Saptakoshi Cement Pvt Ltd

Ratings

Facilities	Amount (Rs. Million)	Rating[1]	Rating Action
Long Term Bank Facilities	**330.49**	CARE-NP BB+ [Double B Plus]	**Reaffirmed**
Short Term Bank Facilities	**790.00 (Increased from 560.00)**	CARE-NP A4+ [A Four Plus]	**Reaffirmed**
Total Facilities	**1,120.49**		

Details of instruments/facilities in Annexure-1

CARE Ratings Nepal Limited (CRNL) has reaffirmed 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 reaffirmation of the ratings assigned to the bank facilities of SCPL continued to be constrained by leveraged capital structure, although on an improving trend at the end of FY21 (Audited, refers to 12 months period ended mid-July 2021), lack of backward integration and raw material price volatility risk with presence only in clinker grinding. The ratings also factor in working capital intensive nature of operations, SCPL's presence in a highly fragmented and competitive industry and cyclical nature of the cement industry. The ratings however, derive strength from established track record of operations and resourceful promoters with experience in cement industry, growth in revenue and net profitability in FY21, demand of cement products in the country over the medium term, locational advantage of the plant site and established brand presence and strong market position in the eastern region of the country.

Going forward, the 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

Improvement in capital structure albeit remained leveraged

The company capital structure remained moderately leveraged at the end of FY21 amid substantial borrowing levels, despite improvement during FY21. At the end of FY21, SCPL's debt equity ratio and overall gearing ratio improved to 2.09x and 2.41x, respectively, from 2.43x and 3.66x at the end of FY20. The improvement in the capital structure was mainly on account of lower debt levels at the year-end coupled with accretion of profits to the reserve. Similarly, interest coverage ratio of the company also improved to 2.87x during FY21 from 2.44x during FY20 on account of lower interest expense during the year aided re-financing of its term debt. Total debt of Gross Cash accruals ratio improved to 6.62x at the end of FY21 from 9.02x at the end of FY20 on account of reduction in debt levels.

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 its dealers, which lead to reliance on working capital limits. The company generally allows two months credit period for cement sale to its customers and maintain inventory for around one month. The operating cycle of the improved from 57 days in FY20 to 41 days in FY21. This was on account of faster realization of receivables as average collection period improved from 65 days in

[1]Complete definition of the ratings assigned are available at www.careratingsnepal.com and other CARE publications

FY20 to 46 days in FY21. As operations of the company is likely to improve over the medium term, backed by increased demand, working capital limits utilization is also expected to commensurately increase, leading to higher dependence on bank borrowings.

Lack of backward integration and raw material price volatility risk

SCPL is engaged in producing cement through its grinding unit and does not possess its own clinker unit. Hence, it needs to procure clinker from other cement manufacturers. Clinker used for cement production is majorly procured locally. During FY21, around 90% of the total raw material requirement was met from SCPL's group associate (Hongshi Shivam Cement Private Limited) while the remaining 10% was in the form of imports from India. Raw material cost continues to be the major cost component of SCPL as cost of goods sold constituted around 83% of the total sales in FY21. 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 remain critical in terms of maintaining stable profit margins. However, increasing competition has led to a very competitive pricing dynamics in the industry and the ability of the company to protect its market share while maintaining a reasonable profitability margin will be key rating sensitivity.

Presence in a highly fragmented and competitive industry with cyclical nature

SCPL is operating in a highly competitive market, dominated by the large cement manufacturers with wide brand acceptability. Given the increased competition, 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. Furthermore, with increase in the capacities of the existing plants and new capacities coming into operation, competition has intensified which has resulted into substantial decline in profitability margins of the industry players in the recent years.

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 21 years in cement manufacturing through its erstwhile company National Cement Private Limited with grinding capacity of 100 TPD. SCPL has been in operations with capacity of 600 TPD for about two years. SCPL 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 23 years of experience in Nepalese cement industry. Recently, Mr Ashish Goel has been appointed as Chairman of the company who, has an overall experience of 11 years in cement industry. The company is supported by a team of qualified professionals with wide experience in cement industry

Established brand presence and reasonable market share in eastern region

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 established network of dealers ranging from 30 to 40 at each targeted zone. Furthermore, each zone has 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 above average sales over the years as compared to other grinding units.

Growth in revenue and net profitability in FY21, although gross margins are shrinking

During FY21, SCPL's average capacity utilization improved to around 89% compared to around 79% during FY20. Consequently, revenues grew 20.33% year on year to Rs. 2,018 Mn during FY21. However, PBILDT margin of the company declined to 7.75% during FY21 from 10.50% in FY20, majorly because of lower price realization amid increased competition coupled with increased selling and administrative costs. Absolute PBILTD declined by 11.21% y-o-y to Rs. 156 Mn despite 20% growth in revenues. However, net profit of the company increased to Rs. 22 Mn during FY21 aided mainly by reduced interest outgo (Rs. 55 Mn during FY21 compared to Rs. 72 during FY20) coupled with non-operating income (insurance claim of Rs. 2.79 Mn). The company's borrowings were approved under re-financing arrangement of Nepal Rastra Bank as a result of which effective interest rate of the company had reduced to 5% for period of 6 months during FY21, helping lower the interest expense for the year.

Demand of cement products in the country

Nepalese economy is developing and growing, and is in phase of investment in infrastructure sectors, power sector and tourism sector. Also, in the recent budget of Nepal for FY22, government has majorly focused towards development of health sectors, economic recovery from covid-19 pandemic and infrastructure development. Further, as per custom authority of Nepal, during 8MFY22 (refers to the eight month period ended mid-March 2022), Nepal imported cement worth Rs. 241Mn and cement clinker of 47,826 Metric ton, which indicate that domestic demand of cement is yet to be fully met through internal production. Furthermore, the government's emphasis on infrastructure development, namely development of roads, hydropower, airports and other infrastructures and estimated recovery in economy over the medium term 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 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 financials of SCPL during last 3 years is given below:

Financial Performance

(Rs. in Mn)

Particulars	FY19	FY20	FY21
	Audited	Audited	Audited
Income from Operations	1,591	1,677	2,018
PBILDT Margin (%)	6.97	10.50	7.75
Overall Gearing (times)	3.35	3.66	2.41
Interest coverage (times)	2.46	2.44	2.87
Current Ratio (times)	0.91	1.25	1.92
Total Debt/Gross Cash Accruals (times)	14.55	9.02	6.62

Annexure-1: Details of Instruments/Facilities

Name of theInstrument	Type of the Facility	Amount (Rs. Million)	Rating
Long Term Bank Facilities	**Term Loan**	330.49	CARE NP BB+
Short Term Bank Facilities	**Fund Based Limit**	750.00	CARE NP A4 +
Short Term Bank Facilities	**Non-Fund Based Limit**	40.00	CARE NP A4 +
Total Facilities		**1120.49**	

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About CARE Ratings:

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