Palpa Cements Industries Private Limited: [ICRANP] LBB/A4+ assigned

April 4, 2019

Summary of rated instruments

Instrument*	Rated Amount (NPR Million)	Rating Action
Long-term loans; fund based	5,440.54	[ICRANP] LBB; Assigned
Short-term loans; fund based	1,247.21	[ICRANP] A4+; Assigned
Short-term loans; non-fund based	550.00	[ICRANP] A4+; Assigned
Total	**7,237.75**	

** Instrument details are provided in Annexure-1*

Rating action

ICRA Nepal has assigned a long-term rating of [ICRANP] LBB (pronounced ICRA NP L double B) to the long-term loans of Palpa Cements Industries Private Limited (PCIPL). ICRA Nepal has also assigned a short-term rating of [ICRANP] A4+ (pronounced ICRA NP A four plus) to PCIPL's short-term loans (including non-fund based limits).

Rationale

The assigned ratings take into account the advanced progress in the under-construction cement plant of the company, leading to a reduction in project execution risks. The ratings also factor in the relatively low capital cost (NPR 3.34 million per tonne of installed grinding capacity) for the project with fully tied-up funding arrangements. The ratings also take comfort from the Group's strength with the company being affiliated to the RMC Group, which has prior experience in the industry and has an operational grinding unit since 2011 (R.M.C. Cement Private Limited). Additionally, operational synergies are expected from the wide and established dealership and distribution channel of the Group's units (including Rajesh Metal Crafts[1]). Moreover, the demand outlook for cement in Nepal is good owing to increasing construction activity in the form of large proposed/under-construction infrastructure projects in the country. This is likely to support the sales growth over the medium term.

Nonetheless, the ratings remain constrained by the intense competitive pressure in the industry, given the presence of many established players/brands as well as large upcoming units. The plant is in the Nawalparasi district, near multiple existing and upcoming cement plants including the largest operational cement plant of Nepal (Hongshi Shivam with 6,000-TPD capacity). This could lower the company's pricing flexibility. The margins are likely to witness further pressure from the established players, which have a low debt burden. The ratings also consider the project stabilisation risks, which might hinder the targeted operational levels once commercial production commences. This, in turn, could pressurise the debt coverage indicators, especially in the initial years of operations. The capitalisation and coverage metrics are also likely to remain stretched with high gearing in the initial years of operations. The interest rate volatility in the market also remains a rating concern, in this regard. Going forward, PCIPL's ability to complete the project within the estimated time/cost, attain plant stability and meet the targeted operational levels will remain the key rating sensitivity. Additionally, the company's ability to establish its brand presence in the competitive landscape would also remain a key monitorable.

[1] *Rajesh Metal Crafts (RMC) primarily manufactures sheets and pipes, since 1993. This gives its promoters adequate experience in the field of marketing of construction materials*

Key rating drivers

Credit strengths

Reduction in execution risks, given the advanced stage of project construction – The 1,800-TPD clinker and 2,200-TPD cement manufacturing plant has reached an advanced stage of construction. As of mid-January 2019, a major portion of the construction work had been completed, thereby reducing execution risks to a large extent. The trial production for clinkers started recently, within ~15 months of active construction, while the grinding unit is expected to start operations in the next 5-6 months.

Low project costs with low funding risks – The project cost estimates remain relatively low at NPR 7,346 million, which is being funded in a debt to equity mix of ~74:26. The debt component has been tied up with a consortium of banks while ~72% of the equity requirement was infused till mid-January 2019 with the rest expected to be injected as per project requirements. Till mid-January 2019, NPR 4,245 million (including project advances) was incurred on the project. Hence, funding risks are low for the project as there are no funding gaps at current cost estimates.

Experienced promoters; operational synergies could arise from being part of RMC Group – PCIPL is a part of the RMC Group, which has more than 25 years of experience in the manufacturing and marketing of construction materials. The robust dealership and distribution channel of the RMC Group, along with its prior exposure in the cement industry through R.M.C. Cement Private Limited (operational since 2011), could result in operational synergies for PCIPL. The Group's extensive track record in the manufacturing sector and the experienced background of its promoters could help PCIPL maintain a modest business performance.

