Shivam Cements Limited

ICRA Nepal assigns [ICRANP] IPO Grade 3+ to the proposed Initial Public Offering (IPO) of Shivam Cements Limited

Instrument/Facility	Issue Size	Grading Action
Initial Public Offerings (equity)	NPR 2,024 million[1]	[ICRANP] IPO Grade 3+ *(Assigned on March 2018 and revalidated with IPO price update in June 2018)*

ICRA Nepal has assigned an "**[ICRANP] IPO Grade 3+**", indicating average fundamentals, to the proposed Initial public offering (IPO) of Shivam Cements Limited (SCL). ICRA Nepal assigns IPO grading on a scale of IPO Grade 1 through IPO Grade 5, with Grade 1 indicating strong fundamentals and Grade 5 indicating poor fundamentals. For the grading categories 2, 3 and 4, the sign of + (plus) appended to the grading symbols indicate their relative better position within the grading categories concerned. SCL is proposing to come out with an IPO of 5,280,000 numbers of equity shares of face value NPR 100/- each at premium. Of the total shares, 880,000 shares will be issued to project affected areas at premium of NPR 200 per share (issue price NPR 300 per share including premium against face value of NPR 100 per share) while remaining 4,400,000 shares will be issued to general public at premium of NPR 300 per share (issue price NPR 400 per share including premium against face value of NPR 100 per share).

The assigned grading takes into account the strong operational and financial profile of SCL which is involved in the manufacturing and selling of cement within Nepal. Improvement in scale of operations aided by phased expansion in clinker and cement manufacturing capacities has resulted in stable profitability margins and improvement in increase in cash accruals for the company. Piecemeal expansions with partial equity funding has kept the indebtedness of the company in check and hence even though the debt levels have increased, the capital structure of the company has improved, and the gearing stood at 0.7 times at mid-Apr-18 end as against 3.2 times at FY2012 end. The operating profitability is also supported by healthy cement realizations which have consistently improved (with the exception of FY2017 when there was a slight dip). The grading also takes into account the potential income stream from SCL's investment (effective holding of 26.8%) in Joint Venture (JV) company (though a subsidiary company) Hongshi Shivam Cement Pvt Ltd (HSCPL) which is setting up cement plant with grinding capacity and clinker capacity of 6000TPD. The promoters of SCL have experience in diverse businesses and have infused equity capital from time to time to fund capital expenditure in SCL and investment in JV company.

The assigned grading is tempered by highly competitive business environment marked by the presence of a number of players given the small size of the overall market. Resultant limited pricing power therefore constrains the ability of the company to pass on input cost increases to the customers. Further, the company has limited control on its input costs as the bulk of the raw material (installed clinker capacity meets ~65% of the plant requirement at current installed grinding capacities) and fuel are imported and thus these prices are vulnerable to regulatory and geo- political changes in policies which can result in supply disruptions and/ or increase in costs.

Cement demand is expected to remain robust which should aid improvement in scale and profitability going forward. Ability of the company to improve its brand recognition and pricing power will be the key driver for returns.

[1] Out of total proposed issue size, face value of shares is NPR 528 million (i.e. 12% of post IPO capital) and premium is NPR 1,496 million as approved by Securities Board of Nepal (SEBON).

SCL is a partially integrated cement mill and primarily manufactures Ordinary Portland Cement, OPC 43. The manufacturing facilities are located in Hetauda in Nepal which is centrally located and hence provides easy access to most of the markets within Nepal. The company has captive clinker capacity of 1900 TPD and meets balance clinker requirement from imports/purchase. Apart from limestone (mined from captive mines) and clinker purchase, the company also procures iron ore (3.5-4.5% of clinker produced) and gypsum (3-4%) of cement produced. The company sources its power from grid however to counter disruptions/ shortages in grid supply, it also has its own generators of ~9 MW (run on diesel and furnace oil). The power requirement of the plant is ~11 MW at 100% utilization of clinker and cement capacities. Roughly 70% of sales is through channel sales (or retail sales) and rest is from projects (or non-trade segment) for SCL. Sales channel is distributed among large number of dealers and regional sales managers whereby billing is made to dealers at ex-mill and freight is borne by dealers.

The company commenced its operations with a grinding unit of 700TPD in FY2011, the capacity has been increased to 2300 TPD in FY2016 (at a cost of NPR 55 crore) and has been further increased to 3000 TPD in March 2018 at a cost of NPR 65 crore. To meet the higher clinker requirement (own capacity of 1900 TPD), the company has been importing clinker from India which had a landed cost of ~Rs 9900 per ton in FY2016 and FY2017, however the same has increased in FY2018 and stood at ~Rs 10,400 per ton in H1FY2018. The increase in price is on account of ban in loading of clinker in Raxaul, Bihar which is the key transit point for import of clinker from India.

Cement sales grew substantially in FY2014 led by increased capacity utilization (82% in FY2014 as against 63% in FY2013) and were largely flat in FY2015 (capacity utilization of 85%). Thereafter, with enhanced capacity available in FY2016 (2300 TPD), the company was able to achieve high sales growth of 72.8%. Increased capacity utilization has supported growth in volumes in FY2017 and H1FY2018 (54% of FY17 sales volume).

The cement price increased by Rs 37 per bag in FY2015 on account temporary disruption of supply led by earthquake in April 2015 (SCL's operations were not impacted). In FY2016 as well, the blockade of passage for imported goods from India (October 2015 to February 2016), resulted in increase in commodity prices including cement and the price increased by Rs 72 per bag in FY2016 (over previous year). Increase in cement prices have resulted in increase in operating profit per ton (of cement sales) in FY2015 (NPR 3,045 per ton) and FY2016 (NPR 3,620 per ton). During FY2017, while the clinker production remained flat, higher external purchases of clinker resulted in increase in raw material expense per ton and hence the operating profit per ton was lower in FY2017 (NPR 3,488 per ton). In H1 FY2018, own clinker production has increased as the clinker capacity expansion to 1900 TPD (from 1200 TPD) was completed in January 2017 and hence the proportion of own clinker out of total clinker consumed has increased resulting in reduction in raw material cost per ton. The operating profit per ton has thus improved in H1 FY2018 to NPR 3,912 per ton.

As per the provisional results, the company achieved a net profit of NPR 937 million over operating income of NPR 7.11 billion during 9MFY2018. During FY2017, the company reported net profit of NPR 811 million over operating income of 7.36 billion.

Company Profile

Shivam Cement Limited (SCL), incorporated in 2003, is involved in manufacturing and selling of cement and clinker. The company's 20 individual promoters are from various business houses of Nepal. The factory is located in Hetauda district in the Central Development region of Nepal. The company has a clinker capacity of 1900 tonnes per day (TPD) and grinding capacity of 3000 TPD. The company principally manufactures OPC 43 grade cement sold under brand “Shivam Cement”. SCL also holds 88% shares in Shivam Holding Private Limited which in turn holds 30% stake in HSCPL, a JV with Hongshi Group of China which is in the process of setting up cement plant with grinding capacity and clinker capacity of 6000TPD.

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