Nepal Shalimar Cement Private Limited: [ICRANP] LBB-/A4 assigned

September 28, 2020

Summary of rated instruments

Instrument (Amounts in NPR Million) *	Rated Amount (NPR million)	Rating Action
Long-term loans	473.52	[ICRANP] LBB-; assigned
Short-term loans	1,330.00	[ICRANP] A4; assigned
Total	**1,803.52**	

** Instrument details are provided in Annexure-1*

Rating action

ICRA Nepal has assigned the rating of [ICRANP] LBB- (pronounced ICRA NP L double B minus) to the long-term loans of Nepal Shalimar Cement Private Limited (Shalimar). ICRA Nepal has also assigned a rating of [ICRANP] A4 (pronounced ICRA NP A four) to the company's short-term loans.

Rationale

The ratings assignment factors in the company's affiliation to the Shalimar Group, which has a long track record (since 1940s) in manufacturing and selling construction materials, among others. The rating action also draws comfort from the company's long track record of operations (since 2003), resulting in an established sales channel and an extensive network of ~2,200 dealers across the country. Shalimar's capitalisation remains satisfactory with gearing of ~2.2 times as of mid-April 2020 (~1.8 times considering the promoter loans as equity). The ratings also consider the company's recent capacity enhancement [~42% of enhanced capacity of ~545,000 tonnes per annum (TPA)], which is expected to aid future sales growth in case of a rise in demand. Shalimar also has a 50% stake in a clinker producing unit (99,000 TPA capacity), which ensures clinker supply to an extent and lowers the risks emanating from it being a standalone grinding unit.

Nonetheless, the ratings are constrained by the likely economic slowdown due to the ongoing Covid-19 pandemic, which could lower the demand for construction materials in the near to medium term. This would impact the company's operating and financial risk profile. Its sales already witnessed ~15% de-growth in FY2019. This situation was exacerbated by the impact of lockdowns in last few months of FY2020, leading to ~18% sales decrease during the year. The ratings are further constrained by the occasional delays (up to 15 days) in the payment of debt obligations that the company faced during the last 12 months ending in mid-July 2020. Intense competition in the industry with sizeable capacity additions/enhancements as seen in the last few years also remains a rating concern. Hence, the resultant lower pricing flexibility could impact the company's margins, especially in case of weak demand and unfavourable movement in raw materials/other input prices. Its high working capital intensity (net working capital to operating income (NWC/OI) of ~49% in 9M FY2020), moderate debt service indicators (interest cover of 1.14 times and DSCR of ~2 times in 9M FY2020) also remain areas of concern. Going forward, Shalimar's ability to improve its OI while withstanding the competitive pressures and judiciously managing its working capital would remain crucial. The company's ability to improve its debt coverage indicators along with its net margins will be a key rating sensitivity.

Key rating drivers

Credit strengths

Long track record with established sales channel and extensive network – Shalimar has a long track record of operations in the industry (since 2003) and currently has a grinding capacity of ~0.5 million TPA. It has developed extensive sales/logistics network over the years, which now comprises ~2,200 dealers across the country. Further, the company has affiliation to the Shalimar Group, which has extensive experience in manufacturing and selling construction materials (since 1940s), among others.

Satisfactory capitalisation along with timely promoter support in case of stress – Shalimar's capitalisation has generally remained adequate with gearing of ~2.2 times as of mid-July 2020. Additionally, promoters have provided timely advances to support any liquidity stress; considering these loans as a part of equity, gearing has remained low at ~1.8 times as on the same date. In the past, dividend payouts remained in check, depending upon the profit levels and liquidity adequacy. Approximately 66% of profits from FY2016 to FY2018 were distributed as dividends with no distribution thereafter. With the cash sales strategy in the recent period (as agreed by all cement manufacturers), gearing levels are likely to remain under control, which remains a positive for the company's financial profile.

Investment in clinker producing unit lowers risks of being a standalone grinding unit – Shalimar has a 50% stake in an operational clinker producing unit, i.e. Unitech Cement Private Limited, which has a 99,000 TPA clinker capacity. Despite it being a standalone grinding unit, this investment ensures partial supply of the required clinkers (~23% clinker requirements met from herein in FY2019). This lowers the rating concerns along with the risks emanating from its position as a standalone grinding unit.

Recent capacity enhancement likely to support future sales – The company completed installation of an additional 231,000 TPA capacity through vertical roller mill technology and started production from mid-October 2019. The increased capacity currently stands at ~0.5 million TPA. The capacity enhancement is likely to improve its competitiveness and support future sales, in case of a rise in demand.

Credit challenges

Economic slowdown due to ongoing pandemic could be challenging – The evolving impact of the pandemic on the economy could have a bearing over the company's revenue performance in the near to medium term. Shalimar's capacity utilisation declined to ~73% in FY2019 from the highest levels of ~81% in FY2018. With the added capacity and lowering demand, capacity utilisation dropped to ~50% in 9M FY2020. However, the sales volume is expected to grow by ~15% in FY2021 as around four months' sales in FY2020 was impacted by lockdowns. The demand growth outlook in the current scenario and the company's ability to improve its operational level would remain the key monitorables.

