Rating Rationale

Mega Cement Industries Private Limited

Rating

Facility/ Instrument	Amount (Rs. In Million)	Rating	Rating Action
Long Term Bank Facilities - Proposed	515	CARE-NP BB [Double B]	Assigned
Short Term Bank Facilities - Proposed	85	CARE-NP A4 [A Four]	Assigned
Total Facilities	**600 (Rs. Six Hundred Million Only)**		

Details of Facilities in Annexure 1

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 Mega Cement Industries Private Limited (MCPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of MCPL are constrained by the implementation and post-implementation stabilization risk associated with its large size project whereby even financial closure is yet to be achieved, small scale of operations, lack of backward integration, raw material price volatility risk, exposure to volatile interest rates and foreign exchange fluctuation risk. The ratings are further constrained by its presence in a highly fragmented & competitive cement industry.

The ratings, however, derive strength from the promoters' experience in cement industry, steady performance in the first full year of its existing operations, expected growth in demand of cement in the country, locational advantage of the plant site and product diversification & own brand.

Timely financial closure of the project, completion of the enhanced project within the envisaged cost and time estimates, satisfactory operations thereafter and the ability of the company to pass through the changes in raw material prices to the finished products and managing the foreign exchange fluctuation risks related to raw materials are the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weakness

Project implementation and stabilization risk associated with its large-size planned capex

The company has just started the capacity enhancement project and is exposed to the risks associated with project implementation and satisfactory operations thereafter. The size of the expansion project is large; being more than five times its current installed capacity and its net worth. Delays in project execution cannot be totally ruled out, given that there are no major developments towards construction and financial closure for the debt portion yet to be made for the enhanced capacity. The company is envisaged to achieve commercial operation date during October 2019. Timely completion of the project within the cost estimates and satisfactory operations thereafter are the key rating sensitivities. Subsequently, it will be exposed to marketing risk associated with its large planned capacity.

Funding risk - financial closure for the enhanced project cost yet to be achieved and exposure to volatile interest rates

Existing unit of 200 metric tons per day of MCPL was established with an investment of Rs. 135 Million which was financed in debt equity ratio of 65:35. The envisaged total cost of the capacity enhancement project is expected to be Rs. 735 Million out of which promoters will infuse equity of Rs. 309 Million and Rs. 427 Million will be raised as Term loan from Bank in Debt equity ratio of 58:42. At present, the proposal for financial closure for the capacity enhancement project is under process. Timely financial closure of the project is the key rating sensitivity as any delay could result in time overrun.

Nepalese banking sectors are fixing interest rate on lending based on quarterly base rate and accordingly interest rates change on quarterly basis. Due to tight liquidity in the market, the interest rate has been high and volatile during the last 12 months. Therefore, funding from Bank and Financial Institutions is subject to volatile interest rate.

Lack of backward integration, Raw material price volatility risk and foreign exchange fluctuation risk

MCPL is engaged in producing cement and does not possess its own clinker manufacturing unit. Hence, it has to procure the clinker from other cement manufacturers which it majorly imports from India. Raw material cost continues to be the major cost component of MCPL constituting around 78% of the total cost of sales in FY18 (Unaudited, refers to period ended mid-July 2018). 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. Further, the majority of its raw material requirements are proposed to be met through imports and the price of the same will be linked to USD, for which it is exposed to the foreign exchange fluctuation risk.

Presence in highly fragmented and competitive cement industry

MCPL is operating in a highly competitive market, dominated by the large cement manufactures with wide brand acceptability. At present there are 50+ cement industries in Nepal including both clinker producing as well as cement producing factories. Annual demand of cement was 6.1 million tons during FY17 in Nepal out of which 80% was fulfilled by domestic industry. MCPL has sold 27,297 metric ton of cement during FY18. MCPL's current production capacity and sales volume during FY18 is small as compared to cement consumption in Nepal. Given the fact that 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 Strength

