Panchakanya Plast Private Limited

Ratings

Facility	Amount (Rs. in Million)	Rating[1]	Rating Action
Long Term Bank Facilities	**79.81**	**CARE-NP BB [Double B]**	**Reaffirmed**
Short Term Bank Facilities	**860.19**	**CARE-NP A4 [A Four]**	**Reaffirmed**
Total Facilities	**940.00**		

Details of Facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has reaffirmed the rating of 'CARE-NP BB' assigned to the long-term bank facilities and the rating of 'CARE-NP A4' assigned to the short-term bank facilities of Panchakanya Plast Private Limited (PPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of PPL remain constrained by the company's leveraged capital structure and modest debt service coverage indicators, working capital intensive nature of operations marked by substantially high inventory levels, exposure to raw material price volatility risk and foreign exchange fluctuation risk, exposure to volatile interest rate risk and foreign exchange fluctuation risk, and the company's presence in highly competitive industry. The ratings also factor in PPL's declined profitability in FY21 (Audited, refers to the twelve-month period ended mid-July 2021).

The ratings, however, continue to derive strength from PPL's strong promoters and established track record of operations along with experienced management team in the related field, established brand with country wide market presence, and positive industry prospects.

Going forward, the ability of the company to profitably scale up its operations, managing the working capital requirements to support growth while limiting its borrowings will be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Below average financial risk profile marked by declined profitability in FY21, leveraged capital structure and modest debt service coverage indicators

During FY21, the PBILDT margin of PPL stood at 8.51%, which declined from a relatively consistent range of around 13% for the last three financial years (FY18-FY20). The decline was due to lower price realizations amid increased competition. With a view to increase the market share, company did not increase its prices proportionately to the increased cost of production, which resulted in lower margins in FY21. However, PPL's total operating income (TOI) rebounded by 7.11% year on year (yoy) to Rs. 895 Mn on account of improved demand scenario in FY21 after the initial wave of the covid-19 pandemic coupled with competitive pricing by the company leading to improved sales.

Furthermore, PPL continued to have a leveraged capital structure at the end of FY21 marked by overall gearing ratio of 3.30x at the end of FY21, deteriorated from 3.17x at the end of FY20. Total debt to gross cash accruals (GCA) and interest coverage ratio also stood modest at 33.68x and 1.56x respectively for FY21 respectively (FY20: 37.20x and 1.31x respectively).

Working capital intensive nature of operations marked by substantially high inventory levels

The operations of PPL are highly working capital intensive marked by a high operating cycle of 370 days in FY21. The company needs to maintain adequate inventory for smooth running of its manufacturing operations as its raw materials are imported from Thailand and Singapore. The company also needs to hold adequate inventory of finished goods in order to meet the immediate demand of its customers, owing to its large product portfolio of different shapes and sizes. This was reflected by high inventory levels with average inventory holding period of 331 days for FY21. Furthermore, being in a competitive industry, the company needs to extend credit to its dealers for upto three months. The average collection period stood around 74 days during FY21, where the average creditor period was 35 days. An elongated operating cycle increases reliance on bank borrowings to meet working capital requirements. The average fund based working capital utilization was 67% for the last 12 months ended mid-June, 2022.

Exposure to raw material price volatility risk and foreign exchange fluctuation risk

PPL is exposed to the raw material price volatility risk due to the volatility experienced in the prices of its raw materials. Raw materials used are CPVC resin powder and PPR granules, which are crude oil derivatives. Crude oil being a product of international importance, its price is volatile depending on the demand-supply situation in the global markets. This exposes the company to volatility in input prices and has a bearing on its profitability margins. Raw materials constituted more than 66% of the total cost of production during FY21 (FY20: 55%), thus any volatility in prices of the same impacts the profitability of the company. Furthermore, the company is exposed to foreign exchange fluctuation risk as the prices of imported raw materials are linked to USD. The company's scope to improve margins will depend on its ability to pass through changes in raw material prices to the finished products while also managing the foreign exchange fluctuation risks related to raw material procurement.

