M. Jaypee Cement Private Limited: [ICRANP] LBB-/ A4 (Assigned)

July 1, 2019

Summary of rated instruments

Instrument*	Rated Amount (NPR Million)	Rating Action
Short-term loans; fund-based	928.73	[ICRANP] A4 (Assigned)
Long-term loans; fund-based	56.34	[ICRANP] LBB- (Assigned)
Total	**985.07**	

** Instrument details are provided in Annexure-1*

Rating action

ICRA Nepal has assigned the long-term rating of [ICRANP] LBB- (pronounced 'ICRA NP L double B minus') to the NPR 56-million long-term loans of M. Jaypee Cement Private Limited (MJP or the company). ICRA Nepal has also assigned the short-term rating of [ICRANP] A4 (pronounced ICRA NP A four) to the existing/proposed short-term loans of MJP.

Rationale

The rating assignment factors in the company's ability to report a healthy sales growth trend (~136% growth in the last three years ending mid-July 2018), aided by the increased demand for cement after the April-2015 earthquake along with phase-wise capacity enhancements by the company. ICRA Nepal also notes the low-cost clinker availability within the country in recent periods, which has aided improvement in operating margins in 9M FY2019 (11.3% against 10.1% for FY2018), despite the sales decline by ~29% during the period.

The rating is, however, constrained by the sharp spike in working capital intensity (NWC/OI)[1], which increased to ~85% in 9M FY2019 compared to ~35% in FY2016. This was on account of elongated debtor days in recent periods (239 days in mid-April 2019) leading to stretched working capital cycle necessitating higher working capital debt. Hence, the capital structure and coverage indicators have deteriorated in recent periods with gearing of 3.3x as of mid-April 2019, interest cover of 1.8x and total debt/OPBITDA of 7.5x for 9M FY2019. The rising debt levels along with volatility in interest rate have also pressurised the profitability indicators of the company with net profitability of 1.2% for 9M FY2019 as against 2.7% for FY2017. The rating is also 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. This might keep the capacity utilisation of the plant low, which reportedly declined to ~19% for 9M FY2019 from ~35% for FY2018. The company's margins are also exposed to the cyclicality inherent in the cement industry. Going forward, MJP's ability to judiciously manage its working capital levels, attain healthy sales growth amid challenges imposed by tightening liquidity and maintain comfortable debt coverage indicators would remain the key rating sensitivities.

Key rating drivers

Credit strengths

Healthy sales growth till FY2018, ability to rebound from sales slump thereafter remains to be seen – MJP's operating income has reported healthy growth over the last three years (~136%), supported by increased cement demand for reconstruction activities following the April-2015 earthquake as well as phase-wise capacity enhancements. The factory was initially established with an installed production capacity of 100 TPD that was increased to 700 TPD from July 24, 2015. The capacity was further increased to 950 TPD from July 16, 2017. Nonetheless, the sales decline by ~29% in 9M FY2019 remains a concern and the ability of the company to improve its sales growth momentum will remain a key monitorable.

[1] *net working capital/operating income*

Improved operational profitability in recent periods – Owing to increased demand after the 2015 earthquake, the operating and net profitability indicators surged to a high of ~14.0% and ~6.8%, respectively, in FY2016 (~5.7% and ~1.6% in FY2015). However, with increasing competition thereafter, the indicators saw some moderation and remained at ~10.1% and ~2.6%, respectively, in FY2018, despite increasing scalability each year. With the availability of low-cost clinkers in the local market in recent periods, the operating margins improved to ~11.3% in 9M FY2019. However, the sustainability of the same remains to be seen. Additionally, volatility in prices for other raw materials, such as fly ash and gypsum, could also have a bearing over the company's profitability.

Good demand outlook for cement in the country – The cement industry in Nepal occupies an important place in the national economy because of its strong linkages to other sectors such as housing, transportation, power and construction. The increasing pace of developmental activities in the country remain positive for the cement industry. Additionally, large proposed/ under-construction infrastructure projects are expected to take pace, given a stable government at present. This remains a positive for the cement industry in Nepal.

