# Rating Rationale

## Shubhashree Agni Cement Udhyog Private Limited

**Rating**

| Facility | Amount (Rs. In Million) | Rating | Rating Action |
|---|---|---|---|
| Long Term Bank Facilities | 2,281.20 (decreased from 2,445.00) | CARE-NP BB+ [Double B Plus] | Reaffirmed |
| Short Term Bank Facilities | 2,610.00 | CARE-NP A4+ [A Four Plus] | Reaffirmed |
| **Total Facilities** | **4,891.20** | | |

*Details of Facilities in Annexure 1*

CARE Ratings Nepal Limited (CRNL) has reaffirmed rating of 'CARE-NP BB+' assigned to the long term bank facilities and 'CARE-NP A4+' assigned to the short term bank facilities of Shubhashree Agni Cement Udhyog Private Limited (SSPL).

**Detailed Rationale & Key Rating Drivers**

The ratings assigned to the bank facilities of SSPL continue to be constrained by leveraged capital structure and modest debt service coverage indicators, working capital intensive nature of operations in FY20. The ratings also factor in raw material price volatility risk, foreign exchange fluctuation risk, presence in cyclical and highly competitive nature of cement industry along with exposure to volatile interest rates. The rating also took cognizance of decline in total operating income and PAT margin during FY20.

The ratings, however, derive strength from experienced promoters, competitive advantage over the standalone grinding units with license for limestone mines, locational advantage of the plant site and favorable demand outlook of the industry.

*Going forward, the ability of the company to profitable scale up of its operations while managing the foreign exchange fluctuation risk will be the key rating sensitivities. Any un-envisaged debt funded capital expenditure deteriorating its capital structure and debt coverage indicators from current levels will also be the key rating sensitivities.*

**Detailed Description of the Key Rating Drivers**

**Key Rating Weaknesses**

***Leveraged capital structure and modest debt service coverage indicators***

SSPL's capital structure stood leveraged marked by debt equity and overall gearing at 2.10x and 3.36x respectively at the end of FY20 (audited, refers to 12 months' period ended mid-July 2020). Overall gearing

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

has shown deterioration over previous balance sheet date from 2.62x due to the decline in net worth base which was attributed dividend payouts in FY20 coupled with increase in debt levels.

The total debt of the company increased from Rs 3,863 Mn in FY19 to Rs. 4,818 Mn in FY20 due to the term loan and working capital loan taken for capex and to support the growing scale of operations respectively. Also, declining profitability margins has led to low GCA levels. Therefore, the interest coverage ratio of the company deteriorated and stood modest at 1.65x in FY20. Furthermore, the total debt/ GCA remained high at 17.60x in FY20.

***Decline in revenue and profitability in FY20***

SSPL reported decline in total sales by 17% during FY20 over FY19 due to decrease in quantity sold of clinker. Despite the decline in total operating income, PBILDT margin improved during the same period from 30.73% in FY19 to 35.94% in FY20 on account of increase in clinker consumption from captive sources. Though the PBIDLT margin improved, PAT margin is showing negative trend on account of higher proportion of finance cost and depreciation as percentage of total operating income. During H1FY21, SSPL has achieved total revenue of Rs. 1,162 Mn while maintaining the PBILDT margin at 36.24%.

***Working capital intensive nature of operation***

Operations of the company are highly working capital intensive marked by an average operating cycle of around 397 days. Being a competitive business, the average collection period remained high at around 69 days during FY20. Being a manufacturer, the company is required to maintain adequate inventory of its finished goods to meet the immediate demand of its customers. The high working capital requirements were met largely through highly payable period of 146 days in FY20 and bank borrowings which resulted in a high average utilization of around 92% of its sanctioned working capital limits for 8 months' period ended mid-March, 2021.