Delay in payment of debt obligations – Shalimar has reported occasional delays (up to 15 days) in payment of the debt obligations during the last 12-month period ending in mid-July 2020. The last instance of delay was in October 2019, which could be attributed to the impact of major festive seasons as well as completion of the latest capex. The delays are currently for a period of less than 30 days and are, therefore, not recognised as default (refer to ICRA Nepal's default recognition policy[1]). Shalimar's track record in debt servicing going forward and augmentation of its liquidity profile would be crucial from a rating perspective.

High working capital intensity – Shalimar's business is highly working capital intensive as reflected in the NWC/OI ratio of ~49% in 9M FY2020. This was mainly on account of very high debtor days (193 days as on mid-April 2020) amid slowdown in sales. As the sales in the last few months of FY2020 were mostly on cash basis, this indicator improved to an extent towards the end of FY2020. Shalimar's ability to manage the working capital levels would remain critical for its liquidity profile.

Stretched liquidity and moderate coverage indicators – The company's liquidity profile remains stretched with the short-term borrowings generally remaining in excess of the drawing power (~113% as of mid-April 2020). The high dependence on external borrowings for its working capital requirements leads to increased finance costs. Additionally, the operating margins reported wide fluctuations in the recent years (generally ~10–11%; ~6% for FY2019), with increasing competition as well as changed sales mix. Hence, the company's coverage indicators moderated with interest coverage of ~1.8 times and DSCR of 1.5 times in FY2019 (~5.8 times and ~3.5 times for FY2017). The margins could remain moderate amid the competition and hence, these indicators are likely to remain at similar levels in the near term. ICRA Nepal also expects timely support from the promoter in case of financial exigencies.

[1] Please find the policy here.

Intense competition – The cement industry in Nepal is highly fragmented, comprising several players and stiff competition from other large/established cement manufacturers. Around 55 cement manufacturing units were already operational in Nepal as of mid-April 2020, while some large cement manufacturing units are in the pipeline. Additionally, many older players have undergone sizeable capacity enhancement in the recent periods. Hence, the pricing flexibility might be lower, going forward, as the capacity creation is much higher than the current demand levels. Any significant upward movements in input prices could further impact the company's margins amid the competition and in turn, the challenges in passing the price increases to final customers.

Vulnerability to cyclicality and seasonal demand; risk of regulatory changes – The cyclical/seasonal nature of the cement industry creates uncertainty over demand and cash cycles for Shalimar. This may impact the company's capacity utilisation, revenues, and profit margins. Volatility in cash flow due to this could pose challenges, especially during the periods of weak demand. Moreover, the cement industry in Nepal is insulated from cheaper imports with duty safeguards and a substantial freight cost is involved in the import of cement. Any changes in Government policies may have a bearing on the performance of the industry players. Any other regulatory changes affecting raw material 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

Incorporated in August 2003, Nepal Shalimar Cement Private Limited (Shalimar) is involved in the production and sales of cement, with current installed grinding capacity of ~545,000 MTPA. The entire shares of the company are held by five individuals from the Shalimar Group. The company produces Ordinary Portland Cement (OPC) and Pozzolana Portland Cement (PPC) under seven brands each, and Portland Slag Cement (PSC) under eight brands. Its factory is located at Pipara, Simara in the Bara district of Nepal.

Key financial indicators

	FY2017 (Audited)	FY2018 (Audited)	FY2019 (Audited)	9M FY2020 (Provisional)
Operating Income-OI (Sales; in NPR Million)	2,988	3,338	2,851	1,800
OPBDITA[2]/OI (%)	13%	11%	6%	11%
Total debt/Tangible net worth-TNW (times)	1.29	2.04	1.93	2.21
Total Outside Liabilities/ TNW (times)	1.86	3.08	2.79	2.75
Total Debt/OPBDITA (times)	2.11	3.34	7.45	5.83
Interest Coverage (times)	5.76	3.47	1.76	1.95
DSCR (times)	3.52	1.58	1.51	1.55
NWC[3]/OI (%)	30%	33%	27%	49%
Current Ratio	1.10	1.07	0.93	1.00

Source: Company data

Annexure-1: Instrument details

Instrument (Amounts in NPR Million) *	Rated Amount	Rating Action
Fund based; Long-term loans - (A)	**473.52**	
Term Loan	348.86	[ICRANP] LBB-; assigned
Hire Purchase	18.82	[ICRANP] LBB-; assigned

[2] *Operating profit before depreciation, interest, tax, and amortization*
[3] *Net Working Capital*

Instrument (Amounts in NPR Million) *	Rated Amount	Rating Action
Unallocated Term Loan	105.84	[ICRANP] LBB-; assigned
Fund-based facilities; Short term – (B)	**1,315.00**	
Overdraft Loan	15.00	[ICRANP] A4; assigned
Demand Loan	100.00	[ICRANP] A4; assigned
Trust Receipt (TR)/Short term Demand Loan	1,200.00	[ICRANP] A4; assigned
Demand Loan (within TR)	(50.00)	[ICRANP] A4; assigned
Non-fund based facilities; Short term (C)	**15.00**	
Letter of credit (within TR)	(1,200.00)	[ICRANP] A4; assigned
Bank guarantee	15.00	
Grand total (A+B+C)	**1,803.52**	

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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 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.

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