Shubhashree Agni Cement Udhyog Private Limited

Ratings

Facilities	Amount (Rs. in Million)	Ratings[1]	Rating Action
Long Term Bank Facilities	2,058.68 (decreased from 2,281.20)	**CARE-NP BB+ [Double B Plus]**	Reaffirmed
Short Term Bank Facilities-Fund Based Limits	1,950.00	**CARE-NP A4+ [A Four Plus]**	Reaffirmed
Short Term Bank Facilities- Non-Fund Based	710.00 (increased from 660.00)	**CARE-NP A4+ [A Four Plus]**	Reaffirmed
Total Facilities	**4,718.68**		

Details of instruments/facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has reaffirmed the ratings of 'CARE-NP BB+' assigned to the long term bank facilities and 'CARE-NP A4+' assigned to the short term bank facilities of Shubhashree Agni Cement Udhyog Private Limited (SSPL).

Detailed Rationale & Key Rating Drivers

The reaffirmation of the ratings assigned to the bank facilities of SSPL continue to remain constrained by its working capital intensive nature of operations and leveraged capital structure. The ratings also factor in foreign exchange fluctuation risk, raw material price volatility risk and presence in highly competitive and cyclical nature of cement industry and exposure to volatile interest rates.

The ratings, however, continue to derive strength from experienced promoters, locational advantage of manufacturing facilities and competitive advantage over the standalone grinding units. The ratings also factor in moderate debt service coverage indicators, accessibility to limestone mines and stable demand outlook of cement products in the country over the medium term. The ratings also take cognizance of rebound in financial performance over FY21 (Audited, refers to the twelve-month period ended mid-July 2021) marked by growth in revenue and net profitability, however, continuation of the same on a sustained basis remains to be seen, particularly in an increasingly challenging and competitive industry landscape.

Going forward, the ability of the company to continue to profitably scale up of its operations while efficiently managing the working capital cycle will be the key rating sensitivities. Any un-envisaged debt funded capital expenditure leading to deterioration in its capital structure and debt coverage indicators from current levels will also be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses Leveraged capital structure and moderate debt service coverage indicators

SSPL's capital structure stood leveraged with debt equity and overall gearing at 2.15x and 3.32x respectively at the end of FY21 (FY20: 2.17x and 3.36x respectively). The slight improvement in gearing ratio is on account of steady accretion of profits to the reserve which resulted in increased in net-worth base by higher proportion than increment in overall debts of the company. Similarly, debt service coverage indicators are also on improving trend amid high operating profitability during FY21. Interest coverage improved to 2.13x in FY21 from 1.65x during FY20 and total debt/GCA of the company improved to 13.15x during FY21, albeit still at high level from 17.60x in FY20.

Working capital intensive nature of operations

The operations of the company are working capital intensive in nature. SSPL is involved in manufacturing of cement and clinker by procuring raw materials both locally and importing. The company has to keep sufficient inventory for smooth operations of business and extend reasonable credit to their dealers amid increasing competition and the company receives

[1]*Complete definitions of the ratings assigned are available at www.careratingsnepal.com and in other CRNL publications*

credit period normally up to 2 months from its suppliers. Net Operating cycle of the company was high at 479 days for FY21 on account of high collection period and inventory levels. Also, being a manufacturer, the company is required to maintain adequate inventory of finished goods and clinker to meet the immediate demand of its customers. Furthermore, it is critical for the company to maintain minimum inventory levels of raw materials for smooth production process; all this led to high working capital requirements which was met through bank borrowings. Average utilization of fund based working capital limits were high around ~95% of SSPL's sanctioned limits for nine-month period ended mid-May, 2022.

Foreign exchange fluctuation risk and raw material price volatility risk

SSPL currently uses coal, limestone, gypsum, clay, iron ore, fly ash and gypsum as major raw materials. 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 India and its import procurement to cost of goods sold stood at around 66% 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 cyclical and competitive nature of cement industry

SPPL is operating in a highly competitive market, dominated by the large cement manufactures with wide brand acceptability. The cement industry is highly competitive having number of players and many established brands have enhanced the capacity in recent years. As of mid-July 2022, the operational cement and clinker manufacturing units were more than 50 and few are under implementation stage. All this has led to market highly competitive and put the price pressure on the manufacturers which is impacting the profitability margins also. 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.

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.

