn) amid low demand leading to reduced price realizations. The decrease in total revenue in FY23 was partially on account of decrease in quantity sold of clinker to 71,568 MT in FY23 from 342,022 MT in FY22. Cement demand was low industry wide during FY22-FY23 owing to slower pace of economic growth coupled with relatively lower infrastructure spending by the government. This led to lower average price realizations. The lower profitability margins were also partly on account of higher input prices which the company was not able to adequately pass through to its customers attributed to highly competitive market. Low margins coupled with higher interest burden amid leveraged capital structure had resulted into net losses of Rs. 433 Mn during FY23. The company reported cash losses during FY23. Financial strain on the company is likely to persist over the near-term owing to subdued scale of operations and muted profitability amid the ongoing industry headwinds.

Highly leveraged capital structure with weak debt protection metrics

The capital structure of the company is highly leveraged with overall gearing ratio of 5.09x at the end of FY23 (FY22: 3.93x) on account of higher debt levels partially related to debt funded capex along with increased working capital borrowings. The company's diluted tangible net worth owing to net losses during FY23 also led to increasing gearing levels in FY23. The interest coverage ratios were below unity during FY23. Total debt to Gross Cash Accrual Ratio stood at negative during FY23. Rationalization of debt levels will remain critical from credit perspective.

Project stabilization risk associated with its large-size capex

SCPL had undertaken a brownfield expansion project to increase the installed capacity of grinding unit to 3,600 MTPD from 1,800 MTPD. The enhanced grinding unit came into operations on July 17, 2022. The company had also backward integrated its manufacturing facility by setting up a 4,000 MTPD clinker unit, which came into operations on January 14, 2021. The total cost of the capex was Rs. 13,128 Mn. Given the relatively sluggish demand outlook for cement products over the near-term and modest capacity utilizations during FY23-H1FY24, the company remains susceptible to risk related with swift stabilization and scalability risk for the enhanced capacity. However, with expected rebound in demand over the medium term, the expansion is likely to boost SCPL's income profile and be margin accretive for the company.

Working Capital Intensive Nature of Operations

The operations of the company are working capital intensive in nature. SCPL is involved in manufacturing cement and clinker by procuring raw materials both locally and by importing. The company needs to maintain sufficient inventory for smooth operations and extend credit to their dealers, which leads to reliance on bank borrowings on working capital requirements. Average collection period stood high at 129 days in FY23 (FY22: 85 days) due to delayed debtor realizations. Payable period also remained stretched at 241 days in FY23 (FY22: 169 days). Consequently, amid muted cash flow from operations, the company's liquidity position remains highly stretched.

Raw material price volatility risk

SCPL currently uses coal, fly ash, gypsum, clay, bauxite and iron ore as major raw materials. Coal constituted around 65-70% of major raw materials consumption in clinker and cement production. The company is exposed to the raw material price volatility risk due to the volatility experienced in the price of coal. The general volatility in the raw material prices also has an impact on the price of its final product. Any sudden spurt in these raw material prices might not be passed on to the end customers instantly on account of highly competitive nature of the industry, which could lead to decline in profitability margins. Raw material cost continues to be the major cost component of SCPL as cost of goods sold constituted ~74% of the total sales in FY23 (FY22: ~75%). Company imported the majority of coal from South Africa, Australia and India during FY23, while the final products are sold completely in the domestic market. Though the company tries to pass on the price and currency volatility to the end users, any adverse fluctuations in the currency markets may put pressure on the profitability of the company. Furthermore, increasing competition has led to a very competitive pricing dynamics in the industry and the ability of the company to protect its market share while maintaining a reasonable profitability margin will be key rating sensitivity.

Presence in highly competitive nature of cement industry

SCPL is operating in a highly competitive market, dominated by the large cement manufactures with wide brand acceptability. Furthermore, there new large players have entered the market over the past few years and most established players have either expanded or are in process of expanding existing capacities. Given the increased number of competitors, the players in the industry do not have pricing power and are exposed to competition-induced pressures on profitability. 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 as seen in decline in price of cement and clinker during last three years.

