Rating Rationale

Ghorahi Cement Industry Private Limited

Rating

Facility/ Instrument	Amount (Rs. In Million)	Rating[1]	Rating Action
Long Term Bank Facilities	8,838.09	**CARE-NP BBB- [Triple B Minus]**	Assigned
Short Term Bank Facilities	3,876.45	**CARE-NP A3 [A Three]**	Assigned
Total facilities	**12,714.54**		

Details of Facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has assigned rating of 'CARE-NP BBB-' to the long term bank facilities and 'CARE-NP A3' to the short term bank facilities of Ghorahi Cement Industry Private Limited (GCIPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of GCIPL derives strength from established track record of operations and experience of promoters in the cement industry, strong operational and financial performance in FY19 (refers to 12 months period ended mid-July 2019) characterized by growth in revenue, comfortable gearing levels and debt service coverage indicators at the end of FY19 however, post availing additional debt for expansion project, the debt service coverage indicators are likely to be deteriorate to moderate levels. The ratings also factor in competitive advantage over standalone grinding units, locational advantage of the plant with accessibility to limestone mines, established brand presence and strong market position, demand of cement products in the country expected to grow in the long term and receipt of all key approvals for the enhancement of clinker and grinding capacity.

The ratings are however, constrained by project implementation and stabilization risk associated with large-size planned capex for the enhanced capacity, foreign exchange fluctuation risk and raw material price volatility risk and working capital intensive nature of operations. The ratings also factor in presence of the company in highly fragmented with competitive and cyclical nature of cement industry, likely negative impact of Covid-19 on the cement demand coinciding with large capacity of the company being commissioned in the near future, high retrospective demand for electricity charges by NEA and exposure to volatile interest rates.

Timely completion of the proposed project within the cost estimates and satisfactory operations and capacity utilisations thereafter are the key rating sensitivities. Also, satisfactory generation of operational cash flows from the existing plant to fund the equity component of the proposed expansion are the key rating sensitivities.

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

Detailed Description of the Key Rating Drivers

Key Rating Strengths

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

GCIPL has an operational track record of more than 7 years in cement manufacturing and is promoted by two leading business groups of Nepal being Sanghai family brothers and individual members of vishal group. Both the groups are involved in diversified business of banking, insurance, manufacturing, trading and other businesses. Sanghai family entered into cement production in the year 2002 and currently also has two other standalone grinding units in its portfolio. The company is chaired by Mr. Purshottam Lal Sanghai. The Chairman is supported by a team of qualified professionals in all the departments with wide experience in cement industry.

Strong operational and financial performance in FY19 characterized by growth in revenue, however with reduced profitability margins

Company's clinker unit has been operating at a full capacity utilization for the last three years, whereas the grinding unit has been operating at an optimal capacity utilization of around 68% in FY19. GCIPL registered a growth of 9% in revenue over FY18. Contribution of clinker sales and cement sales to total sales stood at 32% and 68% respectively in FY19. Company achieved PBILDT margin of 22.09% in FY19 reduced from PBILDT margin of 30.44% in FY18 majorly due to decline in sales realization coupled with increase in sales promotion expenses. Further, GCIPL achieved total sales of Rs. 5,180 Mn during the 11 months period ended FY20.

Comfortable gearing levels and debt service coverage indicators at present with moderate levels post availing debt for expansion project

At the end of FY19 debt-equity ratio of the company was low at 0.51x and overall gearing stood at 0.75x with comfortable interest coverage ratio of 5.23x. Total debt/ GCA for FY19 was 3.26x which increased from 1.79x in FY18. The envisaged total cost of the expansion project is Rs. 9,008Mn out of which Rs. 6,194 Mn will be funded through term loan and rest will be funded by internal accruals in debt-equity ratio of 69:31. Size of the project is moderate at ~1.4 times the net worth of the company at the end of FY19. 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

GCIPL currently has one limestone mine on a 30 years lease which is located in Tapa, Dang District, Nepal. With 4000 TPD mining capacity, the mine located at Tapa has an anticipated mine life of 25 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 GCIPL.

Locational advantage of the project site and accessibility to limestone mines

The plant site is located in far western area of Nepal and is well connected to East-West Highway. The majority of the sales of the company are concentrated at Western and Far-Western region of the country. Further, the mines are located close to the clinker and grinding unit which reduces logistics cost.

