Maruti Cements Limited: [ICRANP-IR] BBB assigned and placed on Watch with Negative Implications

January 08, 2024

Summary of rating action:

Facility	Rated Amount	Rating Action
Issuer rating	NA	[ICRANP-IR] BBB@*; assigned and placed on Watch with Negative Implications

** The symbol '@' Indicates Rating Watch with Negative Implications. Please refer here for further details on rating watch and its implications.*

Rating action

ICRA Nepal has assigned an issuer rating of [ICRANP-IR] BBB to Maruti Cements Limited (MCL or the company) and placed the rating on Watch with Negative Implications. Issuers with this rating are considered to have moderate degree of safety regarding timely servicing of financial obligations. The rating is only an opinion on the general creditworthiness of the rated entity and not specific to any debt instrument.

Rationale

The rating has been placed on Watch with Negative Implications, considering the ongoing industry-wide demand slowdown leading to acute margin pressures, hence resulting in modest coverage metrics, as reported in FY2023. Additionally, the rating watch also factors in the sizeable contingent liabilities related to old and contested electricity costs of ~NPR 978 million, for which the company has recently received claim from the Nepal Electricity Authority (NEA) and is at risk of power cuts like few other similar projects.

However, the assigned rating mainly factors in the company's low leverage levels, which are expected to improve further after the completion of its proposed Initial Public Offering (IPO). ICRA Nepal also takes comfort from the company's comfortable liquidity position with sizeable unutilised drawing power (~62% in mid-October 2023 amounting to ~NPR 1,036 million). The rating also draws comfort from the company's long track record of operations, good brand recall, extensive sales network and its competitive positioning in the eastern region of Nepal. The rating also considers the company's experienced promoter profile, comprising mostly of individuals from the Rathi and Goyal Groups, who have presence across diverse business verticals.

Nonetheless, the rating remains constrained by the decline in revenue and margins amid the industry-wide demand slowdown and increased input prices, leading to moderation in debt coverage and servicing indicators during the last two fiscal years. The rating also remained subdued by the project stabilisation risks associated with the company's recent capacity expansion (capex) amidst the sluggish demand. While the capex is approaching completion at a relatively lower cost, the related term debt burden is likely to accentuate the pressure on coverage metrics in the interim, until completion of loan downsizing plans from proposed IPO proceeds. Additionally, the sizeable contingent liabilities relating to contested electricity costs remains a rating concern. The rating also remains impacted by the company's high working capital intensity (net working capital to operating income ratio; NWC/OI) of ~53% for FY2023. The intense competition and inherent cyclicality in the industry will also have a bearing on the company's incremental financial profile.

Going forward, MCL's ability to improve its revenue/margins, prudently manage its working capital levels and, hence, improve its debt coverage indicators will remain among the key rating sensitivities. The company's ability to successfully complete its IPO at the planned premium price and reduce debt burden amid the margin pressures would remain a key rating monitorable.

Key rating drivers

Credit strengths

Controlled leverage levels and comfortable liquidity – Despite the ongoing capex-related increment in overall debt levels in the recent years, the company's overall leverage level remains controlled on account of the build-up in its net worth base over the years. MCL's gearing ratio (total debt to total net worth) remains low at 0.71 times, while the total outsider liabilities to net worth also remains comfortable at 1.01 times in mid-July 2023. The gearing levels are further expected to improve after the proposed IPO. The company also had sizeable amount of undrawn drawing power at ~62% (amounting to ~NPR 1,036 million) in mid-October 2023, which provides financial flexibility, in case of exigencies.

Competitive positioning in its geography – The ongoing capacity expansion of 1,800 tonnes per day (TPD) for clinkerisation and 2,000 TPD for grinding is estimated to be completed at a total project cost of ~NPR 6,421 million ($ 75/MT[1] based on annual grinding capacity) which remains relatively lower, when compared to other similar scale projects. After completion of the same, the company also has plans to produce PPC to diversify its product range (at present only OPC being manufactured and sold). The company's established brand presence, extensive sales network and competitive market position in the country's eastern region (wherein it faces close competition with the only other greenfield unit in the region) augur well for incremental financial performance. Additionally, the new plant is expected to be more fuel efficient (compared to the current aged plant), hence likely to result in savings in front of power costs, which also remains a positive.

Long track record and experienced promoters – Incorporated in 1994, the company started its operations in 2008 with a clinkerisation capacity of 600 TPD. MCL is promoted by the individuals and institutions associated with the Rathi and Goyal Groups (in addition to an Indian company), who are involved in diverse business verticals in Nepal. The company's operational profile remains supported by its long track record, established sales channel and a good brand recall of Maruti.

