Magnum Coal Private Limited: [ICRANP] LBB-/A4 assigned

June 17, 2019

Summary of rated instruments

Instrument*	Rated Amount (NPR Million)	Rating Action
Short-term loans; Fund based	450	[ICRANP] A4 (Assigned)
Long-term loans; Fund based	70	[ICRANP] LBB- (Assigned)
Short-term loans; Non-fund based	300	[ICRANP] A4 (Assigned)
Total	**820**	

** 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 minus) to the NPR 70-million long-term loans of Magnum Coal Private Limited (MCPL). ICRA Nepal has also assigned a short-term rating of [ICRANP] A4 (pronounced ICRA NP A four) to the existing and proposed short-term loans (including non-fund based limits) of MCPL.

Rationale

The assigned ratings consider the fact that MCPL is a part of the Saurabh Group, which has a long presence in the cement manufacturing and steel industries in Nepal, among others. The experience and linkages of the promoters developed over the years in the end-user industries remain a positive from a growth perspective in the coal trading business. The ratings also factor in the company's ability to attain healthy sales growth momentum in recent months (~40% of the sales in 11M FY2019 were in the last two months of this period). The demand outlook for coal in Nepal remains positive considering the rising demand for construction materials and the presence of several players in the cement, steel and brick manufacturing sectors. The ratings also favourably factor in MCPL's use of a coal grading plant, which assures the requisite quality as desired by the customer segment. This, along with the practice of guaranteeing the calorific value and bearing shortage risks, helps partly mitigate the risk of customer loss due to self-import by the end-users.

Nonetheless, the ratings are constrained by the company's limited operational track record (~one year), high customer concentration risks (a single customer accounted for ~80% of sales in 9M FY2019), and the small scale of operations so far. Though the expected increase in scalability could reduce the client concentration risks going forward, MCPL's ability to diversify the customer base across multiple industrial sectors remains to be seen. The ratings are also constrained by the high working capital intensity (NWC/OI of ~69% as of mid-April 2019), mainly on account of the high inventory holding period and elevated debtor days. This, along with the significant level of debt in the funding mix, led to a high gearing ratio of 4.7x as of mid-April 2019.

ICRA Nepal notes that a high dependence on working capital would temper MCPL's coverage and profitability indicators over the medium term. The company's profitability is also exposed to demand vulnerability to cyclical trends in the cement and steel industries as well as the volatility in international coal prices and exchange rate fluctuations. ICRA Nepal also considers the low entry barriers in the trading sector, which might have a bearing on the company's growth prospects. Going forward, MCPL's ability to attain healthy sales growth by creating better logistics, diversifying its revenue stream over a larger customer base and improving the capitalisation and coverage indicators, while maintaining prudent working capital management, will remain a key rating sensitivity.

Key rating drivers

Credit strengths

Long-standing experience of promoter group - Incorporated in 2016, MCPL is a part of the Saurabh Group, which has an established presence in the cement (>20 years) and steel industries (>10 years) in Nepal, among others. The experience and linkages of the promoters and the management developed over these years, especially in the end-user industries, should aid the revenue growth going forward.

Healthy sales growth momentum - Despite being a new player in the industry**,** MCPL was able to report healthy sales of ~NPR 966 million in 11M FY2019, after having started operations towards the end of FY2018. The sales in recent months remain good with ~40% of the sales in 11M FY2019 being reported in the last two months. So far, the sales are dominated by South African coal (~85%), followed by Indonesian and Indian coals. As MCPL's sales would remain dependent on the demand for construction materials, the recent increase in development activities across the country remains a positive for the company. However, the sustainability of the sales growth momentum would remain a key monitorable.

Focus on improving logistics and quality of coal could aid market penetration - Coal trading is a fragmented business in Nepal with the presence of multiple small-to-medium-sized players. Most of the industries import their coal requirements on their own as well. MCPL is focusing on ensuring the quality/calorific value of coal while bearing the risk of shortages during transportation. This, along with target to maintain relatively better import logistics, could help counter the risks of self-import of coal by its prospective customers and aid MCPL in its efforts to penetrate the market.

