

Rating Rationale
Samrat Cement Company Private Limited

Rating

| Facility/ Instrument | Amount (Rs. In Million) | Rating | Rating Action |
|--|----------------------------|--------------------------|------------------|
| Long Term Bank Facilities – Term Loan | 8,672.74 | CARE-NP BB [Double B] | Reaffirmed |
| Short Term Bank Facilities – Working capital loans | 1,000.00 | CARE-NP A4 [A Four] | Reaffirmed |
| Total Facilities | 9,672.74 | | |

Details of Facilities in Annexure 1

CARE Ratings Nepal Ltd. (CRNL) has reaffirmed 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, low capacity utilization of existing cement plant, exposure to volatile interest rate and raw material price volatility risk. The rating is further constrained by foreign exchange fluctuation risk, presence in a highly fragmented & competitive cement industry and impact of COVID-19 on the business. The ratings, however, derives strength from the experienced promoters in the related field, moderate financial risk profile of the company, demand of cement products in the country, locational advantage of the plant site & license of limestone mines. The rating also factors in product diversification & own brand, financial closure achieved for the clinker unit and enhanced grinding capacity, key approvals for clinker unit and enhanced grinding unit. 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.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

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

The construction of the clinkerization unit is in final stages with installation of equipment completed. The final testing and commissioning is pending due to travel restrictions imposed in Nepal and India, which is expected to be completed once the travel restrictions for COVID-19 will be lifted. Earlier, the clinker plant was projected to be operational by October 2021. However, company expects to start commercial operation of clinker plant from Mid-August 2020. The grinding capacity enhancement project is in the

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

initial stage and it continues to remain exposed to the risks associated with project implementation and satisfactory operations thereafter. Delays in project execution cannot be totally ruled out, as there are no major development works towards grinding expansion plant. Timely completion of the project within the cost estimates and satisfactory operations thereafter are the key rating sensitivities.

Low capacity utilization of existing cement plant

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 87,170 metric ton OPC cement 166,362 metric ton PPC cement and 6,094 metric ton PSC cement (total 259,625 metric ton) leading to low capacity utilization of 44% during FY19. Considering SCPL's current production capacity and sales volume during FY19 as compared to the demand of the cement in the country SCPL'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 been high and volatile during the last 12 months. Therefore, funding from Bank and Financial Institutions is subject to volatile interest rate.

Foreign exchange fluctuation risk

The remaining contract amount for clinker plant consists of Euros 0.07 Million, which is to be payable in Euro currency. Further, the majority of its raw material requirements are met through imports and the price of the same is linked to USD, for which it is exposed to the foreign exchange fluctuation risk. SCPL has not taken any hedging mechanism to minimize the risk associated with fluctuation in foreign currency.

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 77% of the total 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. 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 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.

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 SCPL has been impacted. Also, contractors were not able to mobilize extra 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.

Key Rating Strengths***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, Mr Anil Kumar Rungata is the Vice 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 was the executive director of Ambe Cement Pvt. Ltd. and director at Shubhashree Agni Cement Udhog Pvt. Ltd [CARE-NP BB+/A4+] & United Modi Hydropower Ltd. and is the chairman of various trading entities dealing in imports and distribution of mobile phones, automobiles etc. Mr. Rungata, Vice Chairman, has more than 2.5 decades of experience in Iron, steel and construction industry. 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.

Moderate financial risk profile of the company

SCPL has started its commercial operation of 1,800 MTPD from May 15, 2017 which has operated for 2 months during FY17. The total sales of SCPL increased by 14% during FY19 over FY18, on account of increase in sales quantity. PBILDT of the company increased by 56% to Rs.413 Mn due to the increase in sales quantity coupled with decline in cost of sales leading to improvement in the PBILDT margins. With increase in PBILDT along with the decrease in depreciation cost, PAT of the company increased by 345% to Rs.109 in FY19 over FY18.

Debt Equity ratio of SCPL was deteriorated to 0.97x during the FY19 (FY18: 0.74x) due to the increase in term loans availed for the expansion project. However, the overall gearing ratio improved to 1.32x during FY19 (FY18: 1.55x) due to increase in tangible network of the company on back of accretion of the profit and equity infusion. The interest coverage ratio during FY19 was moderate at 2.52x. The total debt to Gross Cash Accrual Ratio increased to 10.71x due to substantial increase in the debt level for ongoing capex. ***Demand for cement products in the country***

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 SCPL.

Locational advantage of the plant site and license of 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 the 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 and extraction license for the one mine (out of 3 mines) has already been acquired and prospecting license for one mine is in the process to transfer in the name of SCPL. 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. Also, the SCPL has recently introduced the PSC cement. SCPL sell its product all over Nepal with primary focus towards western, mid-western and far western part of Nepal.

Financial closure achieved for the clinker unit and enhanced grinding capacity

Current unit of the company was established with an investment of Rs. 951 Mn, which was financed in debt equity ratio of 64:36. The envisaged total cost of the clinker plant and grinding capacity enhancement is projected at Rs. 10,133 Mn out of which Rs. 8,106 Mn is proposed to be funded through Term Loan. However, the bank has approved term loan of Rs. 7,968 Mn with balance Rs. 2,165 to be injected by promoters and internal accruals in Debt equity ratio of 78.64:21.36. SCPL has entered into the consortium loan agreement on December 12, 2018 for Rs 7,968 Mn term loan.

Key approvals for clinker unit and enhanced grinding unit

The project has received all the key approvals from Government Offices and Regulators for its existing plant. Also, the approval for clinker unit and enhanced grinding capacity has been obtained from Department of Industry. Further, Environmental Impact Assessment (EIA) report has also been submitted and approved. However, the EIA of one mine is pending. SCPL will require total 22 MW electricity after the expansion plan, for which SCPL has already taken approval from concerned authority.

About the Company

Samrat Cement Company Private Limited (SCPL) is a private limited company, established in 2013, for setting up clinker and cement 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 in process of expansion of its grinding capacity to 3,600 MTPD which is expected to come in operation during Mid- January 2021 and adding clinker plant with capacity of 4,000 MTPD as backward integration, which is expected to come in operation during Mid-August 2020.

Brief Financial Performance during last 3 years:

(Rs in Million)

| Particulars | FY17 (A) | FY18 (A) | FY19(A)* |
|---------------------------|----------|----------|----------|
| Income from Operations | 125 | 2,780 | 3,168 |
| PBILD | (17) | 265 | 413 |
| PAT | (64) | 25 | 109 |
| Overall Gearing (times) | 2.57 | 1.55 | 1.32 |
| Interest coverage (times) | (1.37) | 2.08 | 2.52 |

* 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 | 8,466.90 | CARE-NP BB |
| Long Term Bank Facilities (Proposed) | Term Loan | 205.84 | CARE-NP BB |
| Short Term Bank Facilities | Working Capital | 1,000.00 | CARE-NP A4 |
| Total | | 9,672.74 | |