Credit challenges

Stretched working capital cycle leading to weak liquidity – MJP has witnessed sharp increase in debtor days (239 days in mid-April 2019 over 148 days in FY2018) leading to a spike in working capital intensity (NWC/OI) to ~85% from ~35% in FY2016. This led to an elongated working capital cycle in recent periods (270 days for 9M FY2019 as against 169 days for FY2018). Additionally, the tight liquidity conditions in the market and slow pace of government spending could further pressurise the realisation from debtors. This is also evident from increased ageing of debtors wherein a significant chunk of these are already above a 90-day period (~63% as of mid-April 2019 as against ~54% in mid-July 2018). This has necessitated higher working capital debt in recent periods and led to a weak liquidity profile for the company.

Debt coverage indicators likely to remain stretched – Given the rising debt in the funding mix, MJP's gearing increased to 3.3x as of mid-April 2019 (1.4x as of mid-July 2016). With the decline in sales in 9M FY2019, total debt/OPBITDA has also sharply deteriorated to 7.5x as against 4.9x for FY2018. The increasing finance costs have led to decline in interest cover to 1.8x in 9M FY2019 compared to 2.8x for FY2016. Since the competition is increasing, revenue growth is likely to remain muted and hence the coverage indicators are expected to remain subdued over the medium term.

Intense competition – MJP is a comparatively small player in the industry with a grinding capacity of 950 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-April 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 MJP has remains low (~35% for FY2018; ~19% for 9MFY2019). The increasing competition is also likely to keep the capacity utilisation low.

Vulnerability to cyclicality and seasonal demand – Cyclical/ seasonal nature of the cement industry creates uncertainty about the demand and cash cycles for MJP, 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. The construction and development expenditures are largely carried out in a specific season impacting on the overall demand of the cement industry. Volatility in the cash flow due to this could pose challenges, especially during periods of weak demand like the present.

Risk of regulatory changes – The cement industry in Nepal is insulated against cheaper imports with duty safeguards and substantial freight cost involved in import of cement. Any changes in government policies could have a bearing on the performance of industry players. Any other regulatory changes affecting raw materials prices and availability could also impact the overall 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

Established in 2000, M. Jaypee Cement Private Limited is a cement manufacturing company with an installed grinding capacity of 950 tonne per day. The company has mainly been producing Portland Pozzolana Cement (PPC) and Ordinary Portland Cement (OPC) under the three brands of Apex Cement (OPC-33 grade, 43 grade and 53 grade), Buddha Cement (PPC) and Lumbini Cement (PPC). The plant is located at Birpur in Kapilvastu District. The shareholders of MJP include 32 individuals from diverse backgrounds.

Key financial indicators

	FY2016 (Audited)	**FY2017 (Audited)**	**FY2018 (Audited)**	**9MFY2019 (Provisional)**
Operating income-OI (NPR million)	622	820	1,321	701
OPBDITA/OI (%)	14.0%	11.6%	10.1%	11.3%
Total debt/Tangible net-worth-TNW (times)	1.4	1.9	2.8	3.3
Total outside liabilities/ TNW (times)	2.1	2.2	3.2	3.5
Total debt/OPBDITA (times)	2.5	4.1	4.9	7.5
Interest coverage (times)	5.8	2.7	2.3	1.8
DSCR (times)	5.3	1.9	1.7	1.2
Net-working capital/OI (%)	35%	46%	47%	85%

Source: Company data

Annexure-1: Instrument Details

Instrument	**Limit (Amount in NPR Million)**	**Ratings**
Fund-based facilities, Short-term (A)	**910.00**	
Overdraft (OD)	210.00	[ICRANP] A4
Demand Loan	315.00	[ICRANP] A4
Cash Credit/Short term loans	385.00	[ICRANP] A4
Fund-based, Long-term Loans (B)	**56.34**	[ICRANP] LBB-
Proposed short term, fund-based, unallocated (C)	**18.73**	[ICRANP] A4
Total fund-based Loans (A+B+C)	**985.07**	

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About ICRA Nepal Limited:

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