***Foreign exchange fluctuation risk and raw material price volatility risk***

SSPL uses coal, limestone, bauxite, red clay and iron ore as the major raw materials. All the coal requirements are met through import from South Africa, Australia and India. Out of which around 80% import of coal are invoiced in USD, for which it is exposed to the foreign exchange fluctuation risk. SSPL has not taken any hedging mechanism to minimize the risk associated with fluctuation in foreign currency. Raw material cost continues to be the major cost component of SSPL as cost of goods sold constituting around 58% 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 finished products and managing the foreign exchange fluctuation risks related to raw materials will be the key rating sensitivities.

***Presence in cyclical and competitive nature of cement industry***

SSPL 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.

Cement industry is highly cyclical in nature and depends largely on the economic growth of the country. There is a high degree of correlation between the GDP growth and the growth in cement consumption. Cement being a cyclical industry goes through phases of ups and downs, and accordingly impacts the unit realizations.

**Key Rating Strengths**

***Experienced promoters in the related field***

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. Krishna Prasad Pokharel is the Chairman and Dr. Tara Prasad Pokharel is the Managing Director of the Company. Mr. Krishna has been involved in different businesses from the last 25 years and is director in Agni Cement Industries Pvt. Ltd. [CARE-NP BB/A4]. Dr. Tara Prasad, is also the Managing Director of ACPL. ACPL is one of the promoter company and operates clinker grinding plant for six years.

***Locational advantage of the project site and license of Limestone mines***

The plant is located at mid-western part of Nepal. Ghorahi, Tulsipur, Kohalpur, Nepalgunj, Butwal, Bhairahawa etc. are the big cities nearby and are the major local market for the SSPL's product. SSPL imports coal via Barhni border (60 kms from plant) and Sunauli border (90 kms from plant). The company is extracting limestone from two mines, which are within the territory of 70 kms from the plant site. There are numerous large and small grinding plant nearby to the manufacturing facilities of SSPL's which argues well for clinker division of the company.

***Competitive advantage over the standalone grinding units***

SSPL possess two limestone mines in its name, for which it has obtained extraction license from Department of Mines and Geology. It is estimated that mine located at Pyuthan district has ~8.6 million tons and mine located at Dang district has ~4.3 million tons of limestone, which is sufficient to run 1200 MTPD grinding unit for 46 years. Being integrated manufacturing operations, clinker manufacturing units will have added cost competitive advantage over the standalone grinding units.

***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. 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 SSPL.

**About the Company**

Shubhashree Agni Cement Udhyog Private Limited (SSPL) is a private company and was established in 2013. SSPL is engaged in producing clinker by extracting limestone with installed capacity of 700 metric tons per day (MTPD) which came into operations in December 2017. SSPL has grinding unit of 1200 MTPD capacity which came into operation from July 2019.

**Brief Financial Performance of SSPL during last 3 years ending FY20 and H1FY21 is given below:**

(Rs. In Million)

| For the year ended Mid July | FY18 | FY19 | FY20 | H1FY21 |
|---|---|---|---|---|
| | (Audited) | | | (Unaudited) |
| **Period of operation** | **7.5 months** | **12 months** | **12 months** | **6 months** |
| Income from Operations | 1,393 | 2,329 | 1,933 | 1,162 |
| PBILDT Margin (%) | 30.34 | 30.73 | 35.94 | 36.24 |
| Overall Gearing (times) | 2.91 | 2.62 | 3.36 | 3.14 |
| Interest coverage (times) | 2.71 | 2.81 | 1.65 | 2.30 |
| Current Ratio (times) | 1.17 | 1.11 | 1.16 | 1.20 |
| Total Debt/ Gross Cash Accruals (times) | 12.02 | 8.80 | 17.60 | 21.23 |


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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 | 2,281.20 | CARE-NP BB+ |
| Short Term Bank Facilities | Working Capital Loan | 1,950.00 | CARE-NP A4+ |
| Short Term Bank Facilities | Letter of Credit | 660.00 | CARE-NP A4+ |
| **Total** | | **4,891.20** | |