Sonapur Minerals and Oil Limited

Ratings

Facilities	Amount (Rs. Million)	Rating[1]	Rating Action
Long Term Bank Facilities	3,931.08 (Increased from 3,143.43)	CARE-NP BB+ [Double B Plus]	Reaffirmed
Short Term Bank Facilities-Fund based and non-fund based	3,356.00 (Decreased from 3,716.70)	CARE-NP A4+ [A Four]	Reaffirmed
Total	**7,287.08**		

Annexure-1 Details of Facilities/Instruments to be rated

CARE Ratings Nepal Limited (CRNL) has reaffirmed the rating of 'CARE-NP BB+' assigned to the long-term bank facilities and 'CARE-NP A4+' to the short-term bank facilities of Sonapur Minerals and Oil Ltd (SMOL).

Detailed Rationale & Key Rating Drivers

The reaffirmation of the ratings assigned to the bank facilities of SMOL continues to be constrained by its working capital intensive nature of business, moderately leveraged capital structure with modest, albeit improving, debt service coverage indicators. The ratings also factor in project implementation & stabilization risk associated with the ongoing and recently concluded capex for the enhanced capacity, foreign exchange fluctuation risk & raw material price volatility risk coupled with exposure to volatile interest rates. The ratings also factor in company's presence in competitive and cyclical nature of cement industry.

The ratings, however, continue to derive strength from SMOL's experienced promoters and established track record of operations, competitive advantage over the standalone grinding, and improving financial risk profile in FY21 (audited, refers to the twelve-month period ended mid-July 2021). The ratings also factor in optimum utilization of installed capacity for clinker unit in FY21; however, lower utilization in 10MFY22 (Unaudited, refers to the ten-month period ended mid-May 2022), stable demand outlook of cement products in the country over the medium term and locational advantage of the project site and accessibility to limestone mines.

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

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Working capital intensive nature of business

The operations of the company are working capital intensive in nature, which is also reflected by current ratio below unity over last three years (F19-FY21). SMOL is involved in manufacturing of clinker and cement from imported, self-manufactured and locally purchased raw materials. The company has to keep sufficient inventory for smooth operations of business and extend reasonable credit to their dealers amid increasing competition. The company generally allows one month's credit period for its clinker sale and three to four months' credit period for its cement sale to its customers and maintain inventory for around three months. The net-operating cycle of the company was high at 192 days in FY21 on account of accumulation of inventory especially clinker. The price of clinker declined in the last quarter of FY21 and the company opted for holding the inventory instead of selling

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

at lower price. 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 which was met through bank borrowings.

Moderately leveraged capital structure with modest, albeit improving, debt service coverage indicators

With company reliant on external borrowing to support its working capital requirements coupled with the ongoing partially debt-funded capital expenditure, capital structure of the company stands moderately leveraged. Overall gearing ratio of the company remained moderate at 2.16x at the end of FY21, improving from 2.37x at the end of FY20 aided lower utilization of the short term bank facilities at the year-end coupled with increase in net worth amid improved profitability during FY21, offset to some extent by the increased term loans to cater the ongoing capex. Similarly, interest coverage ratio also improved to 3.31x in FY21 from 2.07x in FY20. This improvement was partly on account of interest capitalization amid the ongoing project. Total Debt to GCA stood high at 11.03x at the end of FY21.

Residual project implementation & stabilization risk associated with ongoing capex for the enhanced capacity

SMOL's brownfield project expansion by installing machineries has been ongoing. After completion, the production capacity of the clinker unit will be 1,650 MTPD and 2,300 MTPD of the grinding unit. The project is being funded through debt to equity mix of 80:20. For the same project, the partial debt has been tied up amounting to Rs. 2,511 Mn (i.e. 85% of total debt for the project) as on mid-May, 2022. While capacity enhancement of grinding unit has been completed by mid-Feb 2022, commissioning of the enhanced clinker unit is expected by mid-September, 2022. Although majority of the capex has been completed, the company is still exposed to the residual project implementation risk associated with its ongoing capex. Stabilization and streamlining of production of the recently concluded grinding unit remains to be seen. Similarly, satisfactory operations of the enhanced clinker unit after commencement of the commercial operations will also remain a key monitorable aspect.

Foreign exchange fluctuation risk and raw material price volatility risk

SMOL currently uses coal, limestone, gypsum, clay, iron ore, fly ash and gypsum as major raw materials. Coal constituted around 58% of raw materials consumption in FY21 and the company is exposed to the volatility in raw material prices which are generally market linked. Any sudden spurt in these raw material prices might not be fully passed on to the end customers, particularly on account of highly competitive nature of the industry, which could put pressure on the profitability margins.

Company imports majority of coal from South Africa and its import procurement to cost of goods sold stood at around 65% for FY21. 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

Experienced promoters and established track record of operations

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's limestone requirements are met from these mines and partially from a third mine, which is also owned by group associate of the company. Having its own limestone mines provides competitive advantage to SMOL over other competitors in terms of pricing, transport cost, timely supply etc. Revenue from sale of clinker accounted for around 40% of SMOL's total sales in FY21. Clinker manufacturing units generally have added cost competitive advantage over standalone grinding units. Having both clinker and grinding units, licensed limestone mines and enhanced capacity augurs well for the business prospects of the company over the medium term.

Improving financial risk profile of the company marked by growth in revenue and net-profitability in FY21

Total income from operations increased by 9.47% year on year to Rs. 2,921 Mn in FY21, mainly supported by increase in quantity sold. Although sales price realization of both clinker and cement has decreased in FY21 on a year on year basis owing to increased competition in cement industry, the company total sales quantity increased by approximately 16% in FY21 over previous year. Capacity utilization of the clinker unit had improved to 80% during FY21. Capacity utilization of its grinding unit was relatively lower at 56.23% in FY21 as the company prioritized sale of its clinker amid favorable demand scenario.

PBILDT margin of the company moderated to 22.46% in FY21 from 24.25% in FY20 owing to increase in cost of production mainly raw materials; coal prices has risen up to 200USD per MT by the end of FY21 from 70USD per MT in the start of the fiscal year. However, PBILDT increased by 1.36% to Rs. 656 Mn in FY21 aided by higher sales. Furthermore, PAT of the company increased by 55.90% to Rs. 297 Mn in FY21, also supported by lower interest expenses charged during the year.

As on 10MFY22, company has achieved sales of Rs 1,977 Mn.

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. Furthermore, the government's high emphasis on infrastructure development, namely development of roads, hydropower, airports and other infrastructures as included in the budget for FY23 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 2,300 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 three years ending FY21 are given below:

Brief financials of the company for the past three years are shown as follows:

(Rs. in Million)

Particulars	FY19	FY20	FY21
	Audited	Audited	Audited
Income from Operations	3,223	2,669	2,922
PBILDT Margin	20.95	24.25	22.46
Overall Gearing (times)	2.06	2.37	2.16
Interest coverage (times)	1.88	2.07	3.46
Current ratio (times)	0.97	0.94	0.93
Total Debt/GCA	13.13	14.47	11.03

Annexure-1 Details of Facilities/Instruments to be rated

Name of Instrument	Type of Facility	Amount(Rs in Million)	Rating
Long Term Bank Facilities	Term Loan/BGL	2,531.08	CARE-NP BB+
Long Term Bank Facilities (Proposed)	Term Loan	1,400.00	CARE-NP BB+
Short Term Bank Facilities	Working Capital Loans	2,101.00	CARE-NP A4+
Short Term Bank Facilities	Non–Fund Based Loans	1,255.00	CARE-NP A4+
Total		**7,287.08**	

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About CARE Ratings:

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