Rating Rationale

Shubhashree Agni Cement Udhyog Private Limited

Rating

Facility	Amount (Rs. In Million)	Rating[1]	Rating Action
Long Term Bank Facilities	2,325.00	CARE-NP BB+ [Double B Plus]	Assigned
Long Term Bank Facilities (Proposed)	120.00	CARE-NP BB+ [Double B Plus]	Assigned
Short Term Bank Facilities	975.40	CARE-NP A4+ [A Four Plus]	Assigned
Short Term Bank Facilities (Proposed)	475.00	CARE-NP A4+ [A Four Plus]	Assigned
Total Facilities	**3,895.40**		

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 Shubhashree Agni Cement Udhyog Private Limited (SSPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of SSPL are constrained by project stabilization and associated salability risk, leveraged capital structure, exposure to volatile interest rates, foreign exchange fluctuation risk and raw material price volatility risk. The ratings also factors planned large sized capex, presence in highly fragmented and competitive nature of cement industry and cyclicality of cement industry.

The ratings, however, derive strength from experienced promoters in the cement industry, financial closure achieved for the grinding project's initial cost; commitment for the increased project cost, healthy profitability and its moderate debt service coverage indicators in the first year of operation and during H1FY19 (UA, refers to 6 months period ended mid-January 2019), 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, locational advantage of the plant site and license of limestone mines and receipt of key approvals for the establishment of plant.

Timely approval from Nepal Bureau of Standards & Metrology for the manufactured cement, ability of the company to manage raw material price volatility and foreign exchange fluctuation risk and intense competition in an inherently cyclical industry remain the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Project stabilisation & associated salability risk and planned large sized capex

SSPL has started commercial operation of clinker unit with 700 metric ton per day (MTPD) from December 01, 2017 and the 1200 MTPD grinding unit is also in completion stage. Major works related to the project has been completed till date and SSPL has conducted test production as on March 31, 2019.

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

Once they get Nepal Standard approval, SSPL will start commercial operations and the products of the company will be marketable, which may take next 2-3 months. However, smooth and satisfactory operations of the project and ability of the company to sell cement in the market at the projected level are yet to be seen. Further, SSPL is planning to establish another 2000 MTPD clinker unit and 1700 MTPD grinding unit, construction of the same is expected to start next year. Cost and financing mix for the new units is yet to be finalized.

Leveraged capital structure

The capital structure of the company is leveraged with debt equity ratio of 2.51x and overall gearing ratio of 2.91x as on July 16, 2018 on back of term loans availed for the clinker unit & grinding unit and unsecured loan from promoters during FY18 (refers to 12 months period ended mid-July 2018). Further, debt equity ratio and overall gearing ratio of the company deteriorated to 2.85x and 3.31x respectively as on Jan 14, 2019 (H1FY19), due to additional term loan of Rs.143 Mn and Rs.387 Mn unsecured loan from promoters during same period.

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

Foreign exchange fluctuation risk and raw material price volatility risk

SSPL utilize coal, limestone, bauxite, red clay and iron ore as the major raw materials for the manufacturing of clinker. Coal constitutes ~52% of raw materials consumption during clinker production. All the coal requirements are met through import and ~80% of purchased coal is invoiced in USD, for which the company 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 constitutes ~68% of the total sales in FY18. Hence, any adverse movement in raw material price without any corresponding movement in finished goods price will 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 risk 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 manufactures with wide brand acceptability. There are more than 50 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 which will intensify the competition. 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.

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.

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. He is also the director of Agni Cement Industries Pvt. Ltd. (ACPL). Dr.Tara Prasad, holds Doctor of Philosophy (PHD) in Civil Engineering, is also the Managing Director of ACPL. ACPL, one of the promoters of SSPL holding 14.79% paid up capital of SSPL as on July 16 2018, operates clinker grinding plant since five years. With the involvement of promoters in same line of business, it will help to create market for its products.

