Ghorahi Cement Industry Limited (Revised)

Ratings

Facilities	Amount (Rs. Million)	Rating[1]	Rating Action
Issuer Rating	NA	CARE-NP BBB- (Is)* [Triple B Minus (Issuer)]	**Assigned**
Long Term Bank Facilities	8,082.44 (Decreased from 8,272.69)	CARE-NP BBB- [Triple B Minus]	**Reaffirmed**
Short Term Bank Facilities- Fund based and non-fund based	4,796.45 (Increased from 3,876.45)	CARE-NP A3 [A Three]	**Reaffirmed**
Total	**12,878.89**		

**The issuer rating is subjected to the company maintaining overall gearing not exceeding 1.8x at the end of FY22.*

Annexure-1 Details of Facilities/Instruments to be rated

CARE Ratings Nepal Limited (CRNL) has assigned rating of `CARE-NP BBB- (Is)' to Ghorahi Cement Industry Limited (GCIL). Issuers with this rating are considered to offer moderate degree of safety regarding timely servicing of financial obligations, in Nepal. Such issuers carry moderate credit risk.

Also, CRNL has reaffirmed rating of 'CARE-NP BBB-' assigned to the long term bank facilities and 'CARE-NP A3' assigned to the short term bank facilities of GCIL.

Detailed Rationale & Key Rating Drivers

The ratings assigned to GCIL continue to derive strength from its experienced promoters and directors, mainly from the Triveni Group and Vishal group, experience of promoters in the cement industry and established brand presence & market position. The ratings also factor in competitive advantage over standalone grinding units, locational advantage of the manufacturing facilities and stable demand outlook of cement products in the country over the medium term. Additionally, the rating also took cognizance of rebound in operational performance in FY21 marked by growth in revenue and improving profitability and moderately leveraged capital structure with adequate debt service coverage indicators.

The ratings are however, constrained by project stabilization risk associated with debt-funded expansion, working capital intensive nature of operations, foreign exchange fluctuation risk and exposure to fluctuations in raw material price volatility. The ratings also factor in its presence of the company in highly competitive and cyclical nature of cement industry and exposure to volatile interest rates.

Going forward, stabilization of the expansion project with capacity utilization levels thereafter to generate sufficient cash-flows as envisaged will be the key rating sensitivity. The ability of the company to profitably scale up its operations coupled with its ability to rationalize its debt levels and improve the capital structure would also be key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Strengths

Experience of promoters in manufacturing industries including cement; synergies being part of Triveni Group and Vishal Group

GCIL has an operational track record of more than 9 years in cement manufacturing and is promoted by two leading business groups of Nepal being Sanghai family brothers (Triveni Group) and Vishal group. Both the groups are involved in diversified business of banking, insurance, manufacturing, trading and other businesses. Sanghai family has around 2 decades of experience in cement manufacturing and currently has been operating standalone grinding units. Vishal Group also has a considerable

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

presence in the financial sector of Nepal and is the promoter of banks. Also, Vishal group has strong presence in import and trading of fast-moving consumer goods in Nepal with established distribution network. The company has five directors on its board and is chaired by Mr. Purshottam Lal Sanghai. The Chairman is supported by a team of qualified professionals in all the departments with wide experience in cement industry.

Moderately leveraged capital structure with adequate debt service coverage indicators

Debt-equity ratio and overall gearing ratio of the company stood moderate at 1.17x and 1.54x, respectively at FY21 end, increasing slightly from 0.70x and 1.17x at FY20 end amid increased debt levels to fund capacity expansion. Furthermore, debt service coverage indicators were on improving trend in FY21 backed by increased profitability. Interest coverage ratios improved from 3.20x in FY20 to 4.73x in FY21 while Total debt to Gross Cash Accruals (GCA) improved to 15.20x, albeit still at high levels. Although gearing levels are likely to moderate in FY22 amid the operational challenges faced by the company in FY22, it is likely to improve sequentially over the medium term with likely infusion of equity coupled with steady accretion of profits and moderation in dent levels as majority of the capex has already been completed in FY22.

Rebound in operational performance in FY21 marked by growth in revenue and improving profitability; sluggish performance in 9MFY22 amid issues in logistic procurement

GCIL's total operating income of GCIL increased by 7.35% year on year to Rs. 6,090 Mn in FY21 aided by increased scale of operations mainly from cement segment, albeit with lower price realization amid increasing competition with new players entering the market and with existing players also enhancing their manufacturing capacities in recent years. Similarly, PBILDT margin of the company also improved by 505 bps to 15.35% in FY21 boosted by various cost rationalization steps taken by the company primarily in the form of lower repair and maintenance expenses. Consequently, absolute PBILDT increased by 60.09% to Rs. 935 Mn and PAT of the company increased to Rs. 381 Mn in FY21. GCIL generated Gross Cash Accruals of Rs. 718 Mn in FY21. However, during 9MFY22, GCIL reported sales revenue of only Rs. 3,726 Mn as production was impacted by issues in logistic procurement amid some disagreement with the locals during the year. This has since been resolved and operational performance is likely to improve going forward amid uninterrupted production.

