Rating Rationale

Maruti Cements Limited

Rating

Facility/ Instrument	Amount (Rs. In Million)	Rating[1]	Rating Action
Long Term Bank Facilities	4,957.89	**CARE-NP A- [Single A Minus]**	Reaffirmed
Short Term Bank Facilities	1,070.47	**CARE-NP A2+ [A Two Plus]**	Reaffirmed
Total facilities	**6,028.36**		

Details of Facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has reaffirmed rating of 'CARE-NP A-' assigned to the long term bank facilities and 'CARE-NP A2+' assigned to the short term bank facilities of Maruti Cements Limited (MCL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of MCL continue to derive strength from established track record of operations and brand presence of the company along with strong operational and financial profile characterized by growth in sales however with reduced profitability in FY19 ***(***refers to 12 months period ended mid-July 2019)**.** The ratings also factor in comfortable gearing levels and debt service coverage indicators of the company at the end of FY19, competitive advantage over standalone grinding units, locational advantage of the project site, accessibility to limestone mines and demand of cement products in the country expected to grow in the long term. The ratings are however, constrained by the project implementation and stabilization risk associated with large-size planned debt funded capex, foreign exchange fluctuation risk and raw material price volatility risk. The rating also factors in working capital intensive nature of operations, although low reliance on bank finance for funding, impact of Covid-19 on the business, exposure to volatile interest rates and presence in highly fragmented & competitive market and cyclical nature of cement industry.

Timely completion of the proposed project within the cost estimates and satisfactory operations and capacity utilizations thereafter are the key rating sensitivities. Satisfactory generation of operational cash flows from the existing plant to fund the equity component of the proposed expansion are the key rating sensitivities. Further, vulnerability with regard to prices and demand dependent on factors like construction activities, economy growth and impact of Covid-19 remain the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Strengths

Established track record of operations and experienced promoters in manufacturing industries including cement

MCL has an operational track record of more than 12 years in cement manufacturing under the new management. MCL is managed by industrialists and traders of Nepal, belonging to the Rathi group and Goyal group of companies, who are involved in manufacturing of cement, oil/vansapati ghee, flour, carpet yarns,

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

distillery, confectionery etc. and trading of lubricants. 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. Nand Kishore Rathi is the Chairman and Mr. Sunil Khemka is the Managing Director of the Company.

Strong operational and financial profile characterized by growth in sales however with reduced profitability in FY19

Company's clinker and grinding unit operated at capacity utilization of 91% and 88% respectively in FY19 which has aided to growth in sales. MCL reported revenue of Rs. 7,504 Mn during FY19 registering a growth of 2% as compared to FY18. The company achieved healthy PBILDT margin of 22.49% with PBILDT of Rs. 1,688 Mn during FY19. MCL achieved PAT of Rs. 1,035 Mn in FY19 with PAT margin of 13.79% as compared to Rs. 1,201 Mn in FY18 with PAT margin of 16.39%. Further, MCL reported sales revenue of Rs. 4,210 Mn during 9MFY20 (provisional) and PAT of Rs. 586 Mn.

Comfortable gearing levels and debt service coverage indicators of the company

The working capital utilization of the company is at moderate level on account of usage of internal accruals for funding most of the working capital as well as operational requirements. At the end of FY19, Debt-equity ratio of the company was low at 0.29x and total gearing ratio stood at 0.38x with interest coverage ratio of 9.99x and total debt/ GCA of 1.21x. The envisaged total cost of the clinker plant and grinding capacity enhancement from existing clinker capacity of 1500 MTPD to 3300 MTPD and grinding capacity from 2000 MTPD to 4000 MTPD is projected at Rs. 5,621.81 Mn. The project cost will be funded by debt of Rs. 3,935 Million and rest will be funded by internal accruals of the company in Debt equity ratio of 70:30. The debt-equity and gearing levels of the company are expected to deteriorate due to debt funded capex being undertaken by the company.

Competitive advantage over the standalone grinding units

MCL currently has mining license of one mine, located in Jhanki Khola (Katari) with estimated limestone deposit of ~ 140 Million ton which is sufficient to run 3300 MTPD clinker unit (enhanced capacity) for 60 years. Now, Nepal is manufacturing its own clinker and dependence upon the import of the clinker has reduced substantially over the period. Clinker manufacturing units have cost competitive advantage over the standalone grinding units as the average manufacturing cost per MT of an integrated cement plant is less as compared to a standalone grinding unit.

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. 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 MCL.

Locational advantage of the project site and accessibility to Limestone mines

The plant site is well connected to East-West Highway and with major cities and town nearby. Further, the mines are located close to the clinker and grinding unit (~ 50 Km) which reduces logistics cost. Also, the plant is located in the eastern part of the country where presence of other clinker based cement manufacturing companies is limited.

Established brand presence and strong market position with product diversification plans

MCL sells its product all over Nepal with primary focus towards eastern part of Nepal, with main market being Narayanghat to Kakarbhitta and to north of Narayanghat and sells its product in the market through its ~200 dealers all over Nepal. Company's established brand presence and strong market position, has supported healthy cement price realizations over the years. Further, MCL is currently producing only OPC cement under the brand name "Maruti". The company plans to produce PPC after the expansion of the facilities to diversify its product range.

