Saptakoshi Cement Private Limited

Ratings

Facilities	Amount (Rs. in Million)	Ratings[1]	Rating Action
Long Term Bank Facilities	209.43 (Decreased from 330.49)	CARE-NP BB [Double B]	Reaffirmed and removed from Issuer not Cooperating Category
Short Term Bank Facilities	910.57 (Increased from 790.00)	CARE-NP A4 [A Four]	Reaffirmed and removed from Issuer not Cooperating Category
Total Facilities	1,120.00 (One Billion One Hundred Twenty Million Only)		

Details of instruments/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 'CARE-NP A4' assigned to the short term bank facilities of Saptakoshi Cement Private Limited (SCPL) and subsequently removed the ratings from Issuer Not Cooperating category as the company has submitted the requisite information to CRNL.

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of SCPL continues to be constrained by modest financial risk profile of the company marked by fluctuating scale of operations, suppressed profitability and modest debt service coverage indicators in FY23 (Unaudited, FY refers to the twelve-month period ending mid-July). Margin pressure remain particularly vulnerable amid lack of backward integration and raw material price volatility risk with presence only in clinker grinding. The ratings also factor in working capital intensive nature of operations, SCPL's presence in a highly fragmented and competitive industry and cyclical nature of the cement industry.

The ratings, however, derive strength from SCPL's established track record of operations and resourceful promoters with experience in cement industry, stable demand outlook for cement products over the medium-term notwithstanding near-term macroeconomic headwinds, locational advantage of the plant site and established brand presence and strong market position in the eastern region of the country.

Going forward, the ability of the company to increase the scale of operations while improving the profit margins and rationalization of its debt through efficient working capital management leading to improved debt coverage indicators would be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Declining profitability over FY22-FY23 leading to suppressed coverage indicators

During FY23, although total operating income increased by 31.23% year-on-year (y-o-y) to Rs. 2,350 Mn, PBILDT margin fell sharply to 4.08% (FY22: 6.68%). PBILDT margin has been on a declining trend over FY21-FY23 owing to sluggish demand coupled with intense competition leading to lower price realizations. Profitability in the cement industry, particularly for those with only grinding units, have been on the lower side in FY23 as companies were not able to adequately pass on the hike in input prices to customers. This coupled with higher interest outgo led the company reporting net losses of Rs. 49 Mn during FY23 from profit of Rs. 4 Mn during FY22. Consequently, debt service coverage indicators of the company have also been deteriorating over FY22-FY23. Interest coverage ratio of the company declined to 1.23x during FY23 from 1.83x during FY22 on account of high interest expense and decline in PBILDT. Similarly, total debt to

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

Gross Cash accruals (GCA) ratio also elevated sharply to 27.25x during FY23 from 8.22x during FY22 on account of lower cash accruals. Continued pricing pressure from established market players/new entrants is likely to suppress profitability margins, particularly if demand remains muted over the near-term. The company's ability to achieve scale and profitability as envisaged will remain critical for its business prospects and will remain key monitorable from analytical perspective.

Working capital intensive nature of operations

The operations of the company are working capital intensive in nature. SCPL is involved in manufacturing cement by procuring raw materials both locally and by importing. The company has to maintain inventory for smooth operations and extend credit to its dealers, which lead to reliance on working capital limits. The company generally allows two months credit period for cement sale to its customers and maintain inventory for around one month. The operating cycle of the company remained stable around 52 days during FY23. As operations of the company is likely to improve over the medium term, working capital limits utilization is also expected to commensurately increase, leading to higher dependence on bank borrowings.

Lack of backward integration and raw material price volatility risk

SCPL is engaged in producing cement through its grinding unit and does not possess its own clinker unit. Hence, it needs to procure clinker from other cement manufacturers. Clinker used for cement production is majorly procured locally. Raw material cost continues to be the major cost component of SCPL as cost of goods sold constituted around 83% of the total sales in FY23. Hence, any adverse movement in raw material price without any corresponding movement in finished goods price is expected to affect the profitability of the company. The ability of the company to pass through of changes in raw material prices to the customers will remain critical in terms of maintaining adequate profit margins. However, increasing competition has led to a very competitive pricing dynamics in the industry and the ability of the company to protect its market share while maintaining a reasonable profitability margin will be key rating sensitivity.

Presence in a highly fragmented and competitive industry with cyclical nature

SCPL is operating in a highly competitive market, dominated by the large cement manufacturers with wide brand acceptability. Given the increased competition, the players in the industry do not have pricing power and are exposed to competition-induced pressures on profitability. The demand of cement industry 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 operation, competition has intensified which has resulted into substantial decline in profitability margins of the industry players in the recent years.

