

Palpa Cement Industries Limited: Ratings reaffirmed and removed from Watch with Negative Implications

February 26, 2024

Summary of rating action

Instrument (Amounts in NPR Million) *	Previous Rated Amount	Current Rated Amount	Rating Action
Long-term loan limits	4,609	5,588	[ICRANP] LBB; reaffirmed and removed from Watch with Negative Implications.
Short-term loan limits	3,086	1,686	[ICRANP] A4; reaffirmed and removed from Watch with Negative Implications.
Total	7,695	7,274	

* Instrument details are provided in Annexure-1

Rating action

ICRA Nepal has reaffirmed the long-term rating of [ICRANP] LBB (pronounced ICRA NP L double B) to the long-term loan limits and also reaffirmed the short-term rating of [ICRANP] A4 (pronounced ICRA NP A four) to the short-term loan limits of Palpa Cement Industries Limited (PCIL or the company). The ratings have also been removed from Watch with Negative Implications.

Rationale

The ratings reaffirmation with removal of ratings watch with negative implications mainly factors in the improvement in demand trajectory during H1FY2024 (~48% revenue growth, compared to H1FY2023) along with the improvement in the company's operating profit margins (OPM). While the trends in OPM being in sharp contrast to most of the industry players, raises concerns over its sustainability, increasing scalability is expected to provide some support to PCIL's financial and liquidity profile. The company has also reported increased volume of cement/clinker exports to India given its close proximity with the Indian border region (~22% of revenues in H1FY2024 as against ~8% for FY2023), which has aided the company's revenue profile amidst subdued domestic demand. The ratings also continue to derive comfort from PCIL's experienced and resourceful promoter profile belonging to the RMC Group, which has a long track record in manufacturing/selling construction materials. The ratings also positively factor in the relatively close proximity of its mines and hence lower limestone cost among peer, its improving brand recall and diverse distribution channel.

Nonetheless, the ratings mainly remain constrained by the company's stretched liquidity profile with largely sustained increment in working capital cycle and increased reliance on working capital debt leading to overutilisation of drawing power in recent quarters. The ratings also remain constrained by PCIL's modest capitalisation profile and sub-par debt servicing indicators, which is likely to witness further pressure amid the increased debt repayment obligations for permanent working capital loans. The company's operations also remain exposed to the demand and pricing dynamics in the cement industry, which are influenced by cyclical economic trends in addition to the competitive pressures. Any unfavourable movement in raw materials and other input prices could impact its margins. Going forward, the company's ability to generate adequate revenue/margins, improve the capitalisation and coverage indicators while judiciously managing the working capital levels will remain among the key rating sensitivities.

Key rating drivers

Credit strengths

Improving revenue trajectory and improvement in margins — Despite being in initial years of operation, PCIL was able to report ~8% revenue growth during FY2023, amid the economic slowdown. However, there has been a marked

improved in revenue trajectory during H1FY2024 (~48% growth when compared to H1FY2023 revenues), mainly aided by the increasing exports of cement and clinkers (~22% of H1FY2024 revenues against ~8% of FY2023 revenues) to the bordering towns of India. The scale up in export would support the company's liquidity and margins given the export subsidies announced by the Government of Nepal (4% rebate for exports up to NPR 500 million and 8% for exports >NPR 500 million). With the scalability, the company's OPM has improved to ~22% in FY2023 and further to ~29% in H1FY2024 as compared to ~15% during 10MFY2023, as available during the last rating exercise. However, the movement in margins is in sharp contrast to the overall industry trend, thus raising concerns over its sustainability. Nonetheless, the company continues to enjoy logistic cost advantages against peers, given its relatively close proximity of its mines from factory.

Experienced/resourceful promoters – PCIL is a part of the RMC Group, which has been in the business of manufacturing and selling of construction materials for more than two decades. The Group's flagship unit viz. Rajesh Metal Crafts (rated at [\[ICRANP\] A1](#)) is engaged in manufacturing and selling of sheets and pipes, among others, since 1993. The promoters have gained adequate exposure in the cement industry as well, through a small grinding unit since 2011 (R.M.C Cement Private limited). The dealership and distribution channel of the RMC Group, along with prior exposure in the cement industry, has aided PCIL in quickly scaling up its operations (diverse network of ~500 dealers for PCIL, most of which were sourced from established linkages of the group).