Credit challenges

Reduced scalability/margins leading to a major moderation in coverage indicators – The company witnessed a revenue decline of ~28% and ~15% in FY2022 and FY2023, respectively, amid the economic slowdown impacting the industry-wide demand as well as owing to the addition of new players in recent years. The reduced scalability, along with the rise in input prices (mainly coal) and the competition, restrained commensurate decrease in cement realisations, led to a sustained decrease in operating profit margins (OPM) to ~7% for FY2023, compared to ~21% in FY2021. This led to weakened total debt to OPBDITA metrics of ~15 times in FY2023 (~1 times in FY2021). Decline in scalability/margins, pressurised the company's debt service indicators with a DSCR of 1.3 times in FY2023 (7.2 times in FY2021). Whilst the reduction in coal prices is expected to provide some respite, the company's ability to refine the margins and coverage indicators amid the rising competition, would remain crucial, especially considering the shortly commencing repayment of term loans related to the ongoing capex (which was ~63% debt funded, principal repayments for which have started from December 2023).

Sizeable contingent liabilities and high working capital intensity – MCL has sizeable contingent liabilities related to old and contested electricity costs of ~NPR 978 million, for which the company has recently received claim from the NEA. On account of this, the company is also at risk of power cuts like few other similar projects. Any materialisation of the same would have a significant impact on the company's financial profile and, hence, remains a key rating monitorable. MCL's working capital intensity (NWC/OI) also generally remains high and stood at ~53% in mid-July 2023, mainly on account of the elevated inventory levels, whilst the debtor level remains relatively controlled compared to other players. Despite utilising low debt to manage its working capital requirement, the company's ability to judiciously manage the working capital cycle would remain crucial for its incremental liquidity profile.

Intense industry competition adds up to stabilisation risks for recent capex – The cement industry in Nepal is highly fragmented with several players and stiff competition from other large/established cement manufacturers. The pricing

[1] *Taking Exchange rate $1 = NPR 130*

flexibility has gradually lowered in the recent years as the capacity creation within the country is much higher than the current demand. Any significant upward movements in input prices could impact the company's margins given the competitive pressure and volatility in raw material prices, as seen in the recent past. The industry competition would also have a bearing over the project stabilisation timeline for the capacity, which is being added shortly. However, the company has only one greenfield competitor in its core geography (i.e., the eastern region of Nepal), as opposed to relatively higher competition in the central and western regions of the country, which could remain a positive. As the recent margin correction was influenced by multiple factors including the demand slowdown, raw material price volatility and the added competition over the years, MCL's ability to report higher operating margins compared to its key competitors, after the improvement in demand trajectory, remains a key rating monitorable.

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 MCL. This could 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, like the present. As the cement industry in Nepal is insulated from cheaper imports with duty safeguards, any unfavourable 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 rating, ICRA Nepal has applied its rating methodology as indicated below**.**

Link to the applicable criteria
Issuer Rating Methodology

About the company

Maruti Cements Limited (MCL) was incorporated in 1994 and is involved in the production and selling of clinker and cement. Its factory is at Golbazar, Siraha. Initially established as a plant with capacity of 600 TPD for clinkerisation and 500 TPD for grinding in 2008, the capacity stands at 1,500 TPD for clinker and 2,000 TPD for the grinding unit at present. Additionally, the company is undertaking a capacity expansion to enhance its existing clinker capacity to 3,300 TPD and grinding capacity to 4,000 TPD. The company has been promoted by individuals from the Rathi Group and Goyal Group. MCL mainly manufactures OPC cement under the brand name of Maruti, with PPC production in pipeline.

Key financial indicators

	FY2019 (Audited)	FY2020 (Audited)	FY2021 (Audited)	FY2022 (Audited)	FY2023 (Audited)
Operating income (OI in NPR million)	7,504	5,631	6,865	4,977	4,243
OPBDITA/OI (%)	21%	20%	21%	11%	7%
Total debt/Tangible net-worth-TNW (times)	0.39	0.36	0.35	0.71	0.71
Total outside liabilities/ TNW (times)	0.83	0.72	0.57	0.90	1.01
Total debt/OPBDITA (times)	0.97	1.38	1.38	7.73	14.98
Interest coverage (times)	9.26	8.19	12.59	3.74	2.47
DSCR (times)	4.91	3.61	7.16	1.98	1.32
Net-working capital/OI (%)	45%	52%	41%	66%	53%

Source: Company data

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About ICRA Nepal Limited

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