Dugar Spices & Food Products Private Limited: [ICRANP] LBB/ A4 assigned

August 26, 2019

Summary of rated instruments:

Instrument*	Rated Amount (NPR Million)	Rating Action
Long-term; fund-based limits	244.43	[ICRANP]LBB; assigned
Short-term; fund-based limits	545.00	[ICRANP]A4; assigned
Short-term; non-fund based limits	191.20	[ICRANP]A4; assigned
Total	**980.63**	

* Instrument details are provided in Annexure-1.

Rating action

ICRA Nepal has assigned a long-term rating of [ICRANP]LBB (pronounced ICRA NP L Double B) to the NPR 244.63 million long-term loans of Dugar Spices & Food Products Private Limited (DSPL or the company). ICRA Nepal has also assigned a short-term rating of [ICRANP]A4 (pronounced ICRA NP A four) to the NPR 545 million fund-based limits and the NPR 191.20 million non-fund-based limits of DSPL.

Rationale

The assigned ratings factor in the long track record of DSPL (operating since 1999), its experienced promoter group and established 'Century' brand. DSPL remains one of the large players in the domestic edible spices and snacks segment, all marketed under the brand name Century. The ratings also derive comfort from DSPL's good growth in operating revenues (CAGR of ~21% in last three years ending FY2018), its improving operating margins and profitability indicators. This has enabled DSPL to maintain adequate debt coverage. The ratings are also aided by DSPL's established supply chain with around 250 distributors, its fairly diversified customer profile and low seasonality in operating revenues. The ratings also factor in the duty protection accorded to the domestic industries by the Government of Nepal (GoN) through import barriers on finished spices and snacks.

The ratings are, however, constrained by low capital base and consequently high gearing levels of the company with Total Debt/Tangible Net Worth (TD/TNW) of ~6 times and Total Outside Liabilities/Tangible Net Worth (TOL/TNW) of ~8 times as of July 18. Gearing remains high because of the consistent overutilization of the drawing power while availing the working capital loans. DSPL has been using its working capital limits for financing the sister concerns, which led to the overutilization of the drawing power till 9M FY2019 to some extent. ICRA Nepal also takes note of DSPL's plans to foray into new product lines in the near future, which will increase the working capital requirement for the company. Limited headroom available in the current working capital limits, given the current overutilization of drawing power, could pose liquidity concern to the company to support business expansion. The company's ability to improve its sales and profitability while managing the working capital position and regularising the drawing power thereby maintaining adequate liquidity, would be the key rating sensitivities. This apart, continuation of the import duty on masala and snacks would be critical for improvement in revenues. Hence, any change in Government policy towards the same would also be a key rating sensitivity.

Key rating drivers

Credit strengths

Adequate track record of being an established brand and experienced promoters – Incorporated in 1999, DSPL has adequate track record of over 20 years in manufacturing edible spices (masala) and snacks (extruded snacks and Bhujiya) in Nepal. DSPL remains the one of the largest organised domestic players in the spice segment of the country. Similarly, the company also remains one of the largest players in the snacks segment with wide product range. The brand Century enjoys strong recognition in the market, which is expected to help the offtake of proposed new product lines as well, which is likely to support the company's scalability. Duty protection accorded by the Government of Nepal (GON) to the industry

(up to 15% custom tariff on imported finished spices and up to 40% custom tariff on imported snacks for FY2020) also remains a positive factor for growth. The promoter, Mr. Motilal Dugar, has extensive experience of the manufacturing sector, which remains a comfort.

Improving sales revenue and profitability indicators - DSPL sales grew by a CAGR of 21% during the last three years ending FY2018. The growth rate has moderated in the recent years (10% in FY2018 and 14% in 9m FY2019) amid the liquidity shortage in the Nepalese financial system, stretched cash cycle and limited headroom in the DSPL's working capital limits to finance the additional working capital requirement. The company's operating margin has improved in the recent years due to the decline in raw material prices amid relatively stable sales realisation. The company plans to add new product lines (viz. breakfast cereals, dry fruits, etc) from FY2020, for which it has incurred a 70% debt-funded capex of over NPR 200 million. Given the established supply chain of the company, the added product lines are expected to boost the revenue and profitability profile of the company. It reported an operating profit margin of 17% during 9m FY2019 vs. 15% in FY2018 and 12% in FY2017 while the net profit margin remains largely stable at ~4-6%.

Established sales channel - The company has an established supply chain, comprising around 250 distributors across the country. DSPL's product has a pan-Nepal presence and the company is continuously adding to its distribution network (~50 distributors added in FY2019), which is expected to increase the product penetration of the company. The customer profile of the company remains fairly diversified with the top 10 customers (distributors) accounting for ~34% of its sales in FY2018.

