PRESS RELEASE

SHAURYA CEMENT INDUSTRIES LIMITED
September 2023

Rating

Instruments/ Facilities	Amount (NPR. Mn)	Rating	Rating Action
Issuer Rating	NA	IRN BBB- (Is)	Assigned

Infomerics Credit Rating Nepal Limited (Infomerics Nepal) has assigned the issuer rating of IRN BBB- (Is) [Triple B Minus (Issuer)]. Issuer with this rating is considered to have the moderate degree of safety regarding timely servicing of financial obligations. Such issuer carries moderate credit risk.

Detailed Rationale

The rating assigned to Shaurya Cement Industries Limited (SCIL) derives comfort from its strong promoter groups- "Shanker Group", "Ambe Group" and "Hulas Group" supported by an experienced management team with a long track record in the cement industry. The company benefits from operating efficiency due to backward integration, with adequate supply arrangements for inputs (mainly clinker) and power. The successful ramp up of its manufacturing unit, coupled with an improving regional market share, especially in eastern and central Nepal, is further expected to support the financial risk profile. However, these rating strengths are constrained by its leveraged capital structure, which is nevertheless, improving. The expected proceeds from the initial public offerings (IPO) are likely to support the gearing and debt coverage indicators, assuming full subscription. Furthermore, the increased financial expenses, the risk of stabilization of operations given the competition induced pricing pressure, working capital intensive nature of business operations, susceptibility to volatility in input costs & realizations, and cyclicality in cement industry remains an additional challenge. Hence, the company's ability to scale up its operations while improving its capacity utilization and managing fluctuations in raw material prices remains crucial. Also, the company's ability to strengthen its capitalization and coverage indicators, along with successful raising of IPO at premium, will remain a key rating sensitivity.

Detailed Description of Key Rating Drivers

Key Rating Strengths

Experienced promoter group and management team with long track record in manufacturing industry.
SCIL is a venture between three large corporate houses in Nepal viz. "Shanker Group", "Ambe Group" and "Hulas Group" among others. Operational synergies are expected being a venture of these corporate groups mainly in the area of supply and distribution channel. Long operational track record of its group companies across various sectors including manufacturing, trading, insurance, hydropower, real estate and diverse experience of promoters could help SCIL maintain healthy performance. SCIL also derives strengths from the financial flexibility of its promoter group. These groups are in business for many decades which provides an additional comfort regarding market presence and market knowledge. Further with the experienced and qualified pool of top management is again expected to support the business risk profile going forward.

Backward Integration in the form of captive limestone mines and power plants
SCIL has a backward integration by way of captive clinker manufacturing units with the capacity of 3,000 TPD, which came in commercial operation in late 2021. The company has also acquired mining rights (through sister concern "Shaurya Cement Limited") in Katari, Udaypur district, whose limestone are considered to be of high quality limestone all over Nepal. The mines are located at a distance of ~40 Km from its factory at Mirchaiya, Siraha district. Also, SCIL has recently added two additional mines in a distance of ~50 Km from

the factory. Both these mines are in the process of excavation. The estimated aggregate deposits of all the mines taken together is expected to further boost the operational profile of the company going forward. This backward integration helps the Company on two counts – maintenance of quality, and control on costs, ensuring the sustenance of the brand in the country. In addition to this, SCIL has a 5.5-MW waste heat recovery system (WHRS) plant at Mirchaiya. This source or arrangement is expected to fulfil the energy requirement of the plant by ~25% thereby bringing economies to power cost of the company.

Strategic Location of the Project with well-equipped technologies and wide network

The manufacturing plant of SCIL is situated at Mirchaiya of Siraha district in East-West Highway covering the major city areas, provides a locational advantage in terms of logistic operation and management. The company has healthy market position in the east, which contributes to around 55% of overall sales in FY23. In addition to this, SCIL is equipped with the latest and new technology in cement industry with an installed alkali bypass system, robotic labs, waste heat recovery system among others; ensuring quality product there by supporting the operational efficiency. Also, promoter's as well as group's wide network of more than 80 distributors and above 1,800 dealers all over Nepal distributing multiple grades cement as well as clinker with presence of its own brand name "Shaurya" should continue to support the business.