Financial closure achieved for the grinding project's initial cost; commitment for the increased project cost

Existing clinker unit of the company was established with an investment of Rs.2,253 Mn, which was financed in debt equity ratio of 64:36. The grinding unit will be established at the total project cost of Rs.1,363 Mn which is proposed to be financed by 73% from bank loan and 27% from equity. Bank has already sanctioned Rs.880 Mn term loan towards the project. For the remaining bank financing of Rs.120 Mn, the consortium financers has already agreed to provide additional Rs.120 Mn via consortium meeting, subject to the final approval from respective banks. SSPL has already incurred Rs.1,176 Mn over the grinding project till January 14, 2019 and the same is funded through debt of Rs.829 Mn and promoters' contribution of Rs.347 Mn.

Healthy profitability and moderate debt coverage indicators in the first year of operation and during H1FY19

The clinker plant was operated for 7.5 months during FY18. SSPL reported sales revenue of Rs.1,393 Mn during FY18 from the sale of 136,605 MT clinker. The company achieved healthy PBILDT margin of ~30% with PBILDT of Rs.423 Mn during FY18. SSPL has achieved Rs.53 Mn of PAT during FY18 and the gross cash accruals were at Rs.262 Million during the same year. Interest coverage ratio was comfortable at 2.72x. To fund the grinding unit and for the smooth operations of the company, promoters have infused additional Rs.170 Million towards paid up capital and advance for share capital during FY18. Further, SSPL reported sales revenue of Rs.1,140 Mn during H1FY19 from the sale of 121,250 MT clinker. SSPL achieved PBILDT margin of ~28% and PAT margin of 2.47% with reported GCA of Rs.165 Mn during H1FY19. The interest coverage ratio was moderate at 2.23x.

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. During 7 months of FY19, the import of clinker has been reduced by ~30% to Rs.9.71 Bn as compared to Rs.13.79 Bn import during 7 months of FY18. Clinker manufacturing units will have added cost competitive advantage over the standalone grinding units as the average manufacturing cost per MT of clinker will come around Rs.7,500 and current market price of domestic clinker is around Rs.8,700 per MT.

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 the some modification in the plant, SSPL reported optimum utilization of installed capacity. During FY18 (around 189 days of operations) SSPL produced 147,644 MT which was ~112% of total installed capacity and the company had reported 169,192 MT of clinker production during 8 months of FY19 (around 200 days of operation) ending March 14, 2019 which is ~121% utilization of the installed capacity.

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

It is expected that the demand of cement in Nepal 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 8% 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.

Receipt of all key approvals for the establishment of plant

The project has received all the approvals from Government Offices and Regulators for its existing clinker plant. SSPL got license dt. July 15, 2014 from Department of Industry Nepal to manufacture clinker with production capacity of 363000 MT per annum (1100 MTPD) and cement with production capacity of 99000 MT (300 MTPD). Approval for the remaining cement production (900 MTPD) is yet to be received and is under process.

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). The company is setting up 1200 MTPD grinding unit which is expected to be fully operational from July 2019.

Brief Financial Performance during FY18 (A) and H1FY19 (UA):

(Rs. In Million)

For the year ended Mid July,	FY18 (A) (7.5 months)	H1FY19 (UA) (6 months)
Income from Operations	1,393	1,141
PBILDT	423	321
PAT	53	28
Overall Gearing (times)	2.91	3.31
Interest coverage (times)	2.71	2.23

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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	2,325.00	CARE-NP BB+
Long Term Bank Facilities (Proposed)	Term Loan	120.00	CARE-NP BB+
Short Term Bank Facilities	Working Capital Loan	725.00	CARE-NP A4+
Short Term Bank Facilities (Proposed)	Working Capital Loan	225.00	CARE-NP A4+
Short Term Bank Facilities	Letter of Credit	250.00	CARE-NP A4+
Short Term Bank Facilities (Proposed)	Letter of Credit	250.00	CARE-NP A4+
Short Term Bank Facilities	Bank Guarantee	0.40	CARE-NP A4+
Total		**3,895.40**	