Shivam Cements Limited: Ratings downgraded to [ICRANP] LA+@[1]/A1@, with continuation of 'Watch with Negative Implications'

May 06, 2024

Summary of rating action:

Instrument* (Amounts in NPR million)	Previous rated amount	Current rated amount	Rating Action
Long-term loan limits	11.4	9.1	**[ICRANP] LA+@**; downgraded from [ICRANP] LAA-@
Short-term loan limit	3,098.0	3,098.0	**[ICRANP] A1@**; downgraded from [ICRANP] A1+@
Total	**3,109.4**	**3,107.1**	

** Instrument details are provided in Annexure-1*

Rating action

ICRA Nepal has downgraded the long-term loan rating of Shivam Cements Limited (SHIVM or the company) to **[ICRANP] LA+@** (pronounced ICRA NP L A plus) from [ICRANP] LAA-@ (pronounced ICRA NP L Double A minus). ICRA Nepal has also downgraded the company's short-term loan rating to **[ICRANP] A1@** (pronounced ICRA NP A One) from [ICRANP] A1+@ (pronounced ICRA NP A One plus). The ratings continue to remain on 'Watch with Negative Implications'.

Rationale

The ratings downgrade is mainly on account of the sustained pressure over the company's revenue/operating profit margins (OPM), which started from FY2022 and has continued till H1FY2024, amid the competition induced pressure on realisation despite the spiked input cost. This has led to major moderation in SHIVM's Interest coverage indicator (ICR) to 2.7 times in H1FY2024 (5.2 times in Q1FY2023, during last rating). While the debt service coverage indicator (DSCR) was partly supported by non-operating income (mainly dividend income from subsidiary), continuation of the similar trajectory remains to be seen. The ratings also continue to remain impacted by the company's high working capital intensity (net working capital to operating income ratio; NWC/OI) of ~29% in H1FY2024, amid high inventory holding and elongated debtor collection period. SHIVM's concentration risk also remains elevated given the increase in sales concentration from top-10 dealers to ~21% in H1FY2024, from ~11% in FY2022. 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.

Nonetheless, the ratings continue to remain supported by the company's strong capitalisation profile with a low gearing (total debt to total net worth) of 0.07 times as of mid-January 2024, and satisfactory total debt (TD) to OPBDITA of 0.7 times in FY2023 (notwithstanding the moderations in H1FY2024). ICRA Nepal also takes comfort from the company's strong liquidity profile with sizeable unutilised drawing power (~55% as of mid-January 2024, amounting to NPR 845 million). The ratings also continue to consider the company's experienced promoter profile, comprising individuals from various reputed business houses of Nepal, and a seasoned management team. The company's established brand presence and strong market position as one of the largest selling ordinary portland cement (OPC) brands in Nepal, are expected to help the company in sharply improving its margins and coverage metrics, once the demand picks up. Going forward, SHIVM's ability to improve its revenue and margins amid the competitive pressures and the ongoing economic slowdown, will remain crucial. Its ability to manage its working capital levels while maintaining its comfortable capitalisation and improve the debt coverage indicators would remain the key rating sensitivities.

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[1] *The symbol '@' refers to 'rating watch with negative implications'; Please refer here for details on rating watch and its implications.*

Key rating drivers

Credit strengths

Robust capitalisation indicators – Despite the headwinds in revenue and margins, SHIVM's capitalisation indicator continues to remain strong due to its low reliance on debt. While the gearing remains low at 0.07 times as of mid-January 2024, TD/OPBDITA has increased to 3.47 times for H1FY2024 (1.73 times in Q1FY2023, i.e. during last rating exercise), mainly on account of seasonality on sales and margin pressures. However, the past trend of better sales during the last quarters of the financial year could provide support.

Strong operational profile – SHIVM is a partially-integrated cement mill with an adequate operational track record of over a decade and a sizeable installed capacity of 0.63 million tonnes per annum (MTPA) for clinker and 0.99 MTPA for cement. SHIVM has been one of the largest cement-selling brands in the OPC segment with good brand recall and market positioning, as reflected in its relatively higher realisation compared to most peers, despite the decline across the board. Considering the healthy brand recall of SHIVM among retail consumers and good recognition of product quality by infra projects, ICRA Nepal expects the company's operational and financial profile to recover quickly, in the event of demand gradually picking up. The company also has a ~26% indirect stake in the largest cement unit of Nepal viz. Hongshi Shivam Cement Private Limited (HSCPL, operating in a different geography and rated at [ICRANP] LA@) which has been providing regular dividends in past few years, thereby supporting the net profitability of SHIVM. However, the scalability/margins for HSCPL have also been impacted in the recent periods, which could have bearing on the incremental dividend prospects for SHIVM.

Adequate financial flexibility – The company continues to have a low reliance on external financing to fund its working capital requirements as evident from the adequate headroom in its drawing power (~55% unutilised as of mid-January 2024, with headroom of ~NPR 845 million vis-à-vis the outstanding funded debt of NPR 707 million as on the same date). However, ICRA Nepal continues to take note of SHIVM's contested liability towards dedicated power charges as demanded by the Nepal Electricity Authority related to the load-shedding era. While the contested principal amount of NPR 1.27 billion has been fully provided as a precaution to avoid any financial shocks, the liquidity position could get stretched in the event of negative outcome of the ongoing legal case and, hence, remains a rating sensitivity.