Government support for production based industry

Nepal is a growing economy and is continuously focusing on development of various sectors. The budget for FY24 has focused on high and sustainable growth by building a production-based economy. Cash subsidy up to 8% shall be provided for export of cement. Concession up to 15% shall be given to industries consuming electricity of NPR 100 Mn or more monthly. Further, 30% rebate is given on income tax for companies employing 1000 or more workers during a financial year. Also, GoN has allocated NPR 302 Bn for various capital expenditures which indicates growing demand for construction materials like cement products in developing public as well as private infrastructures, road, bridges and other public facilities.

Key Rating Weaknesses

Low project implementation risk; however, stabilization risk remains a concern

With the commissioning of its integrated grinding unit, the implementation risk for the project has reduced. SCIL has already started its commercial production with recorded sales revenue of ~NPR 7,429 Mn in FY22 which was the first full year of its operation, which has slightly declined to NPR 7,407 Mn in FY23. Although, majority of the capex has been completed, the company is still exposed to the risks associated with project implementation for an enhanced capex of ~NPR 1,162 Mn. Hence, any substantial debt-funded capex or acquisition, which may weaken the financial risk profile will be the key rating sensitivity and given the competition induced pricing pressure, the risk of stabilization of operation remains a major challenge to the company.

Leveraged capital structure and stretched liquidity

Despite the improvement in the capitalization level in FY22, the solvency & coverage indicators still remain modest. The total debt to EBITDA ratio of ~6.5x in FY22 has slightly deteriorated to ~6.6x, primarily due to declining EBITDA resulting from price realization pressure. However, the overall gearing ratio has improved to ~3.6x in FY23 from 3.8x in FY22. The coverage indicators are likely to remain stretched, given the high debt burden in the initial year of operation amid recent liquidity crunch. Although the debt service coverage ratio (DSCR) remained fairly comfortable at ~1.14x in FY23, it is expected to deteriorate with the ballooning repayment obligations over the near to medium term. Nonetheless, the expected proceeds from the IPO, assuming full subscription, is likely to provide some comfort. SCIL's dependency on short term borrowing also remains high, as reflected in the working capital utilization of ~90% as of June 2023. Hence remain a concern in terms of cushion availability in absorbing liquidity shocks going forward. Nonetheless, overall leverage is expected to improve as SCIL does not intend to undertake any additional debt-funded capex over the medium term, along with significant debt reduction expected from the IPO issue.

Susceptibility to risks related to input cost, realizations and cyclicality in the cement industry
Capacity addition in the cement industry tends to be sporadic because of the long gestation period and large number of players adding/enhancing capacity during the peak of a cycle. Also, the construction and development expenditures are largely carried out in a specific season impacting the overall demand of the cement in a country. This led to unfavorable price cycles for the sector in the past. Moreover, profitability remains susceptible to volatility in the prices of inputs, including raw material, power, fuel and freight. Realizations and profitability are also constrained by demand, supply, sales and regional factors.

Intense competition in the Industry
Generally, the large cement producers with high brand recognition dominate the market. Due to the presence of large number of organized and unorganized players, the pricing power of the new entrants remains low, affecting the profitability amid competition. Currently there are more than 60 cement industry and more than 20 clinker manufacturing units operating in Nepal, with many additional units in a pipeline. Together with the new upcoming units and existing units after capacity expansion, is expected to reduce the pricing flexibility going forward. Therefore, any significant increase in the cost of input materials is likely to have an effect on the industry's overall margins amid competition.

Analytical Approach: Standalone

Applicable Criteria:
Issuer Rating Methodology

About the Company:
Shaurya Cement Industries was incorporated in September 2017 as a private limited company and later in August 2022 was converted to public limited company. SCIL is an integrated grinding unit having its manufacturing plant located at Mirchaiya of Siraha district with a total installed capacity of 3,000 TPD. SCIL is jointly owned by three corporate houses- Shanker Group, Ambe Group, Hulas Group, among others, where Mr. Sulav Agrawal is the chairman.

Financial Indicators (Standalone)

For the year ended* As on	FY21	FY22	FY23
	Audited	Audited	Unaudited
Total Operating Income (in NPR Mn.)	2,631	7,429	7,407
EBITDA Margin (%)	39.36	27.65	26.87
Interest Coverage Ratio (x)	1.12	1.94	1.46
Current Ratio (x)	1.17	1.18	1.14
Overall Gearing Ratio (x)	4.57	3.82	3.58

**Classification as per Infomerics Nepal standards*

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