Rating Rationale

Janak Education Materials Centre Limited

Rating

Facility	Amount (Rs. In Million)	Rating	Rating Action
Short Term Bank Facilities	750.00 (reduced from 990.00)	CARE-NP A4+ [A Four Plus]	Revised from CARE-NP A4 [A Four]
Total Facilities	**750.00**		

Details of Facilities in Annexure 1

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

Detailed Rationale & Key Rating Drivers

The revision in the ratings assigned to the bank facilities of JEMC factors in increase in the revenue in FY20 over FY19, reduced cost of production leading to high profitability margins during FY20 (Provisional, refers to 12 months' period ended mid-July 2020) and improvement in the debt service coverage indicators. However, the ratings are continuing to be constrained by 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 also factored in raw materials price volatility risk with no authority to change the price of textbooks, however, price of textbooks for class V to X has been increased by average 33% for academic year 2020 by the concerned government department. The ratings also constrained by 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 factored in diversified and adequate geographical coverage through offices and agents, 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 ~90% of the total income in FY20. 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.

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

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 2-3 months coupled with huge inventory, the operating cycle of the company is high resulting in high working capital requirements.

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 which has been completely eroded on account of losses incurred by the company in the past. However, with the revision of textbook prices and reduced cost of production, the Networth of the company improved at Rs. (1,140) Mn at the end of FY20 from Rs. (1,404) Mn at the end of FY19. In presence of huge negative Networth, the 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 past losses incurred by the company and to support the operations of the company. JEMC has been availing loan from government owned funds as well as directly from GoN for which debt repayment is not scheduled thereby providing financial comfort to the company. However, the interest coverage ratio of the company improved to 2.72x in FY20 (vis-à-vis 1.21x in FY19) due to improved PBILDT. JEMC has moderate total debt to gross cash accruals (GCA) ratio which improved to 6.91x in FY20 from high level of 71.51x in FY19 mainly due to improvement in GCA of the company during the year and repayment of term loan.

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

JEMC 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 is printing paper which accounts for over 80% 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. However, government has increased the price of textbooks in academic year 2020.

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 of the books. 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 loans 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 51 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 and answer sheets; and other documents for different government departments. Also, Government has mandated JEMC on August 2020 for printing 96.9 million pieces of excise duty stickers. 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 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. These offices are strategically located covering major parts of Nepal where the books are stocked for the registered agents to collect and distribute further to government schools. Further, there were 1,281 registered agents of the company in FY20 as compared to 1,201 registered agents in FY19.

Financial risk profile marked by reduced cost of production and healthy profitability margins

Total net revenue of the company increased in FY20 over FY19 mainly on account of increase in revenue from sale of textbooks with the increase in price of textbooks in academic year 2020. PBILDT margin of the company improved significantly in FY20 over FY19 mainly due to low production of textbooks followed by increase in price of text books. PAT margin and GCA of the company was also improved substantially in FY20 over FY19 mainly due to improvement in PBILDT.

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 in advance at the time of collection of textbooks 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 FY2020/21 by Ministry of Finance, the government has proposed free education up to high school level (Class VI to XII). With respect to COVID-19 impact on education sector, government has proposed to start new academic year through television, radio, virtual class and online education. Government has made arrangements for printing and free distribution of text-books to reach all the schools before the commencement of the academic year. Also, Rs. 2.76 Bn was allocated for the distribution of free text-books to 4.6 Mn students (approx) including color text-books up to the primary level.

About the Company

JEMC is a service oriented GoN entity, having registered office located at Bhaktapur, Nepal. 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 15, 2020, paid- up share capital of the company is Rs. 456 Mn which is fully owned by two ministries of GoN.

Brief financials of JEMC for last three years ending FY20 are given below:

For the year ended Mid July, (Rs. Million)	FY18 (Audited)	FY19 (Audited)	FY20 (Provisional)
Income from Operations	1,227	1,044	1,384
PBILDT	251	161	433
PAT	87	21	264
Interest Coverage (times)	1.94	1.21	2.72
Overall Gearing (times)	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	750.00	CARE-NP A4+
Total		**750.00**	