Rating Rationale

Samrat Cement Company Private Limited

Rating

Facility/ Instrument	Amount (Rs. In Million)	Rating[1]	Rating Action
Long Term Bank Facilities	566.64	CARE-NP BB [Double B]	Assigned
Long Term Bank Facilities (Proposed)	8,106.10	CARE-NP BB [Double B]	Assigned
Short Term Bank Facilities	1,000.00	CARE-NP A4 [A Four]	Assigned
Total Facilities	**9,672.74**		

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 Samrat Cement Company Private Limited (SCPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of Samrat Cement Company Private Limited (SCPL) are constrained by the project implementation and stabilization risk associated with its significantly large-size planned capex, high project D/E ratio of the project, financial closure for the clinker unit and enhanced grinding capacity yet to be achieved, key approvals yet to be obtained for additional capacities, exposure to volatile interest rate, presently moderate scale of operations with low capacity utilization, foreign exchange fluctuation risk related to fuel and raw material price volatility risk. The ratings are further constrained by its presence in a highly fragmented & competitive cement industry.

The ratings, however, derive strength from the experienced promoters in the related field, moderate financial risk profile in the first full year of operation in FY18 (UA, refers to 12 month period ended mid-July 2018), healthy demand of cement products in the country, locational advantage of the plant site & prospecting license of limestone mines and product diversification & own brand.

Timely financial closure of the project, timely completion of the clinker plant & enhanced grinding plant within the cost estimates, satisfactory operations thereafter, managing foreign exchange fluctuation risks and ability of the company to pass through of changes in raw material prices to the customers will be the key rating sensitivities.

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

Detailed Description of the Key Rating Drivers

Key Rating Weakness

High project D/E ratio, financial closure for the clinker unit & enhanced grinding capacity yet to be achieved and exposure to volatile interest rates

The current cement manufacturing unit of the company was established with an investment of Rs. 951.23 Million, which was financed in debt equity ratio of 64:36. The envisaged total cost of the new clinker plant and grinding capacity enhancement is projected at Rs. 10,133 Million which is envisaged to be funded through term loan of Rs. 8,106 Million and rest will be funded by promoters and internal accruals in debt equity ratio of 80:20. Also, the size of the project is ~12 times company's existing net worth. The project is also exposed to funding risk as the financial closure for the clinker plant and capacity enhancement is not yet achieved.

Nepalese banking sector is fixing interest rate on lending which is 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 been high and volatile during the last 12 months. Therefore, funding from Bank and Financial Institutions is subject to volatile interest rate. Timely financial closure of the project is the key rating sensitivity as any delay could result in time and cost overrun.

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

The company has started the construction of clinker unit and enhancing grinding capacity. The new capacity will be constructed in the same premises of the existing plant area. Two civil contractors have been contracted for the civil constructions. M/s Humboldt Wedag India Private Limited, India is contracted for designing and the supply of clinker plant and M/s Ingenieurbuero Kuehlerbau Neustadt (IKN), Germany is contracted for the supply of IKN cooler (complete mechanical, Electrical and instrumentation items for the cooler). The enhancement project is in the implementation stage and it continues to remain exposed to the risks associated with project implementation and satisfactory operations thereafter. The size of the expansion project is large in comparison to the current operations of the company. Delays in project execution cannot be totally ruled out, given that there are no major developments towards its construction; and financial closure for the debt portion yet to be made for the new facilities. The company has envisaged achieving commercial operation during July 2021. Timely completion of the project within the cost estimates and satisfactory operations thereafter are the key rating sensitivities.

Key approvals for clinker unit and enhanced grinding unit is yet to be obtained

The company has all the key approvals from Government Offices and Regulators in place for its existing operational plant. However, approval for the new clinker unit and enhanced grinding capacity is yet to be obtained from Department of Industry. Further, Environmental Impact Assessment (EIA) report is yet to be submitted and get approved.

Presently moderate scale of operation with low capacity utilisation

At current production capacity of 1,800 MTPD with 330 working days a year, maximum annual production capacity of SCPL is 594,000 metric tons. SCPL has sold 157,314 metric ton PPC cement and 68,735 metric ton OPC cement (total 226,049 metric ton) leading to low capacity utilization of 38% during FY18, first full year of operation. Further, during the first four months of FY19 ended November 16 2018, SCPL reported sales revenue of Rs. 859 Mn in comparison to sales of Rs. 385 Mn in same period for FY18. Considering SCPL's current production capacity in comparison to the production of cement in Nepal of around 8 Million tons per annum, SCPL's scale of operation seems relatively moderate.

Foreign exchange fluctuation risk

The contract awarded to the clinker plant and cooler supplier consists of € 2.76 Million which is to be payable in Euro currency. Further, the majority of its fuel 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.

