R.M.C. Cement Private Limited: [ICRANP] LBBB-/ A3 (Assigned)

February 28, 2019

Summary of rated instruments

Instrument*	Rated Amount (NPR Million)	Rating Action
Short-term loans; fund-based	555	[ICRANP] A3 (Assigned)
Long-term loans; fund-based	50	[ICRANP] LBBB- (Assigned)
Short-term loans; non-fund based	100	[ICRANP] A3 (Assigned)
Total	**705**	

* Instrument details are provided in Annexure-1

Rating action

ICRA Nepal has assigned the long-term rating of [ICRANP] LBBB- (pronounced ICRA NP L Triple B Minus) to the NPR 50-million long-term loans of R.M.C. Cement Private Limited (RCPL or the company). ICRA Nepal has also assigned the short-term rating of [ICRANP] A3 (pronounced ICRA NP A Three) to the short-term loans (including non-fund-based limits) of RCPL.

Rationale

The rating assignment takes into account the healthy demand outlook and strong financial profile of RCPL which is involved in manufacturing of cement through its grinding unit of ~0.2 million metric tonne per annum (MTPA). Demand outlook for cement industry in Nepal is good owing to increasing construction activities led by large proposed/ under-construction infrastructure projects in the country. The capital structure and coverage indicators are strong with gearing of 0.2x in mid-July 2018, interest coverage of ~5x and Total debt/OPBITDA of 0.8x times in FY2018. The rating action also takes into consideration the operational synergies that could arise out of the clinker supply arrangements from Palpa Cement Industries P. Ltd. (RCPL's sister concern), which is expected to start operations soon. This could help lower RCPL's dependence upon clinker imports and hence maintain competitive positioning

The ratings, however, are 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. ICRA Nepal also notes RCPL's subdued sales growth in FY2018 and 5M FY2019, which has pressurised RCPL's return and coverage indicators. This was mainly on account of tightening banking sector liquidity leading to slower loan disbursements and hence decline in level of construction activities. The company's margins are also exposed to the cyclicality inherent in the cement industry as well as price trends for raw materials and other inputs. The company's high working capital intensity (NWC/OI of ~ 74% in 5M FY2019) also remains an area of concern. Increased working capital requirements in recent periods would necessitate higher working capital debt and the company's debt coverage indicators might witness stress amid rising interest rate across the banking sector. Going forward, RCPL's ability to attain healthy sales growth amid challenges imposed by tightening liquidity, maintain comfortable debt coverage indicators while withstanding competitive pressures and judicious working capital management, will remain the key rating sensitivities.

Key rating drivers

Credit strengths

Experienced promoters; operational synergies could arise from being part of RMC Group - The company is a part of the RMC Group which has more than 25 years' experience in manufacturing construction materials. The Group's main unit, Rajesh Metal Crafts, has primarily been in the business of manufacturing sheets and pipes since 1993. The proposed supply of clinker from the upcoming mine-based cement company of the Group, Palpa Cement Industries P. Limited, could result in operational synergies for RCPL. The Group's long track record in the manufacturing sector and the experienced background of its promoters could help RCPL maintain a modest business performance.

Healthy financial profile - RCPL's operating and net margins remained healthy at ~13% and ~8%, respectively, for FY2018. This resulted in comfortable interest cover of ~5x and DSCR of ~3x in FY2018. However, the operating margins declined to ~6% during 5M FY2019, mainly on account of a sharp spike in selling expenses amid sales slowdown. Though the revenue growth for FY2019 is likely to remain muted, the moderation in operating margins is likely to improve on a YoY basis as sales generally improves towards the second half of a fiscal year. Hence, return and coverage indicators are expected to remain comfortable.

Comfortable capitalisation and substantial unutilised debt provide financial flexibility - RCPL has reported healthy profitability indicators over the years and has retained its profits so far. This led to low gearing of 0.3x as of mid-July 2018. The major chunk of RCPL's working capital requirements are currently being financed through internal funds. RCPL has nominal long-term debt in its capital structure. Given the inherent cyclicality in the cement industry, lower reliance on external financing remains positive, especially given the rising interest rates in bank borrowings. Additionally, the sizeable unutilised working capital debt provides financial flexibility at current times of increased working capital intensity. However, the retained profits might be subject to dividend payments, which could impact the capitalisation profile.