Exposure to volatile interest rate risk

Nepalese banking sector has a floating interest rate regime, where a certain premium is added to the quarterly base rate and interest rate is changed accordingly on quarterly basis. The base rates of the banks and financial institutions (BFIs) in Nepal remain quite volatile as they are impacted by available liquidity in the system which leads to change in interest rates. The volatility in interest rate is more evident currently on account of the ongoing liquidity stress in the economy. Furthermore, increased bank rates announced in the Monetary Policy for FY23 is likely to add to the upward pressure on interest rates going forward. Any significant rate hikes could put increased interest burden on the company, squeezing its profitability and impacting its liquidity position. Therefore, funding taken by the company from BFIs is subject to volatile interest rate.

Presence in highly fragmented and competitive nature of industry

The plastic pipe industry is intensely competitive marked by the presence of both larger players and numerous smaller players in the unorganized segment. 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. Furthermore, the value addition in the manufacturing of pipe and related products is limited, resulting into low product differentiation in the market. Hence, the producers of pipe products are essentially price takers in the market, which directly expose their cash flows and profitability to volatility in the market prices.

Key Rating Strengths

Strong promoters and long track record of operations along with experienced management team in the related field

PPL has an operational track record of around two decades in manufacturing of CPVC and PPR pipes. PPL derives strength from its strong promoter group belonging to Panchakanya Group. Panchakanya Group is one of the established business groups with presence from 1970s in the Nepalese market with involvement in diversified sectors such as trading, manufacturing, energy, automobiles, etc. The company is managed under the overall guidance of its seven-member Board of Directors led by Mr. Prem Bahadur Shrestha, Chairman. Mr. Shrestha is also the founder Chairperson of Panchakanya Group and has more than five decades of experience in various industries of Nepal including manufacturing, trade and service. The board is aptly supported by an experienced management team across various departments.

Established brand with country wide market presence

The company sells CPVC and PPR pipes & fittings under the brand "Panchakanya" which is an established brand in the Nepalese market on account of its long-standing industry presence of more than two decades. This provides competitive advantage to the company against new players entering the industry. Furthermore, PPL has established dealers/sub-dealers and depots across all major cities of Nepal, which provides wide reach to end customers for its products.

Positive industry prospects

Nepalese economy is developing, and is in the phase of investment and growth in infrastructure, power sector and tourism sector, notwithstanding the impact of the covid-19 pandemic. In the recent budget presented by finance minister of Nepal for FY23, Rs. 161.56 Bn has been allocated for infrastructure development along with an estimated GDP growth of 8.00%. Government's continued high emphasis on infrastructure development, namely development of roads, hydropower, airports and other infrastructures augurs well for the business prospects of construction material manufacturers like PPL over the medium term.

About the Company

Panchakanya Plast Private Limited (PPL) was established in 2003 and is engaged in manufacturing Polypropylene Random Copolymer (PPR) and Chlorinated Polyvinyl Chloride (CPVC) pipes and fittings in Nepal. PPL's manufacturing facilities are located in Bhairahawa, Nepal with installed capacity of 5,000 metric tons per annum, as on mid-July 2022.

Brief financials of PPL for the past three years ended FY21 are given below:

(Rs. Million)

For the year ended Mid-July	FY19 (Audited)	FY20 (Audited)	FY21 (Audited)
Income from Operations	965	835	895
PBILDT Margin (%)	13.20	12.93	8.51
Overall Gearing (times)	3.30	3.15	3.30
Interest Coverage (times)	1.55	1.31	1.56
Current Ratio (times)	1.12	1.08	1.20
Total Debt/Gross Cash Accruals (times)	24.70	37.15	33.68

Annexure 1: Details of the Facilities rated

Nature of the Facility	Type of the Facility	Amount (Rs. in Million)	Rating
Long Term Bank Facilities	Term Loan	79.81	CARE-NP BB
Short Term Bank Facilities	Fund Based Limit	860.19	CARE-NP A4
Total		**940.00**	

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