

Rating Rationale

Janak Education Materials Centre Limited

Rating

| Facility | Amount (Rs. In Million) | Rating ¹ | Rating Action |
|----------------------------|----------------------------|---------------------|------------------|
| Short Term Bank Facilities | 990.00 | CARE-NP A4 [A Four] | Assigned |
| Total Facilities | 990.00 | | |

Details of Facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has assigned rating of ‘CARE-NP A4’ to the short term bank facilities of Janak Education Materials Centre Limited (JEMC).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of JEMC are constrained by concentration of major cash flows from operation limited to few months; and negative Networth due to losses in the past followed by high quantum of loans with respect to the size of the company and weak debt service coverage indicators. The rating is also constrained by raw materials price volatility risk with no authority to change the price of textbooks, exposure to volatile interest rates and presence in highly competitive nature of textbook industry. The ratings, however, derive strength from Government of Nepal (GoN) ownership with continuous financial support for business operations; long track record and experienced board members from various offices of GoN; and exclusive publishing rights with diversified product profile. The ratings also factor in diversified and adequate geographical coverage through offices and agents; financial risk profile marked by reduced cost of production and healthy profitability margins during last 2 years ended mid-July 2019 although overall decline in revenue during FY19 (Provisional, refers to 12 months’ period ended mid-July 2019); ownership of sizable machineries/ equipment to execute orders; moderate counter party risk and government support for education sector.

Ability of the company to maintain profitability margin in the long term and timely payment of debt obligations are the key rating sensitivities. Further, continued financial assistance from the GoN to fund the operations and also capital requirements of the company are key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Concentration of major cash flows from operation of the company limited to few months

Major revenue of the company is generated through printing of textbooks for government schools which accounted for ~85% of the total income in FY19. Academic year in Nepal starts from mid- April every year and the textbooks are distributed to respective provincial offices for final distribution to the schools. The registered agents usually collect textbooks on cash basis from the company during the month of March to May every year. Due to the fact that production of textbooks is done throughout the year, but revenue generation being limited to

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

2-3 months coupled with huge inventory, the operating cycle of the company is high resulting in high working capital requirements and reliance on external source of funds.

Negative Networth due to losses in the past followed by high quantum of loans with respect to the size of the company and weak debt service coverage indicators

The financial risk profile of the company is below average marked with huge negative Networth amounting to –ve Rs. 1,382 Mn as on mid- July 2019. Networth of the company has been completely eroded on account of losses incurred by the company in the past. In presence of huge negative Networth, capital structure of the company continues to remain stressed. Further, JEMC is highly leveraged on account of high quantum of loans availed by the company to fund the losses incurred by the company and to support the operations of the company. However, the interest coverage ratio of the company improved to 2.54x in FY18 and 1.86x in FY19 compared to 0.10x in FY17 mainly due to improved PBILDT. JEMC has high total debt to gross cash accruals (GCA) ratio which deteriorated from 7.91x in FY18 to 17.06x in FY19, primarily due to additional working capital loan availed from GoN and decline in net profit.

Raw material price volatility risk with no authority to change the price of textbooks

JEMC does not have any backward integration for its basic raw material for printing textbooks. It procures required raw materials by way of competitive bidding from domestic market, where the price is market linked, thereby exposing the company to volatility in the price of raw materials which has a bearing on its profitability margins. The major raw material of the company is printing paper which accounts for over 70% of total cost of production. Thus, any volatility in prices of the same impacts the profitability of the company. The ability of the company to pass through changes in raw material prices to the finished products and maintain profitability margins is limited as the market price of the textbooks is fixed by the Government.

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

Presence in highly competitive nature of textbook industry

The textbook industry is diverse and intensely competitive marked by presence of many players in the textbook printing market. The company has exclusive publishing rights with regard to printing of textbooks for classes V to X and no direct competition for security printing of sensitive materials which provides positive assurance regarding future prospects of the business in terms of revenue generation capability and offsetting competition risk to certain extent. However, the same cushion available to the company is dependent upon continued government support in the coming years. Further, the operation of the company continues to be affected by changes in education policies and regulations of the government.

Key Rating Strengths***GoN ownership with continuous financial support for business operations***

JEMC is the only government owned publishing house with the authority for printing textbooks for government schools. The company has been set up by the GoN as a service oriented entity with a motive to make textbooks available to all government schools in Nepal. Being a government entity, the operations of the company are highly controlled with respect to pricing which has resulted into it being a loss making organization with eroded Networth. However, continuous support has been extended by the government by way of granting exclusive publishing rights in relation to printing of textbooks for classes V to X and security printing of sensitive materials for different government departments coupled with providing continuous monetary support in form of soft loan at nominal rate of interest to run the operations of the company.

Long track record of operations and experienced board members from various offices of GoN

JEMC is involved in printing and distribution of textbooks and other related materials for over 50 years and enjoyed dominant position in the market with no competitors for almost three decades. JEMC has five members in its board who also hold notable positions in various offices of GoN. Board of directors are further supported by an experienced team across various functions and departments.

