Shivam Cements Limited: [ICRANP] LA/A1 assigned

April 4, 2019

Summary of rated instruments

Instrument*	Rated Amount (NPR Million)	Rating Action
Long-term loans; Fund based (term loans)	2,122.23	[ICRANP] LA; Assigned
Short-term loans; Fund based (working capital loans)	2,120.90	[ICRANP] A1; Assigned
Short-term loans; Non-fund based (letter of credit-LC)	600.00	[ICRANP] A1; Assigned
Total	**4,843.13**	

** Instrument details are provided in Annexure-1*

Rating action

ICRA Nepal has assigned a long-term rating of [ICRANP] LA (pronounced ICRA NP L A) to the long-term loans of Shivam Cements Limited (SCL). ICRA Nepal has also assigned a short-term rating of [ICRANP] A1 (pronounced ICRA NP A one) to SCL's short-term loans (including non-fund based limits).

Rationale

The assigned ratings take into account the strong operational and financial profile of SCL, which manufactures cement through its grinding unit of ~1 million metric tonnes per annum (MTPA). The phase-wise capacity enhancements over the years has made SCL one of the largest cement manufacturing units in Nepal. Additionally, the improving capacity utilisation of the plant has aided the healthy sales growth momentum (~38% during FY2015-FY2018). The ratings also take comfort from the company's established brand presence and strong market position, which has supported healthy cement realisations over the years, and hence stable profitability margins. Additionally, the demand outlook for the cement industry in Nepal is good owing to increasing construction activity in the form of large proposed/under-construction infrastructure projects in the country.

The rating action also takes into consideration the company's strong promoter profile, comprising individuals from various large/reputed business houses of Nepal, who have extensive experience across diverse businesses including manufacturing (mainly edibles processing, FMCG, among others), trading, hydropower, etc. The promoters have injected equity in a timely manner for capacity enhancements and investment in a joint venture (JV) cement company, while keeping the gearing levels in check. This, along with SCL's improving internal accruals, has resulted in a robust capital structure and coverage indicators with gearing of 0.54x as of mid-January 2019, interest coverage of ~6x and total debt/OPBITDA of 1.4x times in H1 FY2019.

Nonetheless, the ratings are constrained by the intense competition in the industry given the presence of several players, while the overall market size remains small. The ongoing large capacity additions in the industry could lower the pricing flexibility further, thereby constraining the company's ability to pass on input cost increases to the customers. SCL'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 ~27% in H1 FY2019) also remains an area of concern. However, this could be cushioned by SCL's unutilised drawing power limits (~20% surplus drawing power as of mid-January 2019), which provide some comfort. Going forward, SCL's ability to attain healthy sales growth, amid challenges imposed by tightening liquidity, and maintain comfortable debt coverage indicators while withstanding competitive pressure and judiciously managing its working capital, will remain the key rating sensitivity.

Key rating drivers

Credit strengths

Strong operational profile, characterised by high capacity utilisation despite increasing installed capacity – SCL is a partially-integrated cement mill, which primarily manufactures ordinary Portland cement, OPC 43. Through phase-wise expansions, the installed capacity of its plant has increased to 1,900/3,000 tonnes per day (TPD) for clinkers/cement from the initial capacity of 1,200/700 TPD. The capacity utilisation has improved in recent years despite the availability of enhanced capacity (82% in FY2018 against 72% in FY2017). Although the capacity utilisation dipped slightly to ~70% in H1 FY2019, it is expected to improve, to an extent, towards the second half of the fiscal year, in line with earlier trends. The resultant increase in revenues aided a steady improvement in SCL's cash accruals. Nonetheless, the capacity utilisation could witness some moderation going forward, given the increasing installed capacity in the country.

Healthy sales growth and established sales network – SCL's established brand presence and strong market position, along with the increasing installed capacity, have supported its sales growth momentum. The company reported ~38% sales growth during FY2015-FY2018 with increasing share of sales to projects (~22% for FY2018). The plant is in Hetauda, providing easy access to most of the markets in Nepal, including the largest market i.e. the Kathmandu Valley. SCL's sales channel is fairly distributed among a large number of dealers and regional sales managers with the top 20 dealers (among >1,800 dealers) accounting for a share of ~20% of FY2018 sales.

Strong financial profile – SCL's operating and net margins remained healthy at ~24% and ~11%, respectively, in FY2018. This resulted in a comfortable interest cover of ~6.7x and DSCR of ~2.7x in FY2018. Despite higher selling expenses and a sharp spike in power costs in H1 FY2019, the operating margins improved further to ~25%. This was mainly driven by the usage of a high proportion of self-produced clinkers (~88% against 69% in FY2018). Additionally, the cost of purchased clinkers has declined in recent periods as these are now locally available at a much lower cost compared to imported clinkers. Though the revenue growth is likely to remain good in FY2019, the net cement realisation might witness some moderation (realisation per bag declined by NPR 5 in H1 FY2019 against an increase of NPR 58 in FY2018). However, the return and coverage indicators are expected to remain comfortable.