Key Rating Strengths

Established track record of operations and resourceful promoters with experience in cement industry

SCPL has an operational track record of more than 22 years in cement manufacturing through its erstwhile company National Cement Private Limited with grinding capacity of 100 TPD. SCPL has been in operations with capacity of 600 TPD for about three years. SCPL is promoted by individuals from HR Goel Group of Nepal which has presence in diversified businesses including cement manufacturing, construction, chemical business, hydropower projects, petroleum, insurance and trading. The group has more than 24 years of experience in Nepalese cement industry. Mr Ashish Goel, Chairman, has an overall experience of 12 years in cement industry. The company is supported by a team of qualified professionals with wide experience in cement industry.

Improved capital structure in FY23 aided by infusion from promoters

The capital structure of the company remained moderately leveraged at the end of FY23 with SCPL's debt equity ratio and overall gearing ratio improving to 0.41x and 0.98x, respectively, from 0.72x and 1.41x at the end of FY22. The improvement was mainly on account of additional infusion of subordinated unsecured loans (treated as part of tangible net worth) from promoters amounting to Rs. 136 Mn during FY23. Although capital structure remains supported by sustained infusion from promoters over the past, debt levels remain relatively higher vis-à-vis scale, particularly as margins remain on the lower side, which continue to remain a key rating constraint.

Established brand presence and reasonable market presence in eastern region

SCPL sells its product all over Nepal with primary focus towards eastern part of the country. The company's target area are Mechi-Koshi-Sagarmatha-Janakpur zones. SCPL has established network of dealers ranging from 30 to 40 at each targeted zone. Furthermore, each zone has a regional sales head to further penetrate the market. SCPL sells its cement directly as well as through dealers. Company's established brand presence and relatively strong market position in the region has supported above average sales over the years as compared to other grinding units in the area.

Stable long-term demand outlook of cement industry in the country, however muted over the short-term

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. Hence, demand of cement in the country is expected to grow over the long term. However, with the construction sector in Nepal currently impacted by slower pace of economic growth coupled with relatively lower infrastructure spending by the government, the outlook of cement industry in Nepal remains challenging over the near term. The government's long-term emphasis on infrastructure development, namely development of roads, hydropower, airports and other infrastructures is likely to benefit cement manufacturers like SCPL in the long term.

About the Company

Saptakoshi Cement Private Limited (SCPL) is a private limited company which was incorporated on April 22, 1996. The name of the company was changed from National Cement Private Limited to Saptakoshi Cement Private Limited three years ago. SCPL is a closed-circuit grinding plant located in Kathari-4, Biratnagar, Morang, Nepal with an installed capacity of 600 TPD for OPC Cement. The plant has two units- Unit-1 of 100 TPD and Unit-2 of 500 TPD which commenced commercial operation from December 2018 onwards. Brief financials of SCPL during last 3 years is given below:

Financial Performance

(Rs. Million)

For the year ended mid-July	FY21 (A)	FY22 (A)	FY223 (UA)
Income from Operations	2,018	1,791	2,350
PBILDT Margin (%)	7.79	6.68	4.08
Overall Gearing (times)	1.10	1.41	0.98
Total Outstanding Liabilities/Tangible Net worth (times)	1.33	1.79	1.18
Interest Coverage (times)	2.88	1.83	1.23
Current Ratio (times)	1.92	1.20	1.34
Total Debt/Gross Cash Accruals (times)	4.88	8.22	27.25

A: Audited, UA: Unaudited

Annexure 1: Details of the Facilities Rated

Nature of the Facility	Type of the facility	Amount (Rs. In Million)	Ratings
Long Term Bank Facilities	Term Loan	209.43	CARE-NP BB
Short Term Bank Facilities	Fund/Non–Fund Based Limits	910.57	CARE-NP A4
Total		1,120.00	

Contact Us

Analyst Contact
Ms. Poonam Agarwal
+977-01-4012630
poonamagarwal@careratingsnepal.com

Mr. Santosh Pudasaini
+977-01-4012628
pudasaini.santosh@careratingsnepal.com

Relationship Contact
Mr. Achin Nirwani
+977-9818832909
achin.nirwani@careratingsnepal.com

About CARE Ratings Nepal Limited:

CARE Ratings Nepal Limited (CRNL) is licensed by the Securities Board of Nepal w.e.f. November 16, 2017. CRNL is supported by CARE Ratings Limited through a technical services agreement to provide technical support in the areas such as rating systems and procedures, methodologies, etc. from CARE Ratings on an ongoing basis. The technical support shall ensure that CRNL has adequate resources to provide high quality credit opinions in Nepal.

Our parent company, CARE Ratings Limited commenced operations in April 1993 and over two decades, it has established itself as one of the leading credit rating agencies in India. CARE is registered with the Securities and Exchange Board of India (SEBI) and also recognized as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI).