Shubhashree Agni Cement Udhyog Limited (Revised)

Ratings

Facilities/ Instrument	Amount (Rs. in Million)	Ratings[1]	Rating Action
Long Term Bank Facilities	1,936.72 (Decreased from 2,058.68)	CARE-NP BB+ [Double B Plus]	Reaffirmed
Short Term Bank Facilities	2,660.00	CARE-NP A4+ [A Four Plus]	Reaffirmed
Total Facilities	4,596.72 (Four Thousand Five Hundred Ninety Six Million and Seven Hundred Twenty Thousand Only)		

** Details of 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 Limited (SSL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of SSL continues to remain constrained by its leveraged capital structure with moderate debt service coverage indicators and working capital intensive nature of operations leading to elongated operating cycle. The ratings also factor in raw material price volatility risk, foreign exchange fluctuation 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 in the related field, locational advantage of project site and accessibility to limestone mines and competitive advantage over the standalone grinding units. The ratings also factor in stable demand outlook for cement over the long term, which however remains muted over the near term. The ratings also take cognizance of improving trend in SSL's Total Operating Income (TOI) in 9MFY23 (Unaudited; refers to nine months period ended mid-April) albeit moderation in profitability margin amid challenging operating environment for cement manufacturers in Nepal amid low demand prospects coupled with increased competition.

Going forward, the ability of the company to profitably increase its scale of operations along with rationalization of its debt through efficient working capital management would be the key rating sensitivities. Also, prolonged unfavorable change in operating environment leading to a margin pressure to the company and adversely impacting its coverage indicators will also be a key rating sensitivity.

Detailed description of the key rating drivers

Key Rating Weaknesses

Leveraged capital structure with moderate debt service coverage indicators

Capital structure of the company stood leveraged with overall gearing ratio at 3.37x at the end of FY22 (Audited; FY refers to the twelve-month period ending mid-July), slight deterioration from 3.33x at the end of FY21 on account of increase in working capital utilization. However, debt equity ratio of SSL improved to 1.92x at the end of FY22 from 2.02x at the end of FY21. Furthermore, interest coverage stood moderate at 1.69x in FY22 which deteriorated from 2.13x in FY21 on account of decrease in PBILDT of the company amid increased input prices. The total debt to Gross Cash Accruals (GCA) of the company

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

stood high at 22.15x during FY22 deteriorated from 13.15x during FY21 on account of decline in the GCA. A limited gearing headroom limits the financial flexibility of the company and could constraint the company from raising additional debt, when required, in future.

Working capital intensive nature of business leading to elongated operating cycle

The operations of the company are working capital intensive in nature. SSL 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. Average collection period was high at 144 days in FY22 (FY21: 109 days) on account of easing of credit policy by the company to its customers amid ongoing liquidity crisis. 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. Before start of monsoon season the company has to bulk up raw material inventory as the accessibility to the plant is impacted by rain pour which leads to high inventory at the end of the year. Consequently, inventory holding period of SSL was high at 528 days in FY22 which increased from 422 days in FY21. This led to a highly elongated operating cycle of 622 days in FY22 which increased from 479 days in FY21. This led to high reliance of the company on the external borrowings for working capital requirements. The high working capital requirements were met largely through bank borrowings which normally results in average utilization of over 90% of its sanctioned working capital limits.

Raw material price volatility risk and foreign exchange fluctuation risk

SSL 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 69% for FY22 (FY21: 66%). 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

SSL is operating in a highly competitive market, dominated by large cement manufacturers with wide brand acceptability. The demand for cement is considered cyclical as it depends upon the capital expenditure plan of major players in the end-user industry. Furthermore, with increase in the capacities of the existing plants and new capacities coming into operations in Nepal, competition has intensified that has resulted into substantial decline in profitability margins of the industry players during the last few years.

Exposure to volatile interest rate risk

Sustained requirement for short-term working capital borrowings has led to a high interest expense for SSL (Rs. 336 Mn during FY22) leading to direct impact in the company's net profitability. SSL's interest expenses are based on 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. Thus, funding taken by the company is exposed to volatile interest rate.

Key Rating Strengths

Experienced promoters in the related field

SSL is promoted by single institutional promoter i.e. Agni Cement Industries Limited (ACIL) (CARE-NP BB-/A4) 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 more than 25 years and is also a chairperson in ACIL. Dr. Tara Prasad Pokharel, Managing Director, has been involved in the related business for more than a decade. He is also Managing Director of ACIL. The board is aptly supported by an experienced management team across various functions.

Improving operating income levels so far in FY23, albeit slight moderation in profitability margin likely amid lower price realizations

The total operating income has rebounded so far in FY23 after sluggish FY22 where demand for cement remained lower amid decline in construction activities. Till 9MFY23 the company's TOI grew 3% year-on-year to Rs. 1,935 Mn (9MFY22: Rs. 1,875 Mn), of which Rs. 1,328 Mn was from the sales of cement and Rs. 607 Mn was from the sales of clinker. Capacity utilization of clinker stood at decent at around 79%, whereas for grinding capacity it stood a bit moderate at around 43% during 9MFY22. Despite y-o-y growth in sales, average price realization has been on a declining trend. Consequently, profitability is expected to decline in FY23 amid industry-wide slowdown leading to margin pressure to the company to sustain in the competitive market.

Competitive advantage over the standalone grinding units

SSL 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 SSL 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.

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 SSL's product. SSL purchased coal either locally or imports from 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 SSL's which augurs well for the company.

Industry Outlook

With the construction sector in Nepal currently impacted by slower pace of economic growth coupled with relatively lower infrastructure spending by the government, the near-term outlook of cement industry in Nepal is challenging. Furthermore, the increased industry capacity over the last couple of years means that the industry capacity utilizations are likely to remain below par over the near-term. However, in the recent budget presented by finance minister of Nepal for FY24, Government of Nepal allocated Rs. 132 Bn in the infrastructure sector. Notwithstanding the recent slowdown, Nepalese economy is developing and growing, and is in phase of investment in infrastructure sectors, power sector and tourism sector. Sustained demand for cement is likely given the need of construction materials in developing public as well as private infrastructures, road, bridges and other public facilities. Thus, the government's long-term emphasis on infrastructure development, particularly for development of roads, hydropower, airports and other infrastructures is likely to benefit the cement manufacturers like SSL in the long term, although the demand outlook for cement is expected to be muted in the short term.

About the Company

Shubhashree Agni Cement Udhyog Limited (SSL) is a public limited company, incorporated on March 04, 2013 as private company and converted into public limited company on July 15, 2022. SSL 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. SSL has grinding unit of 1200 MTPD capacity which came into operation from July 2019.

Financial Performance

(Rs. In Million)

Particulars	FY20 (A)	FY21 (A)	FY22 (A)
Income from Operations	1,933	2,467	2,165
PBILDT Margin (%)	35.94	29.30	26.26
Overall Gearing (times)	3.36	3.33	3.37
Interest coverage (times)	1.65	2.13	1.69
Current Ratio (times)	1.21	1.41	1.36
Total Debt/Gross Cash Accruals (times)	17.60	13.15	22.15

A: Audited

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	1,936.72	CARE-NP BB+ [Double B Plus]
Short Term Bank Facilities	Working Capital Limit	1,950.00	CARE-NP A4+ [A Four Plus]
Short Term Bank Facilities	Non-fund Based Limit	710.00	CARE-NP A4+ [A Four Plus]
Total		**4,596.72**	

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About CARE Ratings:

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