Sonapur Minerals & Oil Limited(Revised)

Rating

Facility	Amount (Rs. In Million)	Ratings[1]	Rating Action
Long Term Bank Facilities	3,143.43 (increased from 3,046.90)	**CARE-NP BB+ [Double B Plus]**	**Reaffirmed**
Short Term Bank Facilities	3,716.70 (increased from 3,203.00)	**CARE-NP A4+ [A Four Plus]**	**Reaffirmed**
Total Facilities	**6,860.13 (increased from 6,249.90)**		

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 Sonapur Minerals & Oil Limited (SMOL).

Detailed Rationale & Key Rating Drivers

The reaffirmation of the ratings assigned to the bank facilities of SMOL factors in its working capital intensive nature of business coupled with leveraged capital structure and debt service coverage indicators. The ratings also factor in residual project implementation & stabilization risk associated with planned capex for the enhanced capacity, foreign exchange fluctuation risk & raw material price volatility risk coupled with exposure to volatile interest rates. Furthermore, it is constrained by impact of COVID-19 on the business of the company and company's presence in competitive and cyclical nature of cement industry. The reaffirmation of ratings also took cognizance of decline in revenue in FY20 (Audited, refers to 12 months' period ended mid-July 2020).

The ratings, however, derive strength from established track record of operations and experienced promoters in manufacturing industries including cement, competitive advantage over the standalone grinding units. The ratings also factor in optimum utilization of installed capacity for clinker unit, demand of cement products in the country expected to grow in the long term and locational advantage of the project site and accessibility to limestone mines.

Going forward, ability of the company to manage its working capital requirements to support the increasing scale of operations and improvement in capital structure would be the key rating sensitivities. Furthermore, timely completion of the proposed project within the cost estimates, and satisfactory operations and capacity utilizations thereafter would also be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Financial risk profile with decline in revenue in FY20, however with improved profitability in FY20 and 9MFY21

Total revenue of the company declined by ~17 % in FY20 to Rs. 2,669 Mn. The operations of the company were significantly impacted in FY20 due to the lockdown imposed during the year by the GoN on account of Covid-19 which has directly impacted the sales of the company. The company witnessed decline in average price realization per MT of clinker sold in FY20. Despite decline in revenue, PBILDT margin of the company increased to 24% in FY20 on account of cost cutting measures adopted by the company specifically reduction in power and fuel expenses which led to decline

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

in cost of goods sold and impacted profitability positively. Furthermore, decline in interest expenses also supported the improvement in net profitability with improvement in PAT margins.

During 9MFY21 (Unaudited, refers to 9 months' period ended mid-April 2021), company has achieved sales of Rs 2,274 Mn with PBILDT margin of 23%.

Working capital intensive nature of business

The company has working capital intensive nature of operations as reflected by below unity current ratio at the end of FY19 and FY20. The company has exceptionally high gross current assets in FY20 on account of lockdown imposed in the last financial year due to which company had high levels of debtors and inventory in the year end. Being a highly competitive business, the company has to extend credit period to its dealers which is upto 120 days. The company is required to maintain adequate inventory of raw material for smooth running of its production processes. Furthermore, being a manufacturer, it is critical for the company to maintain minimum inventory levels to meet immediate demand of its customers; all this led to high working capital requirements. The high working capital requirements were met largely through bank borrowings which resulted in an average utilization of approximately 97% of its working capital limits for the last 4 quarters' period ended mid-January, 2021.

Leveraged capital structure and debt service coverage indicators

The total debt of the company increased by Rs 762 Mn. in FY20 due to term loan taken for capex purposes. On account of high dependence of external borrowing to support its ongoing capex programme and working capital requirements, the capital structure of the company stood leveraged. At the end of FY20, debt equity ratio and overall gearing of the company stood high at 1.43x and 2.03x respectively. In the current financial year (as on mid-April 2021), debt equity ratio of the company improved to 1.26x with scheduled repayment of term loan. Furthermore, due to improving profitability margins, interest coverage ratio of the company has shown improvement in FY20 over previous year and stood at 2.07x in FY20. However, the total debt/ GCA remained high at 14.47x in FY20.

Residual Project implementation and stabilization risk associated with planned capex for the enhanced capacity

SMOL is undertaking an expansion project by installing new machineries that will increase the installed capacity and improve the efficiency of manufacturing process. The total cost is envisaged at Rs 2,460 Mn which will be funded through debt equity mix of 80:20. SMOL has tied up 95% of total debt for the project expansion by the end of May 2021 and remaining is expected to be tied up in near future. SMOL has already incurred ~92% over the expansion project till mid- May, 2021. The plant is in the final stages of installation and is expected to commence production by September 2021. Though the capital expansion will increase the company's installed capacity, company remains susceptible to risk related to the stabilization and streamlining of production process from the enhanced capacity.

