

Rating Rationale

Agni Cement Industries Private Limited

Rating

Facility/ Instrument	Amount (Rs. In Million)	Rating ¹	Rating Action
Long Term Bank Facilities	170.48	CARE-NP BB [Double B]	Reaffirmed
Short term Bank Facilities	709.62	CARE-NP A4 [A Four]	Reaffirmed
Total Facilities	880.10		

Details of Facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has reaffirmed rating of ‘CARE-NP BB’ assigned to the long term bank facilities and ‘CARE-NP A4’ assigned to the short term bank facilities of Agni Cement Industries Private Limited (ACPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of ACPL are continued to be constrained by moderate scale of operations, exposure to volatile interest rates, lack of backward integration and raw material price volatility risk, working capital intensive nature of operations leading to high working capital utilization. The ratings also factors presence in highly fragmented and competitive nature of cement industry, cyclicity of cement industry and impact of COVID-19 on the business of the company. The ratings, however, derives strength from established track record of operations and experienced promoters in the related field, comfortable financial risk profile, however, moderation in the debt service indicators, demand of cement products in the country expected to grow in the long term and established brand and marketing network. Ability of the company to manage the growth in the operations & maintaining the profit margins and rationalization of its debt through efficient working capital management would be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Moderate scale of operations

At current production capacity of 900 MTPD, ACPL was operated at moderate capacity utilization of ~56%. During FY19, ACPL produced 166,120 MT cements and the company reported 73,159 MT of cement production during H1FY20 ending Mid-Jan 2020 which is ~48% utilization of the installed capacity. Considering ACPL’s current production capacity in comparison to the production of cement in Nepal, ACPL’s scale of operation seems relatively moderate.

Exposure to volatile interest rates

Nepalese banking sectors are fixing interest rate on lending 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

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

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 and raw material price volatility risk

ACPL is engaged in production of cement and does not possess its own clinker manufacturing unit. Hence, it is procuring its clinker requirements from other clinker manufacturers. Standalone grinding units will have cost competitive disadvantage over the clinker manufacturing units. However, being the associated company, ACPL has convenient access for its clinker requirements from Shubhashree Agni Cement Udhyog Pvt. Ltd [CARE-NP BB+/A4+]. ACPL uses clinker, flyash, gypsum etc. as the major raw materials. Raw material cost continues to be the major cost component of ACPL constituting around 84% of the total cost of sales in FY19. 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.

Working capital intensive nature of operations leading to high working capital utilization

The operations of the company are working capital intensive in nature. ACPL is involved in the manufacturing of cement by importing and locally purchased raw materials. The company has to keep the inventory for smooth operations and extend high credit to their dealers, which lead to high reliance on working capital limits. Debtors turnover days was high at 154 days during FY19 as compared to 121 days in FY18. Debtor turnover days increased as a result of increase in credit period provided to dealers due to increase in competition in cement industry. The maximum working capital utilization of the company remained high at above 91.22% for the past 12 months ending Mid-May 2020.

Presence in highly fragmented and competitive nature of cement industry

ACPL is operating in a highly competitive market, dominated by the large cement manufacturers with wide brand acceptability. 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. 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.

Cyclicity 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.

Impact of COVID-19 on the business of the company

The outbreak of Coronavirus disease 2019 (COVID-19) which was recognized as Pandemic by World Health Organization has affected Nepal as well. Government of Nepal (GoN) imposed travel restrictions and countrywide lockdown since March 24, 2020 closing most of the organizations which resulted in

slowing down of the economic activities. The manufacturing activities of the ACPL was completely shut down for one month during lockdown. However, the same was resumed on May 8, 2020. Due to the lockdown, manufacturing activities of ACPL has slowdown which has directly impacted the revenue of the company. Further, the central bank of Nepal has provided an extension of 3 months for the repayment of loans falling due in mid-April 2020 to provide some temporary relief. However, ACPL has not availed the relaxation and has paid its debt repayments for quarter ending mid-April 2020.

Key Rating Strengths

Established track record of operations and experienced promoters in the related field

ACPL has an operational track record of around ten years in the cement manufacturing by grinding of clinker. ACPL is promoted by individuals, who have been involved in construction, hospital, education and trading business for a long time. The company is managed under the overall guidance of 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 is also the director of Subhashree Agni Cement Udhyog P. Ltd. (SSPL). Dr. Tara Prasad is the Managing Director of SSPL.