Raw material price volatility risk

SCPL mainly uses clinker, fly-ash, gypsum etc. as the major raw materials. Raw material cost continues to be the major cost component of SCPL as cost of goods sold constituting around 83% of the total 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 adverse changes in raw material prices to the customers will be the key rating sensitivities.

Presence in highly fragmented and competitive nature of cement industry

SCPL 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 Strength

Experienced promoters in the related field

SCPL is promoted by industrialists and traders of Nepal, who are involved in cement, bricks & coal industry and trading of construction & electronic items. 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. Mukunda Prasad Timilsina is the Chairman and Mr. Bashudev Pandeya is the Managing Director of the Company. Mr. Timilsina has been involved in bricks & cement industries, trading and hydropower sector for more than 2.5 decades. He is presently director in Shubhashree Agni Cement Udhyog Pvt. Ltd. & United Modi Hydropower Ltd. and is the Chairman of various trading entities dealing in imports and distribution of mobile phones, automobiles, etc. Mr. Pandeya, Managing Director of SCPL, has more than two decades of experience in the field of coal mining, bricks industry, rice mills and trading of grain items and has 4 years' of experience as Executive Director in one of the cement company of Nepal. The other major shareholder of SCPL, Mr. Anil Kumar Rungata, has vast experience in iron & steel industries and is one of the director at Jagdamba Enterprises Pvt. Ltd. since 2005.

Moderate financial risk profile in the first full year of operation in FY18 (Unaudited)

SCPL has started its commercial operation of 1,800 MTPD from May 15, 2017 which has operated for 2 months during FY17. SCPL has operated for full year during FY18 and achieved PAT of Rs. 28 Million on sales of Rs. 2,780 Million with PBILDT margin of 9.29% as per provisional results. The gross cash accruals were high at Rs. 125 Million during the same year due to high depreciation charge.

Though the first full year of operation, the interest coverage ratio was moderate at 1.99x. Further, due to infusion of Rs. 492 Million as advance for share capital by the promoters during FY18 the overall gearing ratio of the company improved to 1.47x as on July 16, 2018 vis-à-vis 2.57x as on July 15, 2017.

Healthy demand for cement products in the country

It is expected that the demand of cement in Nepal to exceed 10 Million 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 of cement during FY18. Further the Trade and Export Promotion Centre (a national trade promotion organization under the Government of Nepal Ministry of Industry, Commerce and Supplies) data shows Nepal has imported cement and clinker amounting Rs. 31.33 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 SCPL.

Locational advantage of the project site and prospecting license available for Limestone mines

The plant is located at mid-western part of Nepal. Ghorahi, Tulsipur, Kohalpur, Dhangadi, Nepalgunj, Butwal, Bhairahawa, etc. are the big cities nearby and are major local market for the SCPL’s product. The company is planning to extract limestone from the mines, which are within the territory of 50 kms from the plant site. Prospecting license for two mines has already acquired and prospecting license for one mine is in the process. Three clinker and grinding plant are operating around SCPL’s plant. There are also numerous small grinding plants nearby SCPL’s site to which SCPL is proposing to sell excess manufactured clinker.

Product diversification and own Brand

SCPL is manufacturing PPC Cement that has great usage for brick masonry, plastering, tiling and waterproofing works. OPC cement is manufactured which has great usage for Structural Concrete or Reinforced Concrete Works (like Columns, Beams, Slab etc.). SCPL manufactures cement under seven brands namely Gajraj, Gajraj Premium, Baaj, Baaj Premium, Badshah, Samrat and Samrat Premium. SCPL sell its product all over Nepal with primary focus towards western, mid-western and far western part of Nepal.

About the Company

Samrat Cement Company Private Limited (SCPL) is a private limited company, established in 2013, for setting up clinker grinding plant at Dang District of Nepal. The company is presently engaged in manufacturing and selling of cement with grinding capacity of 1,800 MTPD. The company is planning to expand its grinding capacity to 3,600 MTPD and adding clinker plant with capacity of 4,000 MTPD as backward integration, which are expected to come in operation during July 2021.

Brief Financial Performance during FY17 and FY18 (Unaudited): (Rs. In Million)

Particulars	FY17 (A)	FY18 (Prov.)
Income from Operations	125	2,780
PBILDT	(17)	258
PAT	(64)	28
Overall Gearing (times)	2.57	1.47
Interest coverage (times)	(1.37)	1.99

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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	566.64	CARE-NP BB
Long Term Bank Facilities (Proposed)	Term Loan	8,106.10	CARE-NP BB
Short Term Bank Facilities	Working Capital	1,000.00	CARE-NP A4
Total		**9,672.74**	