Foreign exchange fluctuation risk and raw material price volatility risk

Coal constituted more than 43% of the total cost of production for the last 2 years (FY19-FY20). The company is exposed to the raw material price volatility risk due to the volatility experienced in the prices of coal respectively. The general volatility in the raw material prices also has an impact on the price of this final product. Any sudden spurt in these raw material prices might not be passed on to the end customers, instantly, on account of highly competitive nature of the industry, which could lead to decline in profitability margins.

Company imports majority of coal from South Africa and its import procurement to raw material cost (fly ash, gypsum and coal) stood at 60-70% for last three financial years (FY18 to FY20). The material is completely sold in the domestic market. With initial cash outlay for procurement in foreign currency and significant chunk of sales realization in domestic currency, the company is exposed to the fluctuation in exchange rates which the company does not hedge. Though the company tries to pass on the price and currency volatility to the end users, any adverse fluctuations in the currency markets may put pressure on the profitability of the company.

Presence in highly competitive and cyclical nature of cement industry

SMOL 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 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 as seen in decline in price of cement and clinker during last three years.

Key Rating Strengths

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

SMOL has an operational track record of around a decade in cement manufacturing. The company is promoted by industrialists and traders of Nepal, belonging to the members of the Tayal family along with other individual shareholders. Mr. Ratanlal Tayal is the Chairman and Mr. Nipesh Tayal is the Managing Director of the company with long business experience and involvement in various business sectors. BODs are further supported by an experienced team across various functions/ departments.

Competitive advantage over the standalone grinding units

The company currently has mining license for two limestone mines located at same site. The company also purchases limestone from another which mine owned by group associate of the company which provides competitive edge over other competitors in terms of timely supply etc.

Revenue from sale of clinker accounted for ~43% of total sales in FY20. Also, clinker manufacturing units will have added cost competitive advantage over the standalone grinding units and also imported clinker due to high transportation cost during import from India as compared to local transportation cost makes it costlier.

Optimum utilization of installed capacity for clinker unit but lower capacity utilisation of the Grinding Units

The company has optimum capacity utilization for its clinker unit at ~84% in 9MFY21 vis-à-vis ~72% in FY20; however, the capacity utilization of its grinding unit was at modest level at ~49% in 9MFY21 vis-à-vis ~45% in FY20. The company had low-capacity utilization for its grinding units as the company prioritized sale of its clinker as compared to cement on account of favourable demand of clinker attributed to better quality. The same leads to better negotiating power and also helps the company to maintain liquid financial profile.

Locational advantage of the project site and accessibility to limestone mines

The plant site is well connected to East-West Highway with major cities and towns nearby. 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 plant site which reduces logistics cost of the company.

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 as included in the budget for FY21-22 is likely to benefit the cement manufacturers like SMOL.

About the Company

Sonapur Minerals & Oil Private Limited was incorporated in June 13, 2008 as a private limited company which was later converted into public limited company as Sonapur Minerals & Oil Limited on July 22, 2020. The company is presently engaged in manufacturing of cement and has installed capacity of 1,250 MTPD and 1,000 MTPD of clinker and grinding respectively. The company is selling OPC under the brand name 'Sona Cement OPC' and PPC under the brand name 'Sona Shree PPC Cement' and 'Sonatech PPC Cement'.

Brief financials of SMOL for last two years ending FY20 including 9MFY21 are given below:

(Rs. Million)

For the year ended Mid July	2018	2019	2020
	(12m, A)	(12m, A)	(12m, A)
Income from Operations	3,223	2,669	2,274
PBILDT Margin (%)	20.95	24.22	23.24
Overall Gearing (times)	2.06	2.03	1.76
Interest Coverage (times)	1.88	2.07	3.71
Current Ratio (times)	0.97	0.94	NA*
Total Debt/ Gross Cash Accruals (times)	13.13	14.47	12.56

*NA= Not Available
A: Audited

Annexure 1: Details of the Facilities Rated

Nature of the Facility	Type of the Facility	Amount (Rs. In Million)	Ratings
Long Term Bank Facilities	Term Loans	2,282.43	CARE-NP BB+
Long Term Bank Facilities (Proposed)	Term Loans	861.00	CARE-NP BB+
Short Term Bank Facilities	Working Capital Loans	2,101.00	CARE-NP A4+
Short Term Bank Facilities	Non-Funded Loans	1,615.70	CARE-NP A4+
Total		**6,860.13**	

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About CARE Ratings Nepal Limited:

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