

Panchakanya Plast Private Limited

Ratings

Facility	Amount (Rs. in Million)	Rating ¹	Rating Action
Long Term Bank Facilities	90.52 (Increased from 79.81)	CARE-NP BB [Double B]	Reaffirmed
Short Term Bank Facilities	1,154.50 (Increased from 860.19)	CARE-NP A4 [A Four]	Reaffirmed
Total Facilities	1,245.02 (One Thousand Two Hundred Forty-Five Million and Twenty Thousand Only)		

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 Plast Private Limited (PPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of PPL remain constrained by the company's leveraged capital structure with modest debt service coverage indicators, elongated operating cycle marked by substantially high inventory levels, exposure to raw material price volatility risk and foreign exchange fluctuation risk, exposure to volatile interest rate risk and foreign exchange fluctuation risk, and the company's presence in highly competitive industry.

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. The ratings also take cognizance of improving trend in operating performance of the company in FY22 (Audited, FY refers to the twelve-month period ending mid-July).

Going forward, the ability of the company to profitably scale up its operations, managing the working capital requirements to support growth while limiting its borrowings will be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Leveraged capital structure with modest debt service coverage indicators

PPL continues to have a leveraged capital structure marked by overall gearing ratio of 3.16x at the end of FY22, albeit slightly improved from 3.30x at the end of FY21 aided by increased networth owing to accretion of profits to reserve. Total debt of the company increased slightly to Rs. 778 Mn at the end of FY22 (FY21: Rs. 729 Mn) amid, which was however offset by increase in tangible net worth of the company to Rs. 247 Mn from Rs. 221 Mn previous fiscal. Scale of operations and profitability of the company remain relatively modest corresponding to the debt levels resulting in moderate coverage indicators. Interest coverage ratio of the company stood at 1.50x in FY22, deteriorated slightly from 1.56x in FY21 on account of higher interest expenses despite year-on-year (y-o-y) improvement in PBILDT. Total debt/ GCA also stood high at 25.82x in FY22, albeit improved from 33.68x in FY21 on account of increase in cash accruals during the year. The company's ability to rationalize debt levels in commensurate to its scale of operations leading to improved coverage indicators will remain critical from credit perspective. As per combined financials, overall gearing ratio stood high at 3.43x at the end of FY22 which slightly deteriorated from 3.12x at the end of FY21.

Working capital intensive nature of operations marked by substantially high inventory levels

The operations of PPL are highly working capital intensive marked by a high operating cycle of 384 days in FY21. The company needs to maintain adequate inventory for smooth running of its manufacturing operations as its raw materials are imported from Thailand and Singapore. The company also needs to hold adequate inventory of finished goods in order to meet the immediate demand of its customers, owing to its large product portfolio of different shapes and sizes. This was reflected by high inventory levels with average inventory holding period of 377 days for FY22. Furthermore, being in a competitive industry, the company needs to extend credit to its dealers for up to three months. The average collection period stood around 52 days during FY22, where the average creditor period was 45 days. An elongated operating cycle increases reliance on bank borrowings to meet working capital requirements. The average fund based working capital utilization was around 60% of the sanctioned limits for the last twelve-month period ended mid-June, 2023.

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

PPL is exposed to the raw material price volatility risk due to the volatility experienced in the prices of its raw materials. Raw materials used are CPVC resin powder and PPR granules, which are crude oil derivatives. Crude oil being a product of international importance, its price is volatile depending on the demand-supply situation in the global markets. This exposes the company to volatility in input prices and has a bearing on its profitability margins. Raw materials constituted more than around 55%, 66% and 62% of the total cost of production during FY20, FY21 and FY22 respectively. 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

Sustained requirement for short-term working capital borrowings results in a high interest expense for PSPL. The company's interest rates are based on a floating interest rate regime, where a certain premium is added to quarterly base rate and interest rate is changed accordingly on quarterly basis. Base rate 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. Sustained high interest rates, as seen over the last year or so, add to the interest burden of the company, squeezing its profitability and impacting its liquidity position.

Presence in highly fragmented and 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**

PPL has an operational track record of around two decades in manufacturing of CPVC and PPR pipes. PPL 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 CPVC and PPR 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 two decades. This provides competitive advantage to the company against new players entering the industry. Furthermore, PPL has established dealers/sub-dealers and depots across all major cities of Nepal, which provides wide reach to end customers for its products.

Improving trend in operating performance in FY22

During FY22, PPL's total operating income (TOI) increased by 4.64% y-o-y to Rs. 936 Mn on account of improved price realizations. PBILDT margin of PPL also improved to 9.95% in FY22 from 8.51% in FY21, albeit still lower compared to historical range of around 13% (FY18-FY20). Margins over the last couple of years have remained suppressed due to pricing pressure amid increased competition. The company's ability to grow its scale of operations while maintaining a steady margin profile for a sustained period will hinge on how well it can thwart the increasing competition. An established brand presence is likely to benefit PPL on this front over the medium term. As per combined financials, TOI increased by 17% y-o-y to Rs. 10,109 Mn with PBILDT margin of 5.78% during FY22 (FY21: 5.21%).

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 manufacturing 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 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 construction material manufacturers like PPL in the long term, although the demand outlook is expected to be muted in the short term.

About the Company

Panchakanya Plast Private Limited (PPL) was established in 2003 and is engaged in manufacturing Polypropylene Random Copolymer (PPR) and Chlorinated Polyvinyl Chloride (CPVC) pipes and fittings in Nepal. PPL's manufacturing facilities are located in Bhairahawa, Nepal with installed capacity of 5,000 metric tons per annum, as on mid-July 2022.

Rating Approach:

CRNL has taken a combined view of Panchakanya Plast Private Limited, Panchakanya Plastic Industries Private Limited, Panchakanya Rotomould Private Limited, and Panchakanya Steel Private Limited in order to arrive at the ratings.

Brief combined financials of the above-mentioned companies for the past three years ended FY22 are given below:

(Rs. Million)

For the year ended Mid-July	FY20	FY21	FY22
	(Audited)	(Audited)	(Audited)
Income from Operations	5,847	8,635	10,109
PBILDT Margin (%)	9.90	5.21	5.78
Overall Gearing (times)	4.05	3.12	3.43
Interest Coverage (times)	1.37	1.62	1.43
Total Debt/Gross Cash Accruals (times)	31.26	24.98	29.23

Brief standalone financials of PPL for the past three years ended FY22 are given below:

(Rs. Million)

For the year ended Mid-July	FY20	FY21	FY22
	(Audited)	(Audited)	(Audited)
Income from Operations	835	895	936
PBILDT Margin (%)	12.93	8.51	9.95
Overall Gearing (times)	3.17	3.30	3.16
Interest Coverage (times)	1.31	1.56	1.50
Current Ratio (times)	1.08	1.20	1.17
Total Debt/Gross Cash Accruals (times)	37.15	33.68	25.82

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	90.52	CARE-NP BB
Short Term Bank Facilities	Fund Based Limit	397.50	CARE-NP A4
Short Term Bank Facilities	Non-Fund Based Limit	757.00	CARE-NP A4
Total		1,254.02	

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About CARE Ratings:

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