Receipt of all key approvals for the enhancement of clinker and grinding capacity

All key approvals from Government Offices and Regulators for the existing clinker plant are in place. MCL has received license from Department of Industry, Nepal to manufacture additional cement of 660,000 MT. Power supply to the plant shall be met from the nearest grid substation through 8 km long single circuit 33 KV line. Approval from electricity board has been received for load of 10 Megavolt amperes (MVA) for the new plant.

Key Rating Weaknesses

Project implementation and stabilization risk associated with large-size planned capex for the enhanced capacity

The new capacity is being constructed adjacent to the existing plant and contractors for the construction of the project have been appointed. Estimated construction period has been increased by the management from 2 years to 3 years depending on the current progress of the project.The enhancement project is in the initial stage of implementation and it continues to remain exposed to the risks associated with project implementation risks and satisfactory operations thereafter. The company has delayed projected COD from January 2021 to March 2020. Timely completion of the project within the cost estimates and satisfactory operations thereafter are the key rating sensitivities.

Foreign exchange fluctuation risk and raw material price volatility risk

MCL currently uses coal, limestone, bauxite, gypsum, clay and iron ore as major raw materials. Coal constitutes around 60% of raw materials consumption during clinker production and the coal requirements are met through import from South Africa and other countries. Invoicing of the imported coal is done in USD which exposes MCL to foreign exchange fluctuation risk. MCL has not taken any hedging mechanism to minimize the risk associated with fluctuation in foreign currency. Further, raw material cost continues to be the major cost component of MCL as direct material cost constitutes around 50% of total cost of goods sold 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 of changes in raw material prices to the finished products and managing the foreign exchange fluctuation risks related to raw materials will be the key rating sensitivities.

Working capital intensive nature of operations, although low reliance on bank finance

The operations of the company are working capital intensive in nature as it is involved in manufacturing cement by procuring raw materials both domestically and imports. The company has to make advance payments for the raw materials, maintain inventory for smooth operations and extend credit to dealers, which leads to reliance on working capital limits. MCL generally allows two months credit period to its dealers and maintains inventory for around 4 months. The company also needs to maintain huge stock of limestone. This led to high operating cycle of 217 days in FY19. However, MCL has sizeable unutilised working capital limits in the last 12 months ended in mid-May 2020, which provides financial flexibility given the increasing working capital intensity.

Exposure to volatile interest rate

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 fragmented & competitive market and cyclical nature of cement industry

MCL is operating in a highly competitive market, dominated by the large cement manufactures 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 is considered cyclical as it depends upon the capital expenditure plan of major players in the end-user industry. Further, with increase in the capacities of the existing plants and new capacities coming into operation, competition has intensified that has resulted into substantial decline in profitability margins of the industry players. 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.

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 on March 11, 2020, 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. Due to this, production and sales of whole industry including MCL has been impacted. Also, contractors were not able to mobilize manpower due to the pandemic for the expansion of the manufacturing facilities. During lockdown period, the GoN had given some relaxation to manufacturing industries to commence production if accommodation and all other necessary safety arrangements for the workers/employees is provided within the factory premises. During this period, the company has been able to make only limited sales. Further, the company imports the raw materials such as fly ash, gypsum and their shipment is also likely to affect operation of the company in the near future.

About the Company

Maruti Cement Limited (MCL) was incorporated in October 31, 1994 and the current management took over the company in 2005. MCL is managed by industrialists and traders of Nepal, belonging to the Rathi group and Goyal group of companies and all the shares of the company are held by the promoters. The company is presently engaged in manufacturing and selling cement with clinker capacity of 1500 MTPD and grinding capacity of 2000 MTPD located in Mirchaiya, Siraha District of Nepal. MCL is one of the oldest private sector integrated cement manufacturing plant in Nepal. The company is presently engaged in manufacturing and selling Ordinary Portland Cement (OPC) under the "Maruti" brand in Nepal.

Brief Financial Performance during the last 3 years is as follows:

(Rs. In Million)

For the year ended Mid July	FY17 (A)	FY18 (A)	FY19 (A)*
Income from Operations	5,924	7,324	7,504
PBILDT	1,643	1,958	1,688
PAT	905	1,201	1,035
Overall Gearing (times)	0.78	0.45	0.38
Interest coverage (times)	11.24	12.03	9.99

**Audited*

Analyst Contact	Relationship Contact
Ms. Shalini Sanghai	Mr. Sajan Goyal
shalini.sanghai@careratingsnepal.com	sajan.goyal@careratingsnepal.com
Tel No.: +977-01-4445473	Tel No.: 9818832909/+977-01-4445472/3/4

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	1,022.89	**CARE-NP A-**
Long Term Bank Facilities (Proposed)	Term Loan	3,935.00	**CARE-NP A-**
Short Term Bank Facilities	Working Capital Loan	678.47	**CARE-NP A2+**
Short Term Bank Facilities	Letter of Credit	392.00	**CARE-NP A2+**
Total		**6,028.36**	