Credit challenges:

Subdued demand trend in recent periods; sales substantially dominated by Portland slag cement (PSC) segment - RCPL reported healthy sales growth from FY2014 to FY2017 (CAGR 32%), supported mainly by improving cement realisation and increased cement demand for reconstruction activities following the April 2015 earthquake. However, FY2018 and 5M FY2019 sales witnessed a decline of ~1% and ~32% (annualised), respectively, mainly due to tightening banking sector liquidity leading to slower loan disbursements. The demand is, nonetheless, expected to improve, considering the large under-construction/proposed infrastructure projects, increasing household constructions and the expected increase in pace of development works. The sales of RCPL is dominated by PSC segment at ~95% of sales for FY2018, followed distantly by ordinary Portland cement (OPC) at ~5%. The ability of the company to improve its brand recognition could remain a major sales growth driver, going forward.

Increasing competitive pressure likely to limit price flexibility and keep capacity utilisation low - RCPL is comparatively a small player in the industry with a grinding capacity of 600 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-January 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. Despite some improvement in recent years, the capacity utilisation of RCPL remains on a lower side (~50-55%). The increasing competition is also likely to keep the capacity utilisation low, going forward.

Inherent cyclicality of the industry - Cyclical/seasonal nature of the cement industry creates uncertainty about the demand and cash cycles for RCPL, 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. Volatility in the cash flow due to this could pose challenges, especially during the period of weak demands like now. RCPL has resorted to increasing sales incentives to promote sales, which has led to spiked selling expenses from NPR 124 per tonne in FY2018 to NPR 1,192 per tonne for 5M FY2019. This has significantly lowered the OPBITDA per tonne from NPR 1,673 per tonne to NPR 756 per tonne over the same period.

High working capital intensity and tight liquidity in banking sector - RCPL's business is highly working capital intensive as reflected in the net working capital to operating income (NWC/OI) ratio of ~40% in FY2018. Given the increased inventory and debtor days in 5M FY2019, the working capital intensity has further increased to ~74%. Overall working capital requirement is expected to increase in the near-to-medium term, which would result in moderation of coverage indicators. This is also evident from the elongated working capital cycle in recent periods (297 days for 5M FY2019 as against 125 days for FY2018), leading to higher working capital debt. Given the volatility in the banking sector liquidity, RCPL's ability to secure further working capital funding during the period of stretched working capital cycle also remains a challenge.

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

Established in 2009, R.M.C. Cement Private Limited is a cement manufacturing company with an installed grinding capacity of 600 tonne per day. The company has mainly been producing the PSC and OPC since 2011. The plant is located in Simara in Bara district, while RCPL's registered office is in Central Business Park, Thapathali, Kathmandu. RCPL is a family owned business, with Mr. Shrawan Agrawal and his two sons, Mr. Rajesh K. Agrawal and Mr. Vishnu K. Agrawal, holding the entire equity stake. RCPL is part of the RMC Group, which has enjoyed a presence of more than 25 years in the construction materials manufacturing sector, mainly for steel pipes and sheets.

Key financial indicators

	FY2016 (Audited)	FY2017 (Audited)	FY2018 (Audited)	5M FY2019 (Provisional)
Operating income-OI (NPR million)	749	1,311	1,304	369
Profit after tax (NPR million)	115	152	103	2
OPBITDA/OI (%)	25.0%	18.3%	13.2%	5.8%
Total debt/Tangible net-worth-TNW (times)	0.7	0.7	0.2	0.4
Total outside liabilities/ TNW (times)	0.8	0.8	0.3	0.5
Total debt/OPBITDA (times)	1.3	1.4	0.8	4.7
Interest coverage (times)	10.2	8.6	5.3	1.7
DSCR (times)	3.5	3.2	3.0	1.0
Net-working capital/OI (%)	50%	47%	40%	74%

Source: Company data

Annexure-1: Instrument Details

Instrument	Limit (Amount in NPR Million)	Rating Action
Non-fund-based facilities, Short-term		
Letter of credit - LC	100.00	[ICRANP] A3
Bank guarantee – BG (within DL and LC)	(32.16)	[ICRANP] A3
Total non-fund based (A)	**100.00**	
Fund-based facilities, Short-term		
Demand loans – DL	420.00	[ICRANP] A3
Short-term loans – STL	80.00	[ICRANP] A3
Overdraft – OD	55.00	[ICRANP] A3
Trust receipt loans/ Import loan (within LC)	(90.00)	[ICRANP] A3
Short-term loan- STL (within TR)	(90.00)	[ICRANP] A3
Fund-based, Long-term Loans	50.00	[ICRANP] LBBB-
Total fund-based (B)	**605.00**	
Grand total (A+B)	**705.00**	

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About ICRA Nepal Limited:

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