Credit challenges

Debt coverage indicators likely to remain stretched over the near term – Given the sizeable debt in the funding mix, the coverage indicators are likely to remain subdued in the early years of operations, mainly due to the high interest obligation. Moreover, the capacity utilisation could also remain low due to possible issues regarding plant stabilisation, thereby impacting the operational cash flows and accruals during the initial years of operations. Additionally, the repayment schedule is proposed to be lowered to seven years (against the initial 8.5 years), which might further pressurise the debt service indicators, if the cash flows are lower than expected.

Intense competition – 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 units, as of mid-January 2019, while some more cement manufacturing units are in the pipeline. In terms of pricing, PCIPL will have to compete with the larger/established brands, which have a low debt burden, as well as with newer players, which have better scalability. Hence, the pricing flexibility and margins are likely to remain low over the medium term. The company's ability to leverage its Group's strengths and create a brand presence would have a key bearing on its operational and financial profile.

Raw material price volatility risks – Given the expectations of limited pricing flexibility, PCIPL's operating margins would largely depend on the pricing of its raw material inputs. Apart from the limestones, which are to be excavated from its own mines, PCIPL would remain dependent on the import/purchase of other major raw materials like gypsum and petcoke, among others. The volatility in raw material prices could have a bearing on the company's profitability. However, PCIPL's clinker requirements are expected to be largely met through internal production, which provides some comfort.

Inherent cyclicality of the industry with high working capital intensity – The cyclical/seasonal nature of the cement industry could create uncertainty in PCIPL'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. Volatility in the cash flow could pose challenges, especially during the periods of weak demand. Additionally, cement industry operations are highly working capital intensive, necessitating high working capital debt. This remains a concern, given the interest rate volatility in the market.

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 2009, Palpa Cements Industries Private Limited (PCIPL) has an under-construction cement manufacturing plant, which is expected to commence commercial operations shortly. The plant is in Sunuwal VDC, Nawalparasi district, while the mines are located ~30 km from the factory in Rahawas VDC, Palpa District. The plant has a manufacturing capacity of 1,800 TPD clinkers and 2,200 TPD cement, based on the vertical rolling mill (VRM) technology. The company plans to mainly produce ordinary Portland cement (OPC) and Portland slag cement (PSC). PCIPL belongs to the RMC Group, which is a renowned business house in Nepal with extensive experience primarily in the manufacturing sector. The company's registered office is in Central Business Park, Thapathali, Kathmandu, Nepal.

Annexure-1: Instrument details

Instrument	Limit (Amount in NPR Million)	Rating Action
Non-fund based facilities; Short term		
Letter of credit - LC	350.00	[ICRANP] A4+
Bank guarantee – BG	200.00	[ICRANP] A4+
LC (within term/working capital loans)	(2,350.00)	[ICRANP] A4+
Total non-fund based (A)	**550.00**	
Fund-based facilities; Short term		
Working capital loans – WCL*	900.00	[ICRANP] A4+
Bridge gap loans – BGL (within TL)	(662.50)	[ICRANP] A4+
Trust receipt loans - I (within WCL)	(350.00)	[ICRANP] A4+
Unallocated funds; Short term	347.21	[ICRANP] A4+
Fund based; Long-term loans	5,440.54	[ICRANP] LBB
Total fund based (B)	**6,687.75**	
Grand total (A+B)	**7,237.75**	

**WCL includes overdraft (OD), trust receipt loan (TR), working capital and demand loans (DL) and other short-term loans*

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:

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.

Our parent company, ICRA Limited, was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment information and credit rating agency. Today, ICRA and its subsidiaries together form the ICRA Group of Companies. The international credit rating agency, Moody's Investors Service, is ICRA's largest shareholder.

For more information, visit www.icranepal.com

ICRA Nepal Limited,
Sunrise Bizz Park, 6th Floor, Dillibazar, Kathmandu-33, Nepal
Phone:+977 1 4419910/20
Email: info@icranepal.com
Web: www.icranepal.com