Credit challenges

Limited track record - MCPL has a limited track record of operations with low scalability so far. Though it was incorporated in 2016, the company started its core operations only towards mid-2018. Hence, its ability to register healthy sales and financial indicators over a longer timeframe remains to be seen.

Capitalisation and coverage indicators likely to remain stretched - Given the sizeable debt in the funding mix, the coverage indicators (TD/OPBDITA of 7.5x in 9M FY2019) remain high. The capital structure is also high with TD/TNW of 4.7x in mid-April 2019. This is likely to pressurise MCPL's interest coverage indicator (~1.5x for 9M FY2019). The company's ability to improve these indicators through healthy revenue growth and improvement in margins would remain critical.

Working capital intensive operations - Being a working capital intensive business, short-term working capital loans account for almost the whole of MCPL's debt. Given the expected increase in the inventory holding period, the overall working capital requirement is likely to remain high over the medium term. This is also evident from the long working capital cycle so far (207 days for 9M FY2019 with inventory holding period of 158 days) leading to high working capital intensity (NWC/OI of 69% as of mid-April 2019). The company's ability to manage the requisite working capital debt over the rising scale of operations would have a bearing on its growth plans. Moreover, high dependence on working capital loans (~80-85%), rising interest rates and seasonality in demand will have a bearing on the company's profitability.

Limited customer base leading to high concentration risks - MCPL has a limited customer base so far, given its short track record. The company's customer base is largely dominated by the cement industry till now with the largest customer accounting for ~80% of the sales in 9M FY2019. Though the high dependence on a single party currently benefits the company through largely order-backed procurements, it increases the vulnerability regarding the sustainability of the sales growth trend. Additionally, MCPL's ability to diversify its customer base across multiple industrial sectors would remain crucial to lower the demand risks arising from the cyclical trends in the cement industry.

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 2016, Magnum Coal Private Limited (MCPL) is primarily engaged in the trading of coal. The company imports various types of coal including Indonesian, South African, Australian and Indian coal. MCPL's major consumers are cement industries with clinkerisation units, steel industries and brick industries. The company was initially promoted by four individuals and now has a total of six shareholders. Mr. Ankit Agrawal is the Chairman of the company.

Key financial indicators

	9M FY2019 (Provisional)
Operating income (OI; NPR million)	573
OPBDITA/OI (%) *	8.6%
Total debt/Tangible net worth (TNW; times)	4.7
Total outside liabilities/TNW (times)	6.3
Total debt/OPBDITA (times)	7.5
Interest coverage (times)	1.5
DSCR (times) #	1.4
Net working capital/OI (%)	69%

** OPBDITA: Operating profit before depreciation, interest, taxes and amortisation*

 # DSCR: Debt service coverage ratio

Annexure-1: Instrument details

Instrument	Limit (Amount in NPR Million)	Rating Action
Non-fund based facilities; Short term		
Existing limits		
Letter of credit (LC)	200	[ICRANP] A4
Bank guarantee (BG; within LC)	(100)	[ICRANP] A4
Proposed limits		
LC	100	[ICRANP] A4
Total non-fund based (A)	**300**	
Fund-based facilities; Short term		
Existing		
Trust receipt (TR)	200	[ICRANP] A4
Cash credit (CC)	100	[ICRANP] A4
Short-term demand loans (STDL; within TR)	(200)	[ICRANP] A4
Proposed		
TR	100	[ICRANP] A4
CC	50	[ICRANP] A4
STDL (within TR)	(100)	[ICRANP] A4
Fund based; Long term (FTL)	70	[ICRANP] LBB-
Total fund based (B)	**520**	
Grand total (A+B)	**820**	

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

Ms. Grishma Dhungana (Tel No. +977-1-4419910/20)
grishma@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 licenced 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, Nepal.
Phone:+977 1 4419910/20
Email: info@icranepal.com
Web: www.icranepal.com