Panchakanya Plastic Industries Private Limited

Ratings

Facility	Amount (Rs. in Million)	Rating[1]	Rating Action
Long Term Bank Facilities	14.63	CARE-NP BB [Double B]	Reaffirmed
Short Term Bank Facilities	965.87	CARE-NP A4 [A Four]	Reaffirmed
Total Facilities	980.50		

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 Plastic Industries Private Limited (PPI).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of PPI remain constrained by the company's leveraged capital structure and modest debt service coverage indicators, working capital intensive nature of operations, exposure to raw material price volatility risk and foreign exchange fluctuation risk, exposure to volatile interest rate risk, and the company's presence in highly competitive industry. The ratings also factor in moderate financial performance of the company marked by 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 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

Despite growth in total operating income by 4.43% year on year (yoy), PBILDT margin of PPI declined by 635 basis points (bps) to 4.99%, and PAT margin declined by 338 bps to 1.79% in FY21. The decrease in profit margins was due to increased competitive pressures within the industry while securing government contracts thus leading to lower growth in price realizations vis-à-vis increase in input prices. More than 50% of the total sales of PPI in FY21 was derived from government contracts. Although the growth in TOI was supported by slight improvement in average price realizations, the same was not proportionate with increased cost, thus affecting the company's profitability.

Furthermore, the company's capital structure remained leveraged at the end of FY21 due to its continued dependence on external borrowings to meet working capital requirements. The overall gearing ratio of the company stood high at 2.92x at the end of FY21, which deteriorated from 2.77x at the end of FY20 due to rise in short term borrowings amid increased inventory levels. Total debt to Gross Cash Accruals (GCA) deteriorated to 20.96x in FY21 from 7.16x due to increase in working capital utilization coupled with decrease in GCA levels. Interest coverage ratio also stood modest at 1.78x, declined from 2.61x from FY20 majorly due to decline in gross profit. The company's ability to achieve a steady profitability profile leading to improved debt service coverage indicators will remain critical from credit perspective.

Working capital intensive nature of operations

The operations of PPI is working capital intensive in nature marked by average operating cycle of 129 days during FY21. Being a highly competitive business, the company needs to extend long credit period to its dealers. This was reflected by average collection period of 130 days, while average credit period was 57 days. In addition, the company is required to maintain adequate inventory of raw materials to ensure smooth running of its production processes as well as to meet immediate demand of its customers. The average inventory days during FY21 stood at 55 days. An elongated operating cycle increases reliance on bank borrowings to meet working capital requirements. Average utilization of working capital limits for the twelve-month period ended mid-June, 2022 was around 68% of the sanctioned limits.

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

The major raw materials for PPI are High Density Polyethylene (HDPE) granules of different grades, which are crude oil derivatives imported mainly from India. Crude oil being a global commodity, its price is volatile depending on the demand-supply situation in the international markets. This exposes the company to volatility in input prices and has a bearing on its profitability margins. Raw materials constituted around 90% of the total cost of production during FY21 (FY20: 82%), 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 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

PPI has an operational track record of around two decades in manufacturing of CPVC and PPR pipes. PPI 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 HDPE 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 three decades. This provides competitive advantage to the company against new players entering the industry. Furthermore, PPI 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 PPI over the medium term.

About the Company

Panchakanya Plastic Industries Private Limited (PPI) was established in 1982 for manufacturing HDPE pipes and fittings in Nepal. The manufacturing facilities are located in Bhairahawa, Nepal with installed capacity of 9,000 Metric Tons per annum, as on mid-July 2022.

Brief financials of PPI 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	1,242	1,290	1,348
PBILDT Margin (%)	7.27	11.34	4.99
Overall Gearing (times)	5.48	2.43	2.92
Interest Coverage (times)	1.10	2.61	1.78
Current Ratio (times)	0.87	1.03	1.05
Total Debt/Gross Cash Accruals (times)	90.50	6.30	20.96

Annexure 1: Details of the Facilities rated

Nature of the Facility	Type of the Facility	Amount rated (Rs. in Million)	Rating
Long Term Bank Facilities	Term Loan	14.63	CARE-NP BB
Short Term Bank Facilities	Fund Based Limit	790.75	CARE-NP A4
Short Term Bank Facilities	Non-Fund Based Limit	175.12	CARE-NP A4
Total		**980.75**	

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About CARE Ratings:

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