Hansraj Hulaschand and Company Private Limited: [ICRANP] LBBB+/A2 assigned

February 24, 2020

Summary of rated instruments

Instrument*	Rated Amount (NPR Million)	Rating Action
Long-term loans; Fund-based (within funded limits)	(12.1)	[ICRANP] LBBB+; Assigned
Short-term loans; Fund-based	5,290.0	[ICRANP] A2; Assigned
Short-term loans; Non-fund based	500.0	[ICRANP] A2; Assigned
Short-term loans; Non-fund based (within funded limits)	(30.0)	[ICRANP] A2; Assigned
Total	5,790.0	

** Instrument details are provided in Annexure-1*

Rating action

ICRA Nepal has assigned a long-term rating of [ICRANP] LBBB+ (pronounced ICRA NP L triple B plus) to the long-term loans of Hansraj Hulaschand and Company Private Limited (HHC). ICRA Nepal has also assigned a short-term rating of [ICRANP] A2 (pronounced ICRA NP A two) to the short-term loans (including non-fund-based limits) of HHC.

Rationale

The assigned ratings factor in the company's long track record of operations in the Nepalese two-wheeler (2W) dealership industry (since 1998) with a steady market share over the last few years. HHC predominantly deals in the Bajaj brand 2W (~72% share in FY2019 revenues) which has a healthy demand outlook. HHC's 2W segment is further expected to report adequate growth because of lower dependence on bank financing as well as relatively lower cyclicality of the 2W segment compared to the other automotive segments. The ratings take note of company's diverse retail presence through dealers and its experienced board/management team. It also derives comfort from the company's improving operating margins (OPBDITA/OI of ~7.5% for FY2019 against ~4.6% for FY2015), primarily aided by scale economies. HHC has been sourcing an increasing portion of its Bajaj 2W and three-wheeler (3W) sales, from its sister assembly plant i.e. Hulas Autocraft Private Limited (HAC), which has also supported the margins. HAC enjoys tax concessions on assemblage within the country resulting in a lower cost structure compared to the imported vehicles. HHC's coverage indicators remain comfortable with an interest cover of 3.2 times and a DSCR of 2.8 times for FY2019 while its capitalisation remains modest with a gearing of 2.0 times as of mid-July 2019. ICRA Nepal also takes comfort from the company being a part of the Golchha Organisation, which has an established presence across diversified businesses (mainly manufacturing and trading) in Nepal.

The ratings are, however, constrained by the intense competition in the industry, mainly from other established players/brands in the 2W segment viz. Honda and Yamaha. While the range of products in the motorbike segment is largely comparable, key competing brands are additionally benefitted by the strong presence in the scooter segment. HHC's 2W sales remain dominated by its largest selling model i.e. Pulsar (~68% of FY2019 revenues) which also remains a concern in term of product concentration risk. Since the dealership business is characterised by high working capital intensity, the increasing interest rates across the banking sector could also impact HHC's profitability and debt coverage indicators. ICRA Nepal also takes note of the very low chunk of equity capital in HHC's net worth (~7% as of mid-January 2020). While the retained earnings are strong, these could be subject to dividend withdrawal as seen through high dividend payouts in FY2019 (119%). Any such significant withdrawal of retained profits henceforth could pressurise liquidity and the gearing structure and thus could have a bearing on the ratings assigned. Going forward, HHC's ability to reduce its product concentration risk and further improve its market positioning through sustained growth, along with judicious working capital management, remain the key rating sensitivities.

Key rating drivers

Credit strengths

Long track record and strong market presence – HHC has been the sole authorised dealer of Bajaj 2W in Nepal since 1998 and has been able to make Bajaj 2Ws the largest selling motorbike brand in Nepal (market share of ~19%[1] in FY2019). HHC also has an established and wide sales network of 151 sales outlets (including three self-owned showrooms) across the country.

Diverse and sizeable revenue base – HHC has reported a sizeable revenue base of ~NPR 21.7 billion in FY2019, which was mainly contributed by 2W sales (~74%), followed by the 3W segment (14%). Given the age of the dealership, the share of spare and servicing income also remains sizeable at ~6% of FY2019 revenues, the rest being sales of the Servo brand lubricants