Established brand presence and strong market position

GCIPL sells its product under the brand name "Sagarmatha" all over Nepal with primary focus towards western and far western part of the country. Company's established brand presence and strong market position, has supported healthy cement realizations over the years.

Key Rating Weaknesses

Likely negative implications of COVID-19 on the operations and financials of the company and on the cement demand coinciding with large capacity of the company being commissioned in near future

The global outbreak of Coronavirus disease (COVID-19), has affected Nepal as well. With lockdown imposed by Government of Nepal, GCIPL has suspended its manufacturing activities from March 24, 2020. The operations in grinding unit resumed from April 20, 2020 and the clinker plant started from May 29, 2020. Also, Commercial Operation Date (COD) of the new plant has been shifted due to the lockdown. The company was able to make limited sales during the lockdown, which may have a negative impact on the revenue, profitability, cash flow and debt service indicators of the company. However, the Central Bank of Nepal has provided an extension of 3 months for the repayment of loans to provide some temporary relief and has also directed banks and financial institutions to reduce interest rate on bank loans by 2% for the fourth quarter of FY20. While GCIPL's performance in 6MFY20 was moderate, the revenue growth momentum, profitability and debt coverage indicators are expected to be under pressure for FY20. The company's ability to achieve sales and profitability as envisaged and maintain its debt coverage indicators would remain critical.

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

Construction of the expansion project commenced from January 2018 and the clinker plant and grinding unit is expected to be operational from the beginning of FY2021. Setting up of the grinding unit is completed and for clinker unit all the required machineries are in possession with majority of the work completed. The enhancement project is in completion stage and remains exposed to the risks associated with project's satisfactory operations thereafter. 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

GCIPL currently uses coal, limestone, bauxite, gypsum, clay and iron ore as major raw materials. Coal constitutes around 60% of raw materials consumption in clinker production which is met through import from different countries. Invoicing of the coal is in USD which exposes GCIPL to foreign exchange fluctuation risk. GCIPL however, hedges most of its foreign currency exposure in order to minimize the risk associated with fluctuation in foreign currency. Further, raw material cost constitutes around 47% of total cost of goods sold in FY19. Hence, any adverse movement in raw material price without any corresponding movement in finished goods price will impact the profitability of the company. The ability of the company to pass through of changes in raw material prices to the customers and managing the foreign exchange fluctuation risks will be the key rating sensitivities.

Working Capital Intensive Nature of Operations

The operations of the company are working capital intensive in nature as it is involved in manufacturing cement by procuring raw materials both locally and by importing. The company has to maintain inventory for smooth operations and extend credit to their dealers, which lead to reliance on working capital limits. The operating cycle of the company was moderate at 99 days in FY19. This leads to high working capital requirement to fund the operations. The month end working capital utilization of the company against drawing power was around 80% during last 12 months period ended mid-Feb 2020.

Exposure to volatile interest rate

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.

Presence in highly fragmented & competitive market and cyclical nature of cement industry

GCIPL 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.

High retrospective demand for electricity charges by NEA

During FY19, GCIPL had received demand notice from Nepal Electricity Authority (NEA) towards additional electricity charges as dedicated feeder charges for the past period. Accordingly, NEA has demanded Rs. 1,022 Mn from GCIPL as dedicated feeder charges for the period. As per the company, the matter is under discussion in a committee formed by NEA for reversal of such charge. Any adverse impact of this demand on the financial profile will be critical.

About the Company

Ghorahi Cement Industry Private Limited (GCIPL) was incorporated in August 6, 2007 and is one of the large integrated cement manufacturing plant in the country located in Dang valley of Western Nepal. The company is presently engaged in manufacturing and selling cement with clinker capacity of 1900 MTPD and grinding capacity of 2200 MTPD and is undergoing expansion of clinker unit by 3000 MTPD and grinding unit by 1600 MTPD.

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	6,775	8,174	8,875
PBILDT	2,235	2,488	1,960
PAT	1,812	1,590	1,198
Overall Gearing (times)	0.72	0.64	0.75
Interest coverage (times)	8.08	6.97	5.23

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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	6,838.09	**CARE-NP BBB-**
Long Term Bank Facilities (Proposed)	Term Loan	2,000.00	**CARE-NP BBB-**
Short Term Bank Facilities	Working Capital Loan	2,363.49	**CARE-NP A3**
Short Term Bank Facilities	Non-Fund Based Limits	1,512.96	**CARE-NP A3**
Total		**12,714.54**	