Exclusive publishing rights with diversified product portfolio

JEMC mainly generates its revenue from sale of textbooks to government schools where it has exclusive publishing rights for printing textbooks from Class V to X which eliminates competition from private entities to certain extent along with a guaranteed source of revenue. Apart from selling textbooks, JEMC also generates revenue from security printing of sensitive materials like ballot papers for Office of Election Commission; exam question papers for Secondary Education Examination (SEE), Higher Secondary Examination Board (HSEB) and Council for Technical Education & Vocational Training (CTEVT) examination; answer sheets for SEE and HSEB examination; and other documents for different government departments. This has enabled the company to diversify its product portfolio for revenue generation. However, it is imperative that JEMC gets continued support from the government in form of exclusive publishing rights and monetary assistance to enable it to sustain in future.

Diversified and adequate geographical coverage through offices and agents

JEMC has a printing facility located at Bhaktapur followed by a regional press office located at Nepalgunj and 7 provincial offices located in Biratnagar, Janakpur, Bharatpur, Pokhara, Butwal, Surkhet and Dhangadi. These offices are strategically located covering major parts of Nepal where the books are stocked by the company for the registered agents to collect and distribute further to government schools. Further, there were 1,201 registered agents of the company in FY19 as compared to 1,091 registered agents in FY18. JEMC has wide geographical coverage through its offices and agents which enables it to deliver efficiently to the schools across the country.

Financial risk profile marked by reduced cost of production and healthy profitability margins although overall decline in revenue during FY19

Total net revenue of the company increased in FY18 over FY17 mainly on account of increase in revenue from sale of textbooks and other printing income. However, total net revenue decreased in FY19 primarily on account of reduction in other income. PBILDT margin of the company improved significantly in FY18 over FY17 mainly on account of increase in scale of operations and reduction in cost of production. However, PBILDT margin declined in FY19 primarily due to decrease in revenue income. PAT margin of the company was at a moderate level in FY18 mainly due to decline in provisions on account of decrease in number of employees. However, PAT margin deteriorated in FY19 due to decline in PBILDT coupled with increase in interest expense.

Ownership of sizable machineries/ equipment to execute orders

As on July 16, 2019, JEMC had a total asset base of Rs. 322 Mn. The company has been regularly investing in machineries/ equipment to increase its production capacity which has helped the company to increase its production efficiency thereby reducing cost of production and enabling timely execution of orders. Further, the company is setting up a regional press office located at Nepalgunj for printing of textbooks and production is expected to start during FY20. This will benefit the company in terms of reduced logistics cost in transporting raw materials and textbooks for distribution in the adjacent areas.

Moderate counter party risk

Major revenue of JEMC is from government orders related to production and distribution of textbooks for government schools via registered agents. The counter party risk is moderated by the fact that the agents have to make payment beforehand at the time of collection of textbooks (net of commission) thereby mitigating the risk of payment default. Further, with regard to printing of other documents for various government departments, the payments are realized in a timely manner.

Government support for education sector

Industry outlook of the education sector in Nepal looks positive with government prioritizing its development. Printing of textbooks comes under Schedule-1 of Value Added Tax (VAT) Act, 1996 where its manufacturers are exempt from levying VAT on textbooks. In recent Budget announcement for FY20, by Ministry of Finance, the government has proposed compulsory education up to basic level (up to Class VIII) and free education up to high school level (Class IX to XII) along with allocation of budget for infrastructure development of community schools and their restructuring, availability of quality textbooks and educational materials, adequacy of teachers etc. With growing awareness in the country regarding importance of education coupled with various incentives and programs, the number of students going to schools is expected to grow thereby resulting in increase in demand for school textbooks.

About the Company

Janak Education Materials Centre Limited is a service oriented GoN entity, having registered office located at Madhyapur Thimi, Bhaktapur. The company was established in 1966 by GoN which was later on converted to government owned public limited company in September 14, 1978. The company is mainly involved in printing of textbooks for government schools where the company has authority to print, publish and sell textbooks of government schools for classes I to XII with sole right of printing textbooks for classes V to X. As on July 16, 2019, paid-up share capital of the company is Rs. 456.38 Mn which is fully owned by two ministries of GoN.

Brief financials of JEMC for last four years ending FY19 are given below:

| For the year ended Mid July, (Rs. Million) | FY16 | FY17 | FY18 | FY19 |
|---|-----------|-----------|-----------|---------------|
| | (Audited) | (Audited) | (Audited) | (Provisional) |
| Income from Operations | 793 | 961 | 1,227 | 1,029 |
| PBILDT | 49 | 11 | 329 | 256 |
| PAT | (129) | (260) | 117 | 36 |
| Interest Coverage (times) | 0.44 | 0.10 | 2.54 | 1.86 |
| Overall Gearing (times) | NM* | NM | NM | NM |

*Not meaningful

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Annexure 1: Details of the Facilities rated

| Nature of the Facility | Type of the Facility | Amount (Rs. In Million) | Rating |
|---------------------------------------|----------------------|-------------------------|------------|
| Short Term Bank Facilities | Working Capital Loan | 670.00 | CARE-NP A4 |
| Short Term Bank Facilities (Proposed) | Working Capital Loan | 250.00 | CARE-NP A4 |
| Short Term Bank Facilities | Letter of Credit | 70.00 | CARE-NP A4 |
| Total | | 990.00 | |