Credit challenges

High gearing levels, however, adequate coverage indicators owing to good OPBDITA levels - DSPL capital structure remains highly leveraged given the small equity capital base of the company, low profit retention and sizeable scale of operation. The company's gearing ratio stood at ~6 times as of mid-July-2018 as compared to ~12 times as of mid-July 2017. DSPL has been overutilizing its working capital facility vis-à-vis its drawing power, which has also resulted in high gearing. Nonetheless, because of the healthy revenue growth and good OPBDITA levels, coverage indicators remain adequate despite the high gearing. For FY2019, DSPL reported Total Debt/OPBDITA of ~3 times, interest coverage of ~3 times, DSCR of ~2 times and NCA/TD at ~ 17%. Debt coverage indicators (especially DSCR) also remain supported by an elongated repayment schedule of the term loans (10-15 years)

Tight liquidity position – The company has a tight liquidity position as indicated by its consistent overutilization of the drawing power for availing the working capital facility. Besides regular working capital requirements, DSPL has been also using its working capital limits to finance the sister concerns, which resulted in overutilization of the drawing power on a sustained basis. This has reduced the financial flexibility of the business as almost the entire working capital facility has been utilized, which could pose a challenge in the business expansion, especially considering the product range expansion planned by the company in the near future.

Limited product diversification – DSPL's revenue profile remains dominated by two product portfolios i.e. masala and snacks, which cumulatively accounted for over 97-98% of the company's revenue in the last two to three years. Masala and snacks have almost equal contribution to its sales. Therefore, any impact on sales and/or the margin of any of these major product lines could have a corresponding impact on the company's financial profile and debt coverage metrics.

Other external factors like changes in Government regulations - Adverse changes in Government regulations such as changes in tax provisions, restriction on imports and export ban from overseas markets etc. can have a bearing on the performance of all industry players, including DSPL.

About the company

Dugar Spices & Food Products Private Limited (DSPL), incorporated in 1999, is a manufacturing unit producing spices, Bhujiya and extruded snacks. The major products are sold under the brand name Century. DSPL is the largest domestic player in the spices, Bhujiya and extruded snacks segment.

DSPL is a family-owned business of Mr. Moti Lal Dugar, a Biratnagar-based businessman and the chairman of DSPL. As of now, DSPL is the largest business unit of Mr. Dugar, who also owns an operational boutique hotel[1], an under-construction commercial complex (Centurion) and two other manufacturing units, all located in the Biratnagar region of Province-1. Mr. Dugar is also the current Member of Parliament in the Central Government of Nepal.

Key financial indicators

	FY2015 (Audited)	FY2016 (Audited)	FY2017 (Audited)	FY2018 (Audited)	9MFY2019 (Provisional)
Operating Income-OI (NPR Million)	604	773	969	1,063	907
OPBDITA/OI (%)	12%	11%	12%	15%	17%
PAT/OI (%)	4%	4%	3%	4%	6%
ROCE (%)	14%	16%	12%	20%	21%
RONW (%)	32%	45%	48%	73%	57%
Total Debt/Tangible Net Worth TNW (times)	5.03	5.17	12.21	6.07	4.85
Total Outside Liabilities/ TNW (times)	7.32	8.34	16.38	8.27	5.80
Total Debt/OPBDITA (times)	4.71	4.18	4.67	3.24	3.68
Interest Coverage (times)	3.04	3.15	4.51	2.62	2.80
DSCR (times)	0.95	2.87	3.31	2.42	2.56

Source: Company data

Annexure-1: Instrument Details

Instrument	Limit (NPR in Million)	Ratings
Long-term, fund based		
Term loan & Bridge Gap Loan	181.94	[ICRANP] LBB
Hire purchase loan	62.49	[ICRANP] LBB
Total long term, fund based (A)	**244.43**	
Short-term		
Fund based (OD/TR/DL/STL)	545.00	[ICRANP] A4
Non-fund based (LC/PB)	191.20	[ICRANP] A4
Total short term, fund/non-fund based (B)	**736.20**	
Grand total (A+B)	**980.63**	

Analyst Contacts:

Mr. Kishor Prasad Bimali, (Tel No. +977-1-4419910/20)
kishor@icranepal.com

Mr. Sailesh Subedi, (Tel No. +977-1-4419910/20)
sailesh@icranepal.com

[1] *50-room boutique hotel "Hotel Harrison Palace"*

Relationship Contacts:

Ms. Barsha Shrestha, (Tel No. +977-1-4419910/20)
barsha@icranepal.com

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For more information, visit www.icranepal.com

ICRA Nepal Limited,
Sunrise Bizz Park, 6th Floor, Dillibazar, Kathmandu, Nepal.
Phone:+977 1 4419910/20
Email: info@icranepal.com
Web: www.icranepal.com

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