Arghakhanchi Cement Limited: Ratings downgraded to [ICRANP] LBB+/A4+

April 22, 2024

Summary of rating action:

Instrument*	Last Rated Limits (NPR million)	Current Rated Limits (NPR million)	Rating Action
Long-term loan limits	1,747	2,783	**[ICRANP] LBB+**; downgraded from [ICRANP] LBBB-
Short-term loan limits	3,479	1,849	**[ICRANP] A4+**; downgraded from [ICRANP] A3
Total	**5,226**	**4,633**	

** Instrument details are provided in Annexure-1*

Rating action

ICRA Nepal has downgraded the rating assigned to the long-term loan limits of Arghakhanchi Cement Limited (ACL) to **[ICRANP] LBB+** (pronounced ICRA NP L Double B Plus) from [ICRANP] LBBB- (pronounced ICRA NP L Triple B Minus). ICRA Nepal has also downgraded the company's short-term loan rating to **[ICRANP] A4+** (pronounced ICRA NP A Four Plus) from [ICRANP] A3 (pronounced ICRA NP A Three).

Rationale

The ratings downgrade mainly factors in the significant revenue/margin pressures faced by the company during FY2023, which has led to major moderation of its debt servicing/coverage indicators (DSCR and total debt (TD) to OPBITDA of 0.35 times and 10.21 times in FY2023). While the company has reported improvement in these metrics for 8MFY2024, longer-term sustainability of the same remains to be seen, given the likely impact of peak season demand in recent months. The ratings are also constrained by the company's stretched liquidity position, with sustained high overutilisation of drawing power amid margin pressures and high working capital cycle. Additionally, ACL's sizeable contingent liabilities relating to contested electricity costs also remains a rating concern. The cement industry remains highly fragmented and competitive, which could further impact the demand and realisation trends, amid the challenging economic outlook, thus remaining a key rating monitorable. Going forward, the company's ability to report fair revenue growth with adequate margins amid the challenging operating environment, will remain crucial. Its ability to improve its working capital levels and maintain comfortable capitalisation, liquidity and debt coverage indicators would remain the key rating sensitivities.

Nonetheless, the ratings continue to factor in ACL's experienced promoter profile, comprising of individuals from the Siddhartha Group, Kedia Organisation and Murarka Group, which have established presence across multiple sectors. ICRA Nepal also takes comfort from the company's largely controlled gearing levels (0.95 times as on mid-March 2024), its long operational track record (since 1998, albeit initially in small scale) and its sizeable installed capacity (one of the large greenfield units). Additionally, the company has also reported increased volume of cement/clinker exports to India in recent quarters, aided by its close proximity with the Indian border, thus aiding the company's revenue/cash flows amid the subdued domestic demand.

Key rating drivers

Credit strengths

Long operational track record; experienced promoters/management – ACL has a long track record of operations (since 1998, albeit initially in small scale) and has gradually enhanced its capacity over the years. With installed capacity of ~1 million metric tonnes per annum (MTPA) for clinker and ~0.8 million MTPA for cement, ACL is among the large-scale players in the industry, which could provide scale advantages, as and when the demand picks up. The company is mainly promoted by three business groups, namely the Murarka Group, the Siddhartha Group, and Kedia Organisation. These groups have extensive experience across diverse sectors such as manufacturing, trading, banking, and insurance, among others. The groups' established track record and experienced promoters/ management has helped the company, mainly through an extensive sales/logistics network and business relationships developed over the years.

Controlled leverage levels and increasing export prospects – The company's overall leverage levels remain controlled on account of the build-up in its net worth over the years. ACL's gearing ratio (total debt to tangible net worth) and total outsider liabilities to net worth remain controlled at 0.95 and 1.33 times as of mid-March 2024, and could benefit further from the proposed initial public offering plans. After the Government of Nepal announced subsidies for export (~4% rebate for exports up to NPR 500 million and 8% for exports >NPR 500 million), ACL was among the few players initiating the export of cement and clinkers to India, which is on an increasing trend (~12% of 8MFY2024 revenues against ~6% of FY2023 revenues). The scale up in exports has aided the company's revenue profile/cash flows amid the slowdown in local demand.

Credit challenges

Reduced scalability/margins leading to a major moderation in coverage indicators – ACL witnessed a revenue decline of ~13% and ~24% in FY2022 and FY2023 respectively (~6% and ~23% decline respectively, in volumetric terms), amid the economic slowdown impacting the industry-wide demand in the highly fragmented cement sector. The reduced scalability, along with 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 ~23% in FY2021. This led to a weakened TD/OPBITDA metrics of ~10 times in FY2023 while the high interest rates during FY2023 further pressurized the company's debt service indicators with a DSCR of 0.35 times (1.87 times in FY2021) and had to be supported by increased reliance on working capital debt. While the improved revenue trajectory in 8MFY2024 (~16% volumetric growth as compared to 8MFY2023) along with sharply spiked margins remain the positives, longer-term sustainability of the same remains to be seen, given the likely impact of peak season demand in recent months. Further, the currently moderated coal prices (in relation to FY2023 levels) and the restructuring of term debt repayment obligations during FY2024 (extending remaining repayment tenure to 4 years from 8 years and the targeted promoter support) is expected to aid in servicing its near to medium term debt obligations. The long-term revival in demand/margins and the company's ability to improve its coverage indicators remains a key rating monitorable and any sustained pressure over these metrics could have a further downward pressure over the ratings.

