

Rating Rationale
Saptakoshi Cement Private Limited

Rating

Facility/ Instrument	Amount (Rs. In Million)	Rating ¹	Rating Action
Long Term Bank Facilities	437.76	CARE-NP BB+ [Double B Plus]	Assigned
Short Term Bank Facilities	560.00	CARE-NP A4+ [A Four Plus]	Assigned
Total facilities	997.76		

Details of Facilities in Annexure 1

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

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of SCPL are constrained by leveraged capital structure at the end of FY20 (Audited, refers to 12 months period ended mid-July 2020). The ratings are also constrained by lack of backward integration and raw material price volatility risk with presence only in clinker grinding, working capital intensive nature of operations, exposure to volatile interest rates and presence in highly fragmented with competitive and cyclical nature of cement industry. The ratings however, derive strength from established track record of operations and resourceful promoters with experience in cement industry, growth in revenue, margins and profitability in FY20, demand of cement products in the country, locational advantage of the plant site and established brand presence and strong market position. Ability of the company to increase the scale of operations while 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

Leveraged capital structure at the end of FY20

The company is having leveraged capital structure denoted by high Debt Equity ratio at 2.43x at the end of FY20 which deteriorated from 1.88x at the end of FY19 majorly on account of infusion of unsecured loan from promoters for supporting the increased business operations. The overall gearing ratio of the company also deteriorated and was high at 3.66x at the end of FY20 from 3.35x at the end of FY19. Interest coverage ratio of the company has been moderate at 2.44x in FY20 which declined marginally from 2.46x in FY19 on account of increase in interest cost. Total debt to Gross Cash Accrual (GCA)

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

Ratio remained high which however, improved from 14.55x in FY19 to 9.04x in FY20 on account of growth in gross cash accruals of the company.

Working Capital Intensive Nature of Operations

The operations of the company are working capital intensive in nature. SCPL 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 company generally allows two month credit period for cement sale to its customers and maintain inventory for around one month. The operating cycle of the company was moderate at 57 days in FY20 as compared to 47 days in FY18. The average working capital utilization of the company against drawing power was at around 83% during last 12 months period ended mid-Jan 2021.

Lack of backward integration and raw material price volatility risk; presence only in clinker grinding

SCPL is engaged in producing cement and does not possess its own clinker unit. SCPL mainly uses clinker, flyash, slag, gypsum etc. as major raw materials and ~40% of the raw material requirement was imported from India in FY20. Raw material cost continues to be the major cost component of SCPL as cost of goods sold constituted around 82% of the total sales in FY20. 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 customers will be the key rating sensitivities.

Presence in highly fragmented with competitive and cyclical nature of cement industry

SCPL is operating in a highly competitive market, dominated by the large cement manufactures with wide brand acceptability. 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 in Nepal, competition has intensified that has resulted into substantial decline in profitability margins of the industry players during the last 2 year.

Key Rating Strengths

Established track record of operations and resourceful promoters with experience in cement industry

SCPL has an operational track record of more than 20 years in cement manufacturing through its erstwhile company National Cement Private Limited with grinding capacity of 100 TPD. SCPL has been in operation with 600 TPD for about two years and is promoted by individuals from HR Goel Group of Nepal which is involved in diversified trading and manufacturing business including cement manufacturing, construction chemical business, hydropower projects, petroleum, insurance and import and trading. The group has more than 22 years of experience in Nepalese cement trade Industry. The

company is managed under the overall guidance of the Company's Board of Directors (BoD) who possesses wide experience in the related field. SCPL is chaired by Mr. Prakash Kumar Goel, who has an experience of over 30 years in various industries. Mr. Ashish Goel, Director, has an overall experience of 10 years in cement industry. The Director is supported by a team of qualified professionals with wide experience in cement industry.

Growth in revenue, margins and profitability in FY20

During FY20, SCPL was able to scale up its operations and operated at a healthy capacity of 72.90% with entire capacity of 600 TPD being operational in FY20. FY20 was the first full year of operation of the company with 600 TPD capacity which was however impacted by the lockdown imposed on account of Covid-19. Total revenue of the company grew by 5% in FY20 to Rs. 1,677 Mn with improvement in PBILDT and PBILDT margin majorly on account of reduction in selling & distribution expense. Accordingly, profitability of the company increased in FY20, which was however, partially offset by increase in interest expense on account of charging full year interest to profit and loss account which was capitalized in FY19. During H1FY21, the company achieved total sales of Rs. 911 Mn.

Established brand presence and strong market position

SCPL sells its product all over Nepal with primary focus towards eastern part of the country. The company's target area are Mechi-Koshi-Sagarmatha-Janakpur zones. SCPL has a strong network of dealers ranging from 30 to 40 at each targeted zone. Further, each zone has been placed under a regional sales head to further penetrate the market. SCPL sells its cement directly as well as through dealers. Company's established brand presence and strong market position, has supported healthy cement realizations over the years as compared to other grinding units.

Locational advantage of the plant site

The plant is located at eastern part of Nepal where concentration of cement factories is relatively less than the western part of the country. Bhadrapur, Birtamod, Biratnagar, Itahari etc. are the big cities nearby which is the major local market for the SCPL's product. Around 40% of the raw material requirement in FY20 was met through imports via India. Saptakoshi Cement is just 4 Km away from Biratnagar as well as 8 Km away from Jogbani Border making it convenient for raw material procurement at a lower logistic cost.

Demand of cement products in the country

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 SCPL

About the Company

Saptakoshi Cement Private Limited (SCPL) is a private limited company which was incorporated on April 22, 1996. The name of the company was changed by the promoters from National Cement Pvt. Ltd. to Saptakoshi Cement Private Limited two years ago. SCPL is a closed-circuit grinding plant located in Kathari-4, Biratnagar, Morang, Nepal with an installed capacity of 600 TPD for OPC Cement. The plant has two units- Unit -1 of 100 TPD and Unit 2 of 500 TPD which commenced commercial operation from December 2018 onwards.

Brief Financial Performance during the last 3 years is as follows: (Rs. In Million)

For the year ended Mid July	FY18	FY19	FY20
	(Audited)	(Audited)	(Audited)
Income from Operations	380	1,591	1,677
PBILDT Margin (%)	(2.72)	6.97	10.50
Overall Gearing (times)	3.31	3.35	3.66
Interest Coverage (times)	(1.98)	2.46	2.44
Current Ratio (times)	0.99	0.91	1.25
Total Debt/Gross Cash Accruals (times)	(46.45)	14.55	9.04

Analyst Contact Ms. Shalini Sanghai shalini.sanghai@careratingsnepal.com Tel No.: +977-01-4012629	Relationship Contact Mr. Sajan Goyal sajan.goyal@careratingsnepal.com Tel No.: 9818832909/+977-01-4012628/29/30
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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	437.76	CARE-NP BB+
Short Term Bank Facilities	Working Capital Loan	520.00	CARE-NP A4+
Short Term Bank Facilities	Non-fund based limits	40.00	CARE-NP A4+
Total		997.76	