Competitive advantage over standalone grinding units

The company has a captive limestone mine on 30 years lease which is situated in Tapa, Dang District, Nepal. The limestone mine has sufficient proven reserve to support the operations for about next 20 years. Also, GICL has entered another lease agreement for a limestone mine, which is situated in Simpani, at Triveni Distrct which has mining capacity of of 1,200 MTPD. The limestone mine at Triveni is a high grade limestone which is used as sweetener to enhance concrete performance and helps to overall consumption of limestone. Besides above two, group has additional two licensed limestone mines. Having its own limestone mines provides competitive advantage to GCIL over other competitors in terms of pricing, transport cost, timely supply etc. Furthermore, the mines are located close to the clinker and grinding unit which reduces logistics cost. 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.

Established brand presence, 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.

GCIL sells its product under the brand name "Sagarmatha" all over Nepal with primary focus towards western and far western part of the country. GCIL sells its product in the market through its 21 distributors all over Nepal. The company's established brand presence has supported the company to reduce the impact of competition induced volatility in prices over the years.

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 GCIL.

Favorable Industry Outlook

Government of Nepal has announced cash-incentive to support exports with cement being one of the qualifier. GCIL being only 3 hours away from the India border has locational advantage to exploit the export opportunities to India. Furthermore, as per budget FY23, industries consuming electricity worth more than Rs. 100 Million annually will get a rebate up to 15% on their electricity bill and with company completing its expansion, consumption of electricity expected to be above the provided threshold going forward and hence likely to benefit from this new provision.

Key Rating Weakness

Project stabilization associated with debt-funded expansion

The company has completed a brownfield expansion project which is adjacent to its existing plant to increase its clinker manufacturing capacity by 3,000 MTPD and grinding capacity by 1,400 MTPD. Trail production already started in February, 2021 but commercial production couldn't start due to issue in logistic procurement. As a result project cost has increased to Rs. 10,402.36 Mn from Rs. 8,665.38 Mn due to continued capitalization of interest expenses and other finishing expenses incurred. Expected Commercial operation date from the July-end, 2022. Being large sized capex, company remains susceptible to risk related to stabilization and streamlining of production process from the enhanced capacity. Furthermore, post project implementation risk, in the form of achieving the envisaged scale of business and also scalability risk associated with the products in the light of competitive nature of industry remains crucial for credit prospective.

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). GCIL 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 203 days in FY21(audited, refers to the twelve-month period ended mid-july 2021) on account of high inventory holding as company is required to maintain adequate inventory of raw material for smooth running of its production processes. 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 requirements which was met through bank borrowings.

Foreign exchange fluctuation risk and raw material price volatility risk

GCIL currently uses coal, limestone, gypsum, clay, iron ore, fly ash and gypsum as major raw materials. Coal constituted around 51% 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 60-70% for last two financial years (FY20-21). 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 which is offset to some extent as company has equipped one of its line to use Indian Coal as thermal energy, which will help reduce the dollar imports by around 80%. 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

GCIL 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.

About the Company

Ghorahi Cement Industry Private Limited (GCIPL) was incorporated in August 6, 2007 and its integrated cement manufacturing plant situated in Dang valley of Western Nepal. The company was converted into public limited company in March 2021 and the name has been changed to Ghorahi Cement Industry Limited (GCIL). GCIL is presently engaged in manufacturing and selling cement with clinker capacity of 1,900 MTPD and grinding capacity of 2,200 and has completed brownfield expansion enhancing clinker capacity of 3,000 MTPD and grinding capacity of 1,400 MTPD. Brief financials of GCIL for last three years ending FY21 are given below:

(Rs. in Million)

Particulars	FY19	FY20	FY21
	Audited	Audited	Audited
Income from Operations	8,875	5,674	6,090
PBILDT Margin	22.09	10.29	15.35
Overall Gearing (times)	0.75	1.17	1.54
Interest coverage (times)	5.23	3.20	4.73
Current ratio (times)	0.87	0.59	0.87
Total Debt/GCA	3.26	18.81	15.20

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	8,082.44	CARE-NP BBB-
Short Term Bank Facilities	Working Capital Loans	2,283.49	CARE-NP A3
Short Term Bank Facilities	Non–Fund Based Loans	2,512.96	CARE-NP A3
Total		**12,878.89**	

Contact us

Analyst Contact
Mr. Santosh Pudasaini
Contact no: +977-01-4012629
Email: santosh.pudasaini@careratingsnepal.com

Relationship Contact
Mr. Achin Nirwani
Contact No.: +977 9818832909
Email: achin.nirwani@careratingsnepal.com

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Disclosure: Shareholders of Ghorahi Cement Industry Limited are also amongst the shareholders of CARE Ratings Nepal Limited (CRNL). None of the shareholders of CRNL (Including shareholders of Ghorahi Cement Industry Limited) are part of CRNL's rating committee and they do not participate in the rating process. And hence, they didn't have any role in the assignment of credit rating of Ghorahi Cement Industry Limited by CRNL.