Experienced promoters in the related field

MCPL is promoted by industrialists and traders from Jhapa district of Nepal. It is managed under the overall guidance of the Company's Board of Directors (BoD) who possesses wide experience in the cement industry and trading. Mr. Min Prakash Mainali is the Chairman and Mr. Rajesh Kumar Agrawal is the Managing Director of the Company. Mr. Mainali has been involved in tourism and real estate business for more than two decades. He is also chairman at Kanchanjunga Cement Udhyog Private Limited (KCPL) and Dhana Consultancy & Housing and Director at Panchakanya Housing Pvt. Ltd. Mr. Agrawal possess 16 years of experience in the field of manufacturing and trading, who also acts as Managing Director of KCPL. KCPL also operates clinker grinding plant since six years with production capacity of 200 metric tons per day. With the involvement of promoters in same line of business, MCPL can derive benefits in terms of raw material pricing, finished goods pricing and supply and cost effective operations.

Comfortable financial risk profile in the first full year of operation

MCPL achieved Rs. 361 Million income from the operations during FY18 (Prov) out of which Rs. 336 Million is from sale of cement and rest from the sales of clinker with the capacity utilization of 45% in the first full year of operation. The PBILDT was at Rs. 21 Million with PBILDT margin of 5.80%. Though MCPL profit after tax (PAT) margin is low at 0.29% during FY18 with PAT of Rs. 1 Million, its gross cash accrual was Rs. 12 Million during the same year due to high depreciation charge. The interest coverage ratio was comfortable at 2.38x and on back of infusion of Rs. 71 Million share capital by the promoters during FY18 the overall gearing ratio of the company improved to 0.88x as on July 16, 2018 vis-à-vis 1.63x as on July 15, 2017.

Demand of cement products in the country expected to grow

It is expected that the cement demand in the country is expected to exceed 10 million tons per year by 2023. The 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 increased at an annual average rate of 8.1 percent to 6.1 million tons of cement in 2017. Further, NRB data says Nepal has imported cement and clinker amounting Rs. 31.17 Billion 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 8% is likely to benefit the cement manufacturers like MCPL.

Locational advantage of the plant site

The plant is located in the eastern part of Nepal. Bhadrapur, Birtamod, Biratnagar, Itahari etc. are the big cities nearby which are the major local markets for MCPL's product. The plant site is located around 15 Kms from Nepal-India border Pani Tanki (West Bengal). MCPL can import raw materials from India via Pani Tanki either through road or through railways upto Siliguri that makes transportation of raw materials at lower transportation cost.

Product diversification and own Brand

MCPL is manufacturing PPC Cement that has major usage for brick masonry, plastering, tiling and waterproofing works. OPC cement is manufactured which has main usage for Structural Concrete or Reinforced Concrete Works (like Columns, Beams, Slab etc.). MCPL manufactures PPC and OPC cement under five brand names i.e. Namaste, Kabeli & Sky (PPC brands) and Namaste Gold & Topcem (OPC brands). Currently MCPL focus its sales in the territory of Mechi, Sagarmatha, and Koshi zone only (out of 14 zones on Nepal).

About the Company

Mega Cement Industries Private Limited (MCPL) is a private limited company, established in 2014, promoted by the individuals involved in cement industry and trading of hardware items, for setting up clinker grinding plant at Jhapa District of Nepal. The company is engaged in manufacturing and selling of cement with grinding capacity of 200 metric tons per day and is planning to expand its grinding capacity to 1100 metric tons per day which is expected to come in operation during October 2019. Around 80% of sales come from dealers and rest is from government projects and direct marketing. It has now planned to expand its capacity by 900 metric tons per day at a total cost of Rs. 735.18 Million.

Brief Financial Performance during FY18 (Unaudited):

(Rs. In Million)

Particulars	Amount
Income from Operations	361
PBILDT	21
PAT	1
Overall Gearing (times)	0.88
Interest coverage (times)	2.38

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Annexure 1: Details of the Facilities

Nature of the Facility	Type of the Facility	Amount (Rs. Million)	Rating
Long Term Bank Facilities (Proposed)	Term Loan	515.00	CARE-NP BB
Short Term Bank Facilities (Proposed)	Working Capital	85.00	CARE-NP A4
Total		**600.00**	