Jagdamba Cement Industries Private Limited: [ICRANP] A4+ (Assigned)

July 11, 2019

Summary of rated instruments

Instrument*	Rated Amount (NPR Million)	Rating Action
Short-term loans; fund-based	1,345	[ICRANP] A4+ (Assigned)
Short-term loans; non fund-based	20	[ICRANP] A4+ (Assigned)
Total	**1,365**	

** Instrument details are provided in Annexure-1*

Rating action

ICRA Nepal has assigned the short-term rating of [ICRANP] A4+ (pronounced ICRA NP A four plus) to the short-term loans of Jagdamba Cement Industries Private Limited (JCIPL or the company).

Rationale

The rating assignment factors in the company's long track record of operations (since 2001), its established sales channel and healthy brand recognition for its "Jagdamba" brand, leading to healthy capacity utilisation (>90%) over the years. The rating also considers JCIPL being promoted by individuals from two major business houses of Nepal, i.e., the Saurabh Group and the Shankar Group, which have enjoyed a long presence in the cement manufacturing and steel industries, among others. The experienced background of the directors and management remains a positive for the company. The demand for cement over the medium term is expected to remain healthy, given the large proposed/under-construction infrastructure projects and increasing household construction. ICRA Nepal also notes the low-cost clinker availability within the country in recent periods, which has aided improvement in operating margins in 9M FY2019 (10.2% against 6.7% for FY2018), despite the sales decline by ~20% during the period. The improved margins have helped JCIPL maintain comfortable interest coverage indicators at 3.3x for 9M FY2019, despite increased working capital debt.

The rating is, however, constrained by the sharp spike in working capital intensity (NWC/OI)[1], which increased to ~31% in 9M FY2019 over ~20% in FY2018. This was on account of elongated debtor days in recent periods (127 days in mid-April 2019) leading to a stretched working capital cycle necessitating higher working capital debt. Hence, the capital structure has deteriorated with gearing of 2.5x as of mid-April 2019 (1.7x as of mid-July 2016). With generally high dividend pay-outs, debt coverage (net cash accrual to total debt) also remains low at ~5% for 9M FY2019 (-3% for FY2018). JCIPL also has low financial flexibility, given the already high working capital borrowings (~92% as of mid-April 2019) as against the drawing power and hence remains a rating concern. Since JCIPL is already operating at optimum capacity, sales growth could also stagnate, going forward. The rating is further constrained by the intense competitive pressures in the industry with many established players/ brands as well as large upcoming mine-based units in the field. The company's margins are also exposed to clinker price dynamics, cyclicality inherent in the cement industry and the volatility in interest rates, as seen in recent years. Going forward, JCIPL's ability to judiciously manage its working capital levels and maintain comfortable capitalisation and debt coverage indicators would remain the key rating sensitivities.

Key rating drivers

Credit strengths

Experienced promoters/ management; operational synergies could arise from being part of Saurabh/Shankar Group - JCIPL is a part of the Saurabh/Shankar Group, which has more than 20 years' experience in manufacturing construction materials, mainly cement and steel. Shankar Group's main unit, Jagdamba Steels, has primarily been in the business of manufacturing structural steel since 1994. The Group's extensive track record and the experienced background of its

[1] *net working capital/operating income*

promoters/ management could help JCIPL maintain a modest business performance, mainly through extensive sales/ logistics network and business relationships developed over the years. JCIPL derives a major chunk of its clinker requirements from the mine-based cement company of the Saurabh Group, namely Sarbottam Cements. This somewhat reduces the concern arising from the fact that JCIPL is a standalone grinding unit.

Improved operational profitability in recent periods – Despite increasing competition over the last three fiscals, JCIPL's operating profitability indicators remained largely stable at ~7%, while the net profitability remained rangebound at ~2.6-2.9%. With the availability of low-cost clinker in the local market in recent periods, the operating and net margins improved to ~10.2% and ~4.7% in 9M FY2019. This resulted in comfortable interest cover of ~3.3x for the period. Additionally, volatility in prices of other raw materials, such as fly ash and gypsum, could also have a bearing over the company's profitability.

Long track record with high capacity utilisation – JCIPL has been in operation since 2001 and currently has a licensed grinding capacity of 1,000 TPD. With its long track record and established sales channel, its "Jagdamba" brand has evolved over the years. This is also evident from the relatively lower selling expenses per MT of cement sold (NPR 657 for 9M FY2019), compared to brands with larger market share. The company's operating income has reported good growth over the last three years (~13%), supported by healthy demand for its products. Hence, the company was able to report high capacity utilisation of ~100% in the last two fiscals. Nonetheless, the sales decline by ~20% in 9M FY2019 remains a concern (commensurate to ~91% capacity utilisation) and the ability of the company to improve its sales momentum will remain a key monitorable.

Good demand outlook for cement in the country – The cement industry in Nepal occupies an important place in the national economy because of its strong linkages to other sectors such as housing, transportation, power and construction. The increasing pace of developmental activities in the country remain positive for the cement industry. Additionally, large proposed/ under-construction infrastructure projects are expected to pick up pace, given a stable government at present. This also remains a positive for the cement industry in Nepal.

