Ghorahi Cement Industry Limited

Ratings

Facilities	Amount (Rs. in Million)	Ratings[1]	Rating Action
Long Term Bank Facilities	8,272.69 (Decreased from 8,838.09)	**CARE-NP BBB- [Triple B Minus]**	**Reaffirmed**
Short Term Bank Facilities	3,876.45	**CARE-NP A3 [A Three]**	**Reaffirmed**
Total Bank Facilities	**12,149.14 (Decreased from 12,714.54)**		

Details of instruments/facilities in Annexure-1

CARE Ratings Nepal Limited (CRNL) has reaffirmed 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 Limited (GCIL).

Detailed Rationale & Key Rating Drivers

The reaffirmation of the ratings assigned to the bank facilities of GCIL continue to derive strength from its strong parentage, experience of promoters in the cement industry and established brand presence & market position. The ratings also factor in competitive advantage over standalone grinding units, locational advantage of the manufacturing facilities and positive industry prospects. Additionally, the rating also took cognizance of subdued performance of company during FY20 (FY refers to 12 months period ended mid-July 2020) leading to moderation of financial risk profile of the company.

The ratings are however, constrained by stabilization risk associated with debt-funded expansion, working capital intensive nature of operations, foreign exchange fluctuation risk and exposure to fluctuations in raw material price volatility. The ratings also factor in its presence of the company in highly competitive and cyclical nature of cement industry and exposure to volatile interest rates. Additionally, high contingent liability towards payment of additional electricity charges levied by the authority is also the rating constraint for the company.

Early stabilization of the expansion project with capacity utilisation levels thereafter to generate sufficient cash-flows as envisaged will be the key rating sensitivity. Also, scaling up its operations with improvement in profitability coupled with ability of the company to reduce its debt levels and improve the capital structure would also be key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Strengths

Strong parentage and experience of promoters in manufacturing industries including cement

GCIL has an operational track record of more than 8 years in cement manufacturing and is promoted by two leading business groups of Nepal being Sanghai family brothers and Vishal group. Both the groups are involved in diversified business of banking, insurance, manufacturing, trading and other businesses. Sanghai family has around 2 decades of experience in cement manufacturing and currently has been operating standalone grinding units. Vishal Group also has a considerable presence in the financial sector of Nepal and is the promoter of banks such as NIC Asia Bank Limited [CARE-NP A (Is)]. Also, Vishal group has strong presence in import and trading of fast-moving consumer goods in Nepal with established distribution network. The company has five directors on its board and is chaired by Mr. Purshottam

[1]*Complete definitions of the ratings assigned are available at www.careratingsnepal.com and in other CRNL publications*

Lal Sanghai. The Chairman is supported by a team of qualified professionals in all the departments with wide experience in cement industry.

Locational and competitive advantage

The company has a captive limestone mine on 30 years lease which is situated in Tapa, Dang District, Nepal. The limestone mine have sufficient proven reserve to support the operations for about next 20 years. Backward integration and proximity to major raw material sources endow the company with operating benefits, thereby reducing its cost of production. Furthermore, the mines are located close to the clinker and grinding unit which reduces logistics cost.

The manufacturing facilities are located in far western area of Nepal and is well connected to East-West Highway. The significant portion of revenue of the company is generated from Western and Far-Western region of the country where development and construction works are yet to gain momentum, which argues favorably for the company. Nonetheless, the recent upward trajectory of the input costs exposes the cement operations to volatility in prices in future and it remains to be seen to what extent the same can be passed on to the consumers.

Established brand presence and strong market position

GCIL sells its product under the brand name “Sagarmatha” all over Nepal with primary focus towards western and far western part of the country. GCIL sells its product in the market through its 21 distributors all over Nepal. The company’s established brand presence has supported the company to reduce the impact of competition induced volatility in prices over the years.