Experienced promoter profile and seasoned directors/management – SHIVM is promoted by individuals from various large/reputed business houses of Nepal, viz. the Lucky Group, the Goel Group, the Sharda Group, the Bhimsaria Group, the Maru Group and the Mundara Group who have extensive experience across diverse businesses, including manufacturing (mainly edibles processing, FMCG among others), trading, hydropower etc. Extensive experience of the promoters/directors and the management team remains a positive for a controlled business performance going forward.

Credit challenges

Sustained pressure over revenue/margins in last few years – SHIVM witnessed a revenue decline of ~16% in FY2023 (~11% decline in volumetric sales) amid the economic slowdown impacting the industry-wide demand in the highly fragmented industry. The reduced scalability, along with rise in input prices and the competition induced further decrease in cement realisations, led to a sustained decrease in OPM to historically low level of ~3% in H1FY2024 (6.4% in Q1FY2023, when last rated and >20% in years prior to FY2022). This has resulted in moderation in the coverage indicators with ICR of ~2.7 times in H1FY2024 (~5.2 times in Q1FY2023). However, the DSCR was slightly higher than ICR at ~6.4 times (17.2 times in Q1FY2023), being supported by the non-operating income (dividend income). Nonetheless, SHIVM has reported improvement in volumetric sale during 9MFY2024 (~26% increase compared to same period last year), which along with moderation in the input prices (mainly coal prices, compared to FY2023 levels), could benefit near-term margins. However, the long term sustainability of the same remains to be seen.

High working capital intensity – SHIVM's working capital intensity remains high at ~29% in H1FY2024. This was mainly due to the elongated debtor collection period and high inventory holding days which remained at ~95 days and ~103 days respectively. The debtor days have increased owing to slow pace of government fund release, which has impacted the company's dealers engaged in supply to infra projects/construction contractors, while the high inventory holding is due to stocking of limestone/clinker for the upcoming monsoon months. While the spike is expected to gradually decline over the near term, any major/sustained elongation could give rise to higher working capital financing needs and hence erode the liquidity cushion and/or gearing levels.

Intense industry competition and vulnerability to cyclicality and seasonal demand; risk of regulatory changes – The cement industry in Nepal is highly fragmented with several players and stiff competition from other large/ established cement manufacturers. The pricing flexibility has gradually reduced in recent years as the capacity has been gradually added over the years, thus leading to capacity creation much higher than the current domestic demand levels. Any significant upward movements in input prices could further 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 SHIVM. 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.

Link to the previous rating rationale:
Rationale_Shivam-Cements_Bank-Loan-Rating-Surveillance_February-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 May 2003 as a private limited company, Shivam Cements Limited (SHIVM) was converted into a public limited company in July 2015. The company has been promoted by individuals from various business houses of Nepal, including the Lucky Group, the Sharda Group and the Goel Group, among others. SHIVM manufactures and sells OPC cement under the brand name 'Shivam Cement'. The company has four mines near its manufacturing facilities from which it sources limestone for clinker production. SHIVM also holds a stake of 88% in Shivam Holdings Private Limited, which in turn holds a 30% stake in the largest cement plant in Nepal i.e., Hongshi Shivam Cement Private Limited (HSCPL), a joint venture with the Hongshi Group of China.

Key financial indicators

	FY2021 (Audited)	FY2022 (Audited)	FY2023 (Audited)	H1FY2024 (Provisional)
Operating income (OI; revenues in NPR million)	9,615	9,260	7,753	3,520
Profit after tax (NPR million)	1,412	691	595	149
OPBITDA/OI (%)	22%	12%	7%	3%
Return on capital employed (RoCE %)	17%	9%	8%*	4%*
Total debt/Tangible net worth (TNW; times)	0.07	0.07	0.04	0.07
Total outside liabilities/TNW (times)	0.33	0.34	0.28	0.31
Total debt/OPBITDA (times)	0.31	0.54	0.72	3.47
Interest coverage (times)	81.75	17.68	5.37	2.68

	FY2021 (Audited)	FY2022 (Audited)	FY2023 (Audited)	H1FY2024 (Provisional)
DSCR (times)	49.03	17.55	8.12*	6.40*
Net working capital/OI (%)	21%	22%	17%	29%

Source: Company data

** Higher RoCE vs. OPM and higher DSCR vs. ICR was on account of sizeable non-operating income (mainly dividend).*

Annexure-1: Instrument details

Instrument (Amounts in NPR million)	Last Rated Limit	Current Rated Limit	Rating Action
Long-term loan limits (A)	**11.4**	**9.1**	**[ICRANP] LA+@**; downgraded from [ICRANP] LAA-@
Hire purchase loan	11.4	9.1	
Short term loan limits (B)	**3,098.0**	**3,098.0**	**[ICRANP] A1@**; downgraded from [ICRANP] A1+@
Fund-based working capital loans (Overdraft)	1,998.0	1,998.0	
Fund-based working capital loans (Trust receipt/Short term loans - within other short-term limits)	(1,400.0)	(1,400.0)	
Non-fund-based limits (Letter of credit – LC)	1,100.0	1,100.0	
Non-fund-based limits (LC/Bank guarantee/ Customer Acceptance - within other short-term limits)	(1,150.0)	(1,150.0)	
Grand total (A+B)	**3,109.4**	**3,107.1**	

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. Pranil Dahal (Tel No. +977-1-4519910/20)
pranil@icranepal.com

Relationship Contacts

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

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.

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