Credit challenges

Increasing gearing and low unutilised debt reduce the financial flexibility – Despite reporting largely stable profitability indicators over the years, JCIPL has maintained high dividend pay-out ratio (169% for FY2018). This has led to increased gearing of 2.5x as of mid-April 2019 (1.7x as of mid-July 2016). Almost the entire chunk of JCIPL's working capital requirements are currently being financed through bank loans. Given the inherent cyclicality in the cement industry, high reliance on external financing (~92% as of mid-April 2019) remains a concern, especially given the rising interest rates in bank borrowings. Additionally, the low unutilised working capital debt reduces the financial flexibility at current times of increased working capital intensity.

Stretched working capital cycle – JCIPL has witnessed sharp increase in debtor days (127 days in mid-April 2019 over 75 days in FY2018) leading to a spike in working capital intensity (NWC/OI) to ~31% from ~20% in FY2018. This led to an elongated working capital cycle in recent periods (110 days for 9M FY2019 as against 82 days for FY2018) and hence necessitated higher working capital debt. Additionally, the tight liquidity conditions in the market and slow pace of government spending could further pressurise the realisation from debtors.

Intense competition – JCIPL is a comparatively small player in the industry with a licensed grinding capacity of 1,000 TPD. The cement industry in Nepal is highly fragmented with a large number of players and stiff competition from large/ established cement manufacturers. There were around 50 operational cement manufacturing industries as of mid-April 2019, while some more new cement manufacturing units are in the pipeline. Hence, price flexibility might be lower, going forward, as the large units start operations.

Vulnerability to cyclicality and seasonal demand – Cyclical/ seasonal nature of the cement industry creates uncertainty about the demand and cash cycles for JCIPL, more so because it is based in a single region. This could have an impact on the capacity utilisation, revenue and profit margins of the company. The construction and development expenditures are largely carried out in a specific season impacting on the overall demand of the cement industry. Volatility in the cash flow due to this could pose challenges, especially during periods of weak demand like the present.

Risk of regulatory changes – The cement industry in Nepal is insulated against cheaper imports with duty safeguards and substantial freight cost involved in import of cement. Any changes in government policies could have a bearing on the performance of industry players. Any other regulatory changes affecting raw materials prices and availability could also impact the overall cement industry. Additionally, considering JCIPL's proximity to Lumbini (a UNESCO World Heritage site), recent environmental concerns could give rise to regulatory uncertainty.

Analytical approach: For arriving at the ratings, ICRA Nepal has applied its rating methodology as indicated below**.**

Links to applicable criteria:
Corporate Credit Rating Methodology

About the company

Incorporated in February 2001, Jagdamba Cement Industries Private Limited (JCIPL) is involved in the production and sales of cement, with a licensed grinding capacity of 1,000 TPD. The shareholding of the company is held by seven individuals from two business houses of Nepal—namely, the Shankar Group and the Saurabh Group. JCIPL produces Ordinary Portland Cement (OPC) and Pozzolana Portland Cement (PPC). Its factory is located at Gonaha VDC-07 in Bhairahawa District.

Key financial indicators

	FY2016 (Audited)	FY2017 (Audited)	FY2018 (Audited)	9MFY2019 (Provisional)
Operating income-OI (NPR million)	2,678	3,979	4,581	2,772
OPBDITA/OI (%)	7.3%	6.7%	6.7%	10.2%
Total debt/Tangible net-worth-TNW (times)	1.7	1.8	2.2	2.5
Total outside liabilities/ TNW (times)	2.5	2.7	3.4	3.6
Total debt/OPBDITA (times)	4.0	3.5	3.2	3.0
Interest coverage (times)	4.1	3.7	2.7	3.3
DSCR (times)	3.7	3.3	2.4	2.9
Net-working capital/OI (%)	28%	26%	20%	31%

Source: Company data

Annexure-1: Instrument Details

Instrument	Limit (Amount in NPR Million)	Ratings
Non-fund-based facilities, Short-term		
Letter of credit (Sight + usance)	12	[ICRANP] A4+
Bank guarantee	8	[ICRANP] A4+
Total non-fund based (A)	20	
Fund-based, short-term Loans		
Demand loan	200	[ICRANP] A4+
Overdraft	45	[ICRANP] A4+
Trust receipt (TR) loans	300	[ICRANP] A4+
Cash Credit (CC)	800	[ICRANP] A4+
TR (within CC)	(400)	[ICRANP] A4+

Total fund-based (B)	**1,345**	
Grand total (A+B)	**1,365**	

Analyst Contacts:

Mr. Kishor Prasad Bimali (Tel No. +977-1-4419910/20)
kishor@icranepal.com

Mr. Rajib Maharjan (Tel No. +977-1-4419910/20)
rajib@icranepal.com

Relationship Contacts:

Ms. Barsha Shrestha (Tel No. +977-1-4419910/20)
barsha@icranepal.com

About ICRA Nepal Limited:

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For more information, visit www.icranepal.com

ICRA Nepal Limited,
Sunrise Bizz Park, 6th Floor, Dillibazar, Kathmandu, Nepal.
Phone:+977 1 4419910/20
Email: info@icranepal.com
Web: www.icranepal.com

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