Panchakanya Rotomould Private Limited

Ratings

Facility	Amount (Rs. in Million)	Rating[1]	Rating Action
Short Term Bank Facilities	**861.00**	**CARE-NP A4 [A Four]**	**Reaffirmed**
Total Facilities	**861.00**		

Details of Facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has reaffirmed the rating of 'CARE-NP A4' assigned to the short-term bank facilities of Panchakanya Rotomould Private Limited (PRPL).

Detailed Rationale & Key Rating Drivers

The rating assigned to the bank facilities of PRPL remain constrained by the company's leveraged capital structure, working capital intensive nature of operations, exposure to raw material price volatility risk and foreign exchange fluctuation risk, exposure to volatile interest rates and presence in competitive nature of industry. The rating also factors in PRPL's declined gross margin in FY21 (Audited, refers to the twelve-month period ended mid-July 2021).

The rating, however, continues to derive strength from strong promoters and long track record of operations along with experienced management team in the related field, established brand with country wide market presence, and positive industry prospects. The rating also takes cognizance of the company's growth in revenue in FY21 with improved profitability and debt service coverage indicators.

Going forward, the ability of the company to profitably scale up its operations and manage 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 gross margin in FY21 and leveraged capital structure

During FY21, PRPL's PBILDT margin declined by 527 basis points (bps) to 10.14%, breaking a consistent growth trend seen in the previous three financial years (FY18-FY20). 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. Furthermore, PRPL had a leveraged capital structure marked by overall gearing ratio of 3.78x at the end of FY21, deteriorated from 3.62x at the end of FY20 (Audited, refers to the twelve-month period ended mid-July 2020) due to increased short term borrowings coupled with additional long term loan.

Working capital intensive nature of operations

The operations of PRPL are working capital intensive in nature marked by average operating cycle of 140 days during FY21. Being a highly competitive business, the company needs to extend credit period to its dealers. In addition, the company is required to maintain adequate inventory of raw materials to ensure smooth running of its production processes and finished goods inventory to meet immediate demand of its customers. This was reflected by average collection period of 104 days and average inventory period of 114 days while average credit period was 78 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 material for PRPL is Polyvinyl Chloride (PVC) resin powder, which are crude oil derivatives imported mainly from Thailand. 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 75% of PRPL's total cost of production during FY21, thus any volatility in prices of the same impacts the company's profitability. 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

PRPL has an operational track record of around two decades in manufacturing of Unplasticized Polyvinyl Chloride (UPVC) pipes and fittings. PRPL 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

PRPL sells UPVC 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, the company has established dealers/sub-dealers and depots across all major cities of Nepal, which provides wide reach to end customers for its products.

Increased scale of operations, and improved net profits amid lower interest outgo

PRPL's total operating income (TOI) increased by 88.61% year on year (yoy) to Rs. 861 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 higher sales. The company also registered increment in PAT margin by 384 bps due to decreased interest expenses amid lower interest rates during FY21, which also resulted in improved interest coverage ratio of 2.93x during FY21 (FY20: 1.11x). However, its sustainability will remain a challenge amid the upward pressure in interest rates going forward. With improved net profit, PRPL's total debt to GCA also improved to 9.88x in FY21 from 45.55x in FY20. The company's ability to achieve a steady profitability profile leading to improved debt service coverage indicators will remain critical from credit perspective.

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 PRPL over the medium term.

About the Company

Panchakanya Rotomould Private Limited (PRPL) was established in 1989 and is engaged in manufacturing UPVC pipes and fittings. PRPL's manufacturing facility is located in Bhairahawa, Nepal with installed capacity of 5,400 Metric Tons per annum. Brief financials of PRPL 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	535	456	861
PBILDT Margin (%)	12.94	15.41	10.14
Overall Gearing (times)	3.73	3.62	3.78
Interest Coverage (times)	1.08	1.11	2.93
Current Ratio (times)	0.86	0.89	1.11
Total Debt/Gross Cash Accruals (times)	58.67	45.55	9.88

Annexure 1: Details of the Facilities rated

Nature of the Facility	Type of the Facility	Amount (Rs. in Million)	Rating
Short Term Bank Facilities	Fund Based Limit	712.00	CARE-NP A4
Short Term Bank Facilities	Non-Fund Based Limit	149.00	CARE-NP A4
Total		**861.00**	

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