Robust capitalisation and coverage indicators; sizeable unutilised debt and recent IPO provide financial flexibility – SCL has kept the gearing levels in check with requisite equity infusions over the years for fresh capex and investment requirements. With improving internal accruals, the gearing level declined gradually to 0.54x as of mid-January 2019 and the coverage indicators remained comfortable with interest coverage of ~6x and total debt/OPBITDA of 1.4x in H1 FY2019. SCL's reliance on bank financing for its working capital requirements is also expected to decline over the near term, considering the recently-concluded IPO issue (~NPR 1.5 billion collected including premium of ~NPR 1 billion; specific usage of these funds is yet to be fixed). Given the inherent cyclicality in the cement industry, lower reliance on external financing remains a positive, especially given the rising interest rates for bank borrowings. This, along with the sizeable unutilised working capital debt (~20% surplus drawing power as of mid-January 2019), could provide financial flexibility given the increasing working capital intensity. Going forward, the capitalisation profile is expected to remain comfortable despite a probable increase in dividend outflow.

Credit challenges

Increasing competitive pressure likely to limit pricing flexibility; raw material price volatility remains a challenge – The cement industry in Nepal is highly fragmented, given the presence of several players and rising competition. There were around 50 operational cement manufacturing units, as of mid-January 2019, while a few more cement manufacturing units/capacity expansion of existing units are in the pipeline (~4-5 million tonnes capacity additions are in the pipeline against the current installed capacity of ~12 million tonnes). Hence, pricing flexibility might be lower, going forward, as the proposed units start operations. This could limit SCL's flexibility in passing the increases in raw material costs to the final consumers. The major raw materials, i.e. clinkers and coal, have witnessed volatility in prices in the past and price increases, going forward, could impact the company's margins.

Inherent cyclicality of the industry – The cyclical/seasonal nature of the cement industry creates uncertainty about SCL's demand and cash cycles, more so as it is based in a single region. This could impact its capacity utilisation, revenue and profit margins.

High working capital intensity and tight liquidity in banking sector – SCL's business is highly working capital intensive as reflected in the net working capital to operating income (NWC/OI) ratio of ~24% in FY2018. Given the increased inventory and debtor days in H1 FY2019, the working capital intensity has increased further to ~27%. The overall working capital requirement is expected to increase in the near-to-medium term, especially given the tightening liquidity in the banking sector. This has led to slower loan disbursements, which could slow down the demand for construction material. Hence, inventory holding periods and debtor days are likely to remain high over the near term. This is also evident in the elongated working capital cycle in recent periods (109 days in H1 FY2019 against 88 days in FY2018). However, the sizeable proceeds from the company's recent IPO and improving internal accruals provide comfort.

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 May 2003 as a private limited company, Shivam Cements Limited (SCL) was later converted into a public limited company in July 2015. The company was promoted by individuals from various business houses of Nepal including Lucky Group, Sharda Group and Goel Group, among others. SCL principally manufactures OPC 43 grade cement sold under the brand, Shivam Cement. The company has four mines near its manufacturing facilities from which it sources limestone for clinker production. SCL also holds a stake of 88% in Shivam Holdings Private Limited, which, in turn, holds a 30% stake in the largest cement plant in Nepal i.e. Hongshi Shivam Cement Private Limited (HSCPL). HSCPL is a joint venture with Hongshi Group of China and has a production capacity of 6,000 TPD in the first phase.

Key financial indicators

	FY2016 (Audited)	FY2017 (Audited)	FY2018 (Audited)	H1 FY2019 (Provisional)
Operating income (OI; NPR million)	5,773	7,364	10,265	5,225
Profit after tax (NPR million)	778	811	1,143	658
OPBITDA/OI (%)	27%	26%	24%	25%
RoCE (%)	27%	21%	20%	19%
Total debt/Tangible net worth (TNW; times)	0.71	0.81	0.69	0.54
Total outside liabilities/TNW (times)	1.06	1.13	1.04	0.83
Total debt/OPBITDA (times)	1.37	1.70	1.74	1.44
Interest coverage (times)	8.80	9.19	6.72	6.32
DSCR (times)	2.53	2.78	2.66	2.26
Net working capital/OI (%)	28%	23%	24%	27%

Source: Company data

Annexure-1: Instrument details

Instrument	Limit (Amount in NPR Million)	Rating Action
Fund based; Long-term loans	2,122.23	[ICRANP] LA
Fund-based facilities; Short term		
Overdraft – OD	2,120.90	[ICRANP] A1
Short-term loans (within OD)	(500.00)	[ICRANP] A1

Trust receipt loans - USD (within LC)	(250.00)	[ICRANP] A1
Total fund based (A)	**2,120.90**	
Non-fund based facilities; Short term		
Letter of credit - LC	600.00	[ICRANP] A1
LC (within OD)	(102.58)	[ICRANP] A1
Bank guarantee – BG (within LC/OD)	(150.00)	[ICRANP] A1
Customer acceptance (within LC)	(100.00)	[ICRANP] A1
Total non-fund based (B)	**600.00**	
Grand total (A+B)	**4,843.13**	

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About ICRA Nepal Limited:

ICRA Nepal Limited, the first credit rating agency of Nepal, is a subsidiary of ICRA Limited (ICRA) of India. It was licensed by the Securities Board of Nepal (SEBON) on October 3, 2012. ICRA Nepal is supported by ICRA Limited through a technical support services agreement, which envisages ICRA helping ICRA Nepal in areas such as rating process and methodologies, analytical software, research, training, and technical and analytical skill augmentation.

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