Moderation in financial risk profile due to increase in debt levels for capacity expansion and subdued performance

GCIL’s total operating income (TOI) declined by 36% in FY20 to Rs. 5,674 Mn. Decline in revenue in FY20 was majorly due to reduction in quantity sold of both clinker and cement coupled with decrease in average sales realization per bag due to increased competition and subdued demand on account of pandemic. The same also led to significant decline in profitability margins. PBILDT and PAT margins of the company stood at 10.29% and 0.98% respectively (PY: 22.09% & 13.50%) respectively. Consequently, GCIL reported growth in TOI by 7.24% during FY21 (based on provisional results) with improvement in PBILDT margin to 13.61%. The same was on account of improvement in average price realizations coupled with steps taken by the company to rationale its costs due to better management of resources.

The company has undertaken a debt funded expansion which has increased debt levels during last 2 FYs (FY 20 & FY21). Though the capital structure of the company has deteriorated at the end of FY20, it continued to remain at moderate levels. As on mid-July 2020, debt-equity ratio and overall gearing stood at 0.70x and 1.17x respectively. The increase in debt levels coupled with decline in profitability has led to weakening of coverage indicators. Interest coverage ratio moderated in FY20 and stood at 3.20 times. Since the enhanced capacity has not started operations in FY20; total debt / GCA stood weak at 18.81x.

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 GCIL.

Key Rating Weaknesses

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

GCIL has undertaken a brownfield expansion project to increase the installed capacity of both clinker and grinding unit at a project cost of Rs. 8,665 Mn which has been financed mostly through debt (Debt: Equity ratio of around 9:1). Both clinker and grinding unit has started trial operations in February 2021. Being significant capacity expansion, the stabilization and streamlining of production remains to be seen. Furthermore, post project implementation risk, risks in the form of achieving the envisaged scale of business and also scalability risk associated with the products in the light of competitive nature of industry remains crucial for credit prospective. Post expansion the existing capacity of both clinker and grinding unit has increased by 3000 TPD and 1400 TPD respectively.

Working capital intensive nature of operations

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 collection and inventory holding period in FY20 on account of lockdown imposed in the last financial year. Being a highly competitive business, the company has to extend credit period to its dealers which is upto 90 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 83% of the drawing power during last 8 months period ended mid-May 2021.

Foreign exchange fluctuation risk and raw material price volatility risk

Coal constituted around 65% of raw materials consumption in clinker 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 its 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, Australia and its import procurement to raw material cost (fly ash, gypsum and coal) stood at 60-70% for last two 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 partially hedges. 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 market and cyclical nature of cement industry

GCIL 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.

About the Company

Ghorahi Cement Industry Private Limited (GCIPL) was incorporated in August 6, 2007 and its integrated cement manufacturing plant situated in Dang valley of Western Nepal. The company was converted into public limited company in March 2021 and the name has been changed to Ghorahi Cement Industry Limited (GCIL). GCIL is presently engaged in manufacturing and selling cement with clinker capacity of 1900 MTPD and grinding capacity of 2200 MTPD and is undergoing trial production for the enhanced clinker capacity of 3000 MTPD and grinding capacity of 1400 MTPD.

Financial Performance

(Rs. Million)

For the year ended Mid July	2018 (12m, A)	2019 (12m, A)	2020 (12m, A)
Income from Operations	8,174	8,875	5,674
PBILDT Margin (%)	30.44	22.09	10.29
Overall Gearing (times)	0.64	0.75	1.17
Interest Coverage (times)	6.97	5.23	3.20
Current Ratio (times)	1.09	0.89	0.60
Total Debt/ Gross Cash Accruals (times)	1.79	3.26	18.81

A: Audited

Annexure 1: Details of the Facilities Rated

Name of the Bank Facilities	Type of the Facility	Amount (Rs. In Million)	Rating
Long Term Bank Facilities	Term Loan	8,272.69	CARE-NP BBB-
Short Term Bank Facilities	Working Capital Loans	2,363.49	CARE-NP A3
Short Term Bank Facilities	Non-Fund Based Limits	1,512.96	CARE-NP A3
Total		**12,149.14**	

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