Comfortable financial risk profile and moderate debt service Indicators

ACPL's reported marginal decline in revenue by 0.14% during FY19 over FY18 due to decline in average price realization despite increase in quantity sold. Further, PBILDT has increased by ~11% during FY19 to Rs.187 Mn over FY18 on account of decrease in the cost of the raw materials. However, PAT of the company declined by 20% in FY19 over FY18 due to increase in interest expenses on account of increase in utilization of the working capital loans on back of increase in the working capital cycle and the increase in term loan for the expansion of grinding capacity to 900 MTPD. Debt Equity ratio of ACPL improved to 0.68x at the end of FY19 from 0.72x at the end of FY18 due to increase in total networth of the company on account of the accretion of the profit and repayment of promoter's loan inspite of increase in term loan. However, the overall gearing ratio deteriorated to 2.23x at the end of FY19 on account of increase in working capital loans and term loans. The interest coverage deteriorated to 2.15x during FY19 due to increase in interest expenses. The total debt to Gross Cash Accrual Ratio increased to 12.15x in FY19 from 8.27x during FY18 due to substantial increase in the debt level.

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

Nepalese economy is developing and growing, and is in phase of investment in infrastructure sectors, power sector and tourism sector. It is highly probable that the national economy will be in need of construction materials in developing public as well as private infrastructures, road, bridges and other public facilities. In the recent budget presented by finance minister of Nepal for FY21, government has allocated Rs. 55 Bn towards post-earthquake reconstruction of private housing, archaeological heritage,

school building, and government building. Further, government has majorly focused towards development of health sectors, tourism sectors, agriculture and other infrastructure development. Cement being fundamental requirement for any construction activity is therefore going to be in regular demand. Further, the government’s high emphasis on infrastructure development, namely development of roads, hydropower, airports and other infrastructures and estimated GDP growth of 7.00% as included in the budget for FY20-21 is likely to benefit the cement manufacturers like ACPL.

Established brand and marketing network

ACPL is manufacturing Portland Pozzolana Cement (PPC) under three brands (Agni, Orient and Tridev), which has great usage for brick masonry, plastering, tiling and waterproofing works. Ordinary Portland Cement (OPC) is manufactured under one brand namely Alpha, which has great usage for Structural Concrete or Reinforced Concrete Works (like Columns, Beams, Slab etc.). Currently ACPL focus its sales in the territory of nine zones only (out of 14 zones of Nepal) covering 31 districts (out of 77) of Nepal. ACPL is planning to increase its market presence and improve brand image by conducting dealers meet all over the Nepal, expenditure towards advertisement and business promotion.

About the Company

Agni Cement Industries Private Limited (ACPL) is a private limited company, established in 2007, promoted by the individuals involved in construction, hospital, education and trading business for setting up clinker grinding plant to manufacture cement at Rupendehi District of Nepal. Presently ACPL is engaged in producing cement by grinding clinker with installed capacity of 900 metric ton per day. ACPL principally manufactures Portland Pozzolana Cement (PPC) and Ordinary Portland Cement (OPC) cement under four brands.

Brief Financial Performance during last 3 years:

(Rs. In Million)

For the year ended Mid July,	FY17 (A)*	FY18 (A) *	FY19(A) *
Income from Operations	1,630	1,974	1,972
PBILD	149	169	187
PAT	53	64	51
Overall Gearing (times)	2.04	1.91	2.23
Interest coverage (times)	3.28	3.08	2.15

**Audited*

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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	165.48	CARE-NP BB
Long Term Bank Facilities	Term Loan (Proposed)	5.00	CARE-NP BB
Short Term Bank Facilities	Overdraft	200.00	CARE-NP A4
Short Term Bank Facilities	Working Capital Loan	440.00	CARE-NP A4
Short Term Bank Facilities	Letter of Credit/ Bank Guarantee	50.00	CARE-NP A4
Short Term Bank Facilities	Working Capital Loan (Proposed)	19.62	CARE-NP A4
Total		880.10	