Key Rating Strengths

Experienced promoters in the related field

SSPL is promoted by single institutional promoter i.e. Agni Cement Industries Private Limited (APL) and a group of individual promoters involved in cement industry, hospital and education sectors. The company is managed under the overall guidance of the Company's Board of Directors (BoD) who possesses wide experience in the related field. Mr. Krishna Prasad Pokharel, Chairperson, has been involved in different business for 25 years and is also a chairperson in APL [CARE-

NP BB/A4]. Dr. Tara Prasad Pokharel, Managing Director, is also Managing Director of APL. APL, one of the promoters of SSPL holding operates cement grinding plant since twelve years.

Rebound in financial performance during FY21 marked by growth in revenue and net profitability

SSPL's total operating income (TOI) increased by 28% yoy to Rs. 2,467 Mn in FY21 mainly on account of increased sales of cements aided by start of self-consumption of clinker for its grinding unit. However, average price realization declined to Rs. 430 and Rs. 518 per bag of PPC and OPC during FY21 (FY20: PPC-Rs. 496 and OPC- Rs. 570 per bag) amid competitive pricing. With decrease in average price realization followed by increase in cost of raw materials, PBILDT margin declined to 29.30 % during FY21 as compared to 35.94% in FY20. However, PAT of the company increased by 3.27% during FY21 from 2.25% during FY20 aided mainly by reduced interest and depreciation outgo.

During 11MFY22, (Unaudited, refer to eleven-month period ended mid-June, 2022), sales have been a bit sluggish with the company booking revenues of Rs. 2,018 Mn. Although scope for increasing sales over the medium term augurs well for the company's growth prospects, sustained downward pressure on profitability is likely given the competitive industry landscape.

Competitive advantage over the standalone grinding units

SSPL possess two limestone mines in its name, for which it has obtained extraction license from Department of Mines and Geology. It is estimated that mine located at Pyuthan district has ~8.6 million tons and mine located at Dang district has ~4.3 million tons of limestone, which is sufficient to run 1200 MTPD grinding unit for 46 years. Having its own limestone mines provides competitive advantage to SSPL over other competitors in terms of pricing, transport cost, timely supply etc. Now Nepal is manufacturing its own clinker and dependence upon the imports of the clinker are reduced substantially over the period. Clinker manufacturing units will have added cost competitive advantage over the standalone grinding units. 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.

Stable demand outlook for 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. 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 SSPL.

Locational advantage of the project site and accessibility to limestone mines

The plant is located at mid-western part of Nepal. Ghorahi, Tulsipur, Kohalpur, Nepalgunj, Butwal, Bhairahawa etc. are the big cities nearby and are the major local market for the SSPL's product. SSPL imports coal from South Africa, Australia and India via Barhni border (60 kms from plant) and Sunauli border (90 kms from plant). The company is extracting limestone from two mines, which are within the territory of 70 kms from the plant site. There are numerous large and small grinding plant nearby to the manufacturing facilities of SSPL's which argues well for the company.

About the Company

Shubhashree Agni Cement Udhyog Private Limited (SSPL) is a private company and was established in 2013. SSPL is engaged in producing clinker by extracting limestone with installed capacity of 700 metric tons per day (MTPD) which came into operations in December 2017. SSPL has grinding unit of 1200 MTPD capacity which came into operation from July 2019.

Brief financials of SSPL for last three years for period ending FY21 are as under:

Financial Performance

(Rs. Million)

For the Period	FY19 (Audited)	FY20 (Audited)	FY21 (Audited)
Income from Operations	2,329	1,933	2,467
PBILDT Margin (%)	30.73	35.94	29.30
Overall Gearing (times)	2.62	3.36	3.33
Total Outstanding Liabilities/Tangible Net worth (times)	3.07	3.71	3.60
Interest Coverage (times)	2.81	1.65	2.13
Current Ratio (times)	1.11	1.16	1.41
Total Debt/Gross Cash Accruals (times)	8.80	17.60	13.15

Annexure 1: Details of the Facilities Rated

Name of the Bank Facilities	Type of the Facility	Amount (Rs. In Million)	Ratings
Long Term Bank Facilities	Term Loan	2,058.68	CARE-NP BB+ [Double B Plus]
Short Term Bank Facilities	Fund Based Limits	1,950.00	CARE-NP A4+ [A Four Plus]
Short Term Bank Facilities	Non Fund Based Limits	710.00	CARE-NP A4+ [A Four Plus]
Total		**4,718.68**	

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About CARE Ratings:
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