Key Rating Strengths

Experienced promoters in the related field

SCPL is managed under the overall guidance of its three-member Board of Directors (BoD) comprised of individuals who possess wide experience in the related field. The two directors, Mr. Nirvana Chaudhary and Mr. Barun Chaudhary are from Chaudhary Group (CG). CG is one of the leading business groups of Nepal and is involved in diversified business like FMCG, manufacturing, real estate, cement and other businesses. Being a part of the prominent group, SCPL has privilege in terms of technical and financial assistance. Mr. Anil Kumar Rungta, Chairman, has more than 25 years of experience in different sector like cement, iron, wire etc.

Established Brand Presence and locational advantages

SCPL manufactures PPC cement (used for brick masonry, plastering, tiling and waterproofing works) and OPC cement (used for reinforced concrete structures). SCPL sells its products under seven brands namely Gajraj, Gajraj Premium, Baaj, Baaj Premium, Badshah, Samrat and Samrat Premium. Gajraj, Baaj, Badshah & Samrat are PPC cement brands and Gajraj Premium, Baaj Premium & Samrat Premium are OPC cement brands.

The company's manufacturing facility is located in the mid-western part of Nepal nearby the big cities like Ghorahi, Tulsipur, Kohalpur, Dhangadi, Nepalgunj, Butwal and Bhairahawa, which are major local market for the SCPL's product. One of the limestone mines is located at a distance of 50 km from the plant site which eases the extraction / transportation of limestone from the mines. Clinker manufacturing units generally have added cost competitive advantage over standalone grinding units. Having both clinker and grinding units, three licensed limestone mines and enhanced capacity augurs well for the business prospects of the company over the medium term.

Industry outlook

With the construction sector in Nepal is currently impacted by slower pace of economic growth coupled with relatively lower infrastructure spending by the government (4% y-o-y decline in 7MFY24 on a low base), the outlook of cement industry in Nepal remains challenging over the near term. Furthermore, with increase in the capacities of the existing plants and new capacities coming into operations resulting in overcapacity amid sluggish demand, competition has intensified which has resulted into substantial decline in capacity utilizations and profitability of the industry players in the recent years. Nevertheless, the government's long-term emphasis on infrastructure development, namely development of roads, hydropower, airports and other infrastructures is likely to benefit cement manufacturers like SCPL in the long term. Sustained demand for cement is likely given the need of construction materials in developing public as well as private infrastructures, road, bridges and other public facilities. Hence, demand of cement in the country is expected to grow over the long term. However, will remain checked in near term.

About the Company

Samrat Cement Company Private Limited (SCPL) is a private limited company, established in 2013. The company is engaged in manufacturing of cement with an installed capacity of 3,600 MTPD, expanded from 1,800 MTPD on July 17, 2022. The company has also backward integrated its plant by setting a clinker manufacturing unit of 4,000 MTPD capacity which came into operation on January 14, 2021. The manufacturing facilities are located in Dang District of Nepal.

Financial Performance

(Rs. in Million)

For the year ended Mid-July	FY21 (Audited)	FY22 (Audited)	FY23 (Audited)
Income from Operations	3,704	4,875	3,375
PBILDT Margin (%)	26.79	21.13	20.64
Overall Gearing (times)	3.98	3.93	5.09
Interest Coverage (times)	2.09	1.42	0.70
Current Ratio (times)	1.09	0.81	0.56
Total Debt/Gross Cash Accruals (times)	21.27	38.39	Negative

Annexure 1: Details of the Facilities rated

Nature of the Facility	Type of the Facility	Amount (Rs. in Million)	Rating
Long Term Bank Facilities	Term Loan	10,144.79	CARE-NP BB-
Short Term Bank Facilities	Fund Based Limit	2,350.98	CARE-NP A4
Total		**12,495.77**	

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About CARE Ratings:

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