Credit challenges

Stretched liquidity profile – The company has reported sustained increase in its working capital cycle as reflected in the working capital intensity (net working capital to operating income ratio; NWC/OI) of ~58% in H1FY2024 (~49% in FY2023). This was mainly due to the elevated inventory levels amid coal purchases and limestone stocking while the earlier controlled debtor levels have also increased owing to the ongoing pressures in availing fresh funding from the banking channel by its debtors after the implementation of Central Bank's working capital guidelines. PCIL's ability to control the working capital levels would remain critical given its stretched liquidity profile with ~110% utilisation of drawing power as of mid-January-2024 (~81% as of mid-April, 2023 when last rated), leaving it more vulnerable to any additional liquidity shocks.

Modest financial profile – The company's coverage and capitalisation ratios remain moderate with a gearing of 1.8 times, total debt to OPBDITA of 5.9 times and DSCR of 0.8 times in H1FY2024. Ongoing industrywide demand/margin pressures, spiked term debt level (after conversion of a major chunk of working capital loans into permanent working capital loans) along with sharp ballooning in repayment obligations, are likely to exert pressure over the company's near-term debt coverage/service indicators. Therefore, the company's ability to raise equity through proposed initial public offering at targeted price and lower the debt reliance, would shape its incremental financial profile and therefore remains a key rating monitorable.

Intense industry competition – PCIL has limited operational track record in the Nepalese cement industry, with the start of clinkerisation from April 2019 and grinding from January 2020. The industry is highly fragmented, comprising several players with stiff competition from other large cement manufacturers and established brands. The pricing flexibility has gradually lowered in the recent years as the capacity creation within the country is much higher than the current demand levels. Given the challenges in passing the increased cost to consumers (amid competitive pressure), the company's margins remain vulnerable to any significant upward movement in input prices.

Vulnerability to cyclicity and seasonal demand; risk of regulatory changes – The cyclical/seasonal nature of the cement industry creates uncertainty over demand and cash cycles for PCIL. 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. Since the Nepalese cement industry is insulated from cheaper imports with duty safeguards, any unfavourable changes in government policies could have a bearing on the performance of the industry players. Any other regulatory changes affecting raw material prices and availability could also impact the industry.

Link to the previous rating rationale:

[Rationale Palpa Cement BLR-Surveillance July-2023](#)

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

Link to the applicable criteria

[Corporate Credit Rating Methodology](#)

About the company

Incorporated in 2009, Palpa Cement Industries Limited (PCIL) is a greenfield cement manufacturing unit, which started commercial production of clinker from April 2019 and cement from January 2020. The company's plant is located in Sunuwal VDC of Nawalparasi district, while the mines are located ~30 kms from the factory in Rahawas VDC of Palpa district. The plant has a manufacturing capacity of 0.59 million metric tonne per annum (MTPA) for clinker and 0.73 million MTPA for cement, based on the vertical rolling mill (VRM) technology. PCIL belongs to the RMC Group, which is a renowned business house in Nepal with extensive experience, primarily in the construction material manufacturing sector. The company's registered office is in Central Business Park, Thapathali, Kathmandu, Nepal.

Key financial indicators

Particulars	FY2020 (Audited)	FY2021 (Audited)	FY2022 (Audited)	FY2023 (Audited)	H1FY2024 (Provisional)
Operating Income-OI (Sales; in NPR Million)	3,000	4,440	3,818	4,129	1,807
OPBDITA/OI (%)	32%	25%	24%	22%	29%
Total debt/Tangible net worth-TNW (times)	2.8	1.6	1.7	1.8	1.8
Total Outside Liabilities/ TNW (times)	2.9	1.8	1.9	1.9	2.1
Total Debt/OPBDITA (times)	6.4	4.9	6.3	6.7	5.9
Interest Coverage (times)	1.7	2.4	1.9	1.2	1.4
DSCR (times)	1.7	2.5	1.2	0.9	0.8
Net Working Capital/OI (%)	44%	44%	53%	49%	58%*
Current Ratio	1.3	2.5	1.5	2.3	1.5

Source: Company data

*Annualized

Annexure-1: Instrument details

Instrument (Amount in NPR Million)	Previous rated amount	Current rated amount	Rating Action
Long-term loan limits (A)	4,609	5,588	[ICRANP] LBB; reaffirmed and removed from Watch with Negative Implications
Fund based; Term loans and Permanent Working Capital Loans	4,609	5,588	
Short term loan limits (B)	3,086	1,686	[ICRANP] A4; reaffirmed and removed from Watch with Negative Implications
Fund-based; Working capital loans	2,886	1,000	
Non-fund-based; Bank guarantee	200	200	
Non-fund-based; Letter of credit	-	486	
Non-fund-based; Letter of credit (within fund-based limits)	(1,436)	(1,000)	
Grand total (A+B)	7,695	7,274	

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About ICRA Nepal Limited

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