Stretched liquidity profile and sizeable contingent liabilities – The company's working capital intensity (net working capital to operating income ratio) generally remains high and stood at ~47% as of mid-March 2024, mainly on account of the increased inventory and debtor days. This, along with the margin pressures, increased the company's dependency on short-term debts resulting in significant overutilization of its drawing power (~160% as of mid-March 2024, as against marginal overutilisation during last rating), which remains a major rating concern. ACL also has sizeable contingent liabilities related to old and contested/unprovided electricity costs of ~NPR 1,257 million, for which the company has recently received claim from the Nepal Electricity Authority. The company's financial and liquidity position could get further stretched in the event of any major materialisation of the same and, hence remains a key rating sensitivity.

Intense industry competition and vulnerability to cyclicality and seasonal demand; risk of regulatory changes – The cement industry in Nepal is highly fragmented, comprising of several players with stiff competition from other established cement manufacturers and brands. The pricing flexibility has gradually reduced in recent years as the capacity creation within the country remains much higher than the current demand levels. Any significant upward movements in input prices could impact the company's margins given the competitive pressures, as seen during FY2023. The cyclical/seasonal nature of the cement industry creates uncertainty over demand and cash cycles for ACL. 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 cement industry in Nepal is insulated from cheaper imports with duty safeguards, 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, including ACL.

Link to the previous rating rationale:

Rationale Arghakhanchi Cement Limited-BLR Surveillance December 2022

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 July 1998 as Dynasty Industries Nepal Private Limited and renamed to Arghakhanchi Cement Private Limited in June 2011, the company was converted into a public limited company and its name was changed to Arghakhanchi Cement Limited (ACL) on July 02, 2021. The company is involved in the production and selling of clinker and cement with a current installed capacity of ~1 million MTPA for clinkerisation unit and ~0.8 million MTPA for grinding unit. ACL's shares are held by eight individuals from three business groups viz. Siddhartha Group (35.0%), Murarka Group (30.0%), Kedia Group (17.5%), and one Indian company viz. Uma Cement International (17.5%). Its factory is located in Mainahiya (Rupandehi district). The company currently manufactures OPC and PPC cement under the brand 'Arghakhanchi Cement'.

Key financial indicators

	FY2020 (Audited)	FY2021 (Audited)	FY2022 (Audited)	FY2023 (Audited)	8MFY2024 (Provisional)
Operating income (OI; Revenues in NPR million)	7,379	8,704	7,589	5,772	3,367
OPBDITA/OI (%)	24%	23%	9%	7%	14%
Total debt/Tangible net worth (TNW; times)	1.16	0.97	1.22	1.01	0.95
Total outside liabilities/TNW (times)	1.39	1.20	1.69	1.44	1.33
Total debt/OPBDITA (times)	3.12	2.39	7.23	10.21	4.99
Interest coverage (times)	3.42	5.46	1.60	0.71	1.68
DSCR (times)	1.76	1.87	0.67	0.35	1.22
Net working capital/OI (%)	47%	41%	47%	42%	47%
Current ratio (times)	1.05	1.14	0.88	1.45	1.62

Source: Company data

Annexure-1: Instrument details

Instrument (Limits in NPR Million)	Last Rated Limits	Current Rated Limits	Ratings
Long-term loan limits (A)	**1,747**	**2,783**	**[ICRANP] LBB+**; downgraded from [ICRANP] LBBB-
Term Loans	1,747	1,139	
Permanent Working Capital Loans	-	1,644	
Short-term loan limits (B)	**3,479**	**1,849**	**[ICRANP] A4+**; downgraded from [ICRANP] A3
Letter of Credit/Trust Receipt/Short Term Loans	-	600	
Cash Credit/Demand Loan/ Short Term Loans	-	1,249	
Working capital loan limits	2,529	-	
Customer acceptance (within short-term limits)	(150)	-	
Trust receipt loans (within short-term limits)	(950)	-	
Bridge gap loan (within fund-based limits)	-	-	
Letter of credit	950	-	

Instrument (Limits in NPR Million)	Last Rated Limits	Current Rated Limits	Ratings
Bank guarantee (within short-term limits)	(100)	-	
Grand total (A+B)	**5,226**	**4,633**	

Analyst Contacts

Mr. Sailesh Subedi (Tel No. +977-1-4519910/20)
sailesh@icranepal.com

Mr. Rajib Maharjan (Tel No. +977-1-4519910/20)
rajib@icranepal.com

Mr. Aslesh Adhikari (Tel No. +977-1-4519910/20)
aslesh.adhikari@icranepal.com

Relationship Contacts

Ms. Barsha Shrestha (Tel No. +977-1-4519910/20)
barsha@icranepal.com

About ICRA Nepal Limited

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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.

For more information, visit www.icranepal.com

ICRA Nepal Limited
Sunrise Bizz Park, 6th Floor, Dillibazar, Kathmandu, Nepal.
Phone: +977-1-4519910/20
Email: info@icranepal.com
Web: www.icranepal.com