

Pashupati Ceramics Private Limited: [ICRANP] LB+/A4 assigned

August 21, 2023

Summary of rating action

Instrument*	Rated Amount (NPR million)	Rating Action
Long-term limits; fund based	580	[ICRANP] LB+; assigned
Short-term limits; non-fund based	300	[ICRANP] A4; assigned
Short-term limits; fund based (within long-term limits)	(350)	[ICRANP] A4; assigned
Short-term limits; fund based (within short-term non-funded limits)	(200)	[ICRANP] A4; assigned
Total	880	

* Instrument details are provided in [Annexure-1](#)

Rating action

ICRA Nepal has assigned a long-term rating of [ICRANP] LB+ (pronounced ICRA NP L B plus) to the long-term loan limits of Pashupati Ceramics Private Limited (PCPL), and a short-term rating of [ICRANP] A4 (pronounced ICRA NP A four) to the short-term loans of the company.

Rationale

The assigned ratings remain constrained by the project execution risk, given the early stage of project development with ~25% of project cost incurred till mid-August 2023 and funding risk with ~40% of the committed equity infused till date. Rating concern also arises from the offtake risk associated with PCPL's product, given the growing number of domestic manufacturers. The tile manufacturing industry is expected to become competitive over the next few years, with one project already commissioned and few others under different stages of development. This is likely to increase fragmentation and exert margin pressure on the industry players, which could be exacerbated given the weak-to-moderate outlook of the construction sector amid challenging economic conditions and slow growth in banking sector credit. The ratings also remain constrained by the relatively higher reliance of the project on the debt financing (~71% of the project cost) and resulting leveraged capital structure, which is expected to stretch the coverage metrics until the project stabilises. In addition, the inherent cyclic nature of the construction sector remains a concern as it exposes the flooring tile business to cash flow volatility and could pose challenges, especially during any periods of weak demand.

However, the assigned ratings factor in the prior experience of the (foreign) promoters of over 20 years in the ceramic tiles manufacturing industry, which partly cushions the project execution and offtake risks. ICRA Nepal also notes the protection of the domestic manufacturers accorded by the Government of Nepal (GoN) through higher custom duty on the import of finished porcelain tiles (up to 40%). The locational advantage of the manufacturing unit, given its proximity to the Indian boarder, is also expected to benefit the logistics management. Notwithstanding the subdued construction sector outlook over the near to medium term, the rising urbanisation and infrastructural deficit in the country remain long-term positives for the company's growth prospects.

Going forward, the company's ability to commission the project within the budgeted cost and timeline will remain a key monitorable. Further, the smooth offtake and stabilisation of the project will also remain among the key rating sensitivities.

Key rating drivers

Credit strengths

Experienced promoters – The promoter group has over two decades of experience in the ceramic tiles manufacturing industry (in India), which remains a positive. Further, the prior involvement of promoters in trading business and linkages in the distribution network is also expected to aid the project's offtake and stabilisation.

Duty protection against imports – PCPL will be among the first few tile manufacturers in Nepal, which could offer the early-mover advantage to the company. At present, the demand in the Nepalese market is met through import, which could be replaced by the domestic players, given the recent increase in import duty by up to ~40%. PCPL plans to source raw materials locally, which, coupled with the inherently high-margin nature of the business, could reflect positively on the company's financial profile.

Long-term demand prospects – The use of floor and parking tiles is on the rise in Nepal with the adoption of relatively modern techniques and materials for construction activities. As such, the rapid rise in urbanisation and the resulting growth in residential/commercial construction are expected to positively support the demand prospects for PCPL's product.

Credit challenges

Project execution and funding risks – The company has incurred ~25% of the project cost, majorly on the civil works for factory building and the procurement of machinery is underway. The debt financing for the project capex has been tied up with lender banks and the promoters have injected ~40% of the committed equity as of mid-August 2023, which remains adequate against the project progress. The ability of the promoters to timely raise the requisite debt and equity required for project commissioning (including cost overruns, if any) will remain essential for completion of project within the management's planned commissioning by November/December 2023.

Project offtake risk – The Nepalese flooring tile market is dominated by reputed foreign brands. High competition from the imported products from established brands as well as probable addition of new domestic manufacturers over the near to medium term will increase the competition in the sector, which could affect PCPL's offtake, to some extent. Further, given the company's plan to export its product to the nearby Indian market, its cost competitiveness in the foreign market will remain a monitorable.

High leverage; coverage indicators likely to remain suppressed in the initial years of operations – PCPL is expected to have a leveraged capital structure with ~71% of the capex financing through debt. The coverage indicators are expected to remain stretched over the near term until the company achieves stabilisation on the revenue profile. Incremental leverage and coverage indicators will also depend on the company's ability to achieve its projected margins and control its working capital intensity.

Inherent cyclicity in construction industry – The demand for ceramic floor tiles will remain dependent on overall trend in the construction sector. The inherent cyclicity of the construction sector and the challenging economic environment at, creates uncertainty about the demand and cash cycles of the players in the construction material sector such as PCPL. This could impact the company's capacity utilisation, revenues, and profit margins over the near to medium term. The resulting volatility in the cash flow could pose liquidity challenges for the company, especially during any periods of weak demand.

Analytical approach: For arriving at the rating, ICRA Nepal has applied its rating methodology as indicated below.

Links to applicable criteria:

[Corporate Credit Rating Methodology](#)

About the company

Incorporated in 2023 as a private limited company, Pashupati Ceramics Private Limited (PCPL) manufactures floor and parking tiles (porcelain). The company is constructing its production plant Jitpur Simara Sub-Metropolitan-4, Bara with a capacity of 81,000 MT per annum.

The shareholders of the company are Mr. Tulasi Sah with a 50% stake, Mr. Ashokkumar Chhaganlal Bhiwani with a 30% stake and Mr. Yagnesh Nagjibhai Chovatiya & Mr. Sarangbhai Dineshbhai Chovatiya with a 10% stake each.

Annexure-1: Instrument details

Instrument (Amount in NPR million)	Rated Limits	Rating Action
Long-term limits; fund based		
Term Loan	580	[ICRANP] LB+; assigned
Subtotal (A)	580	
Short-term limits; non-fund based		
Letter of Credit	250	[ICRANP] A4; assigned
Bank Guarantee	50	
Subtotal (B)	300	
Short-term limits; fund based (within long-term limits)		
Revolving Bridge Gap Loan (within Term Loan)	(350)	[ICRANP] A4; assigned
Letter of Credit (within Term Loan)	(350)	
Cash Credit (within Term Loan)	(30)	
Subtotal (C)	(350)	
Short-term limits; fund based (within short-term non-funded limits)		
Cash Credit Demand Loan (within LC)	(200)	[ICRANP] A4; assigned
Trust Receipt Loan (within LC)	(200)	
Subtotal (D)	(200)	
Total (A+B+C+D)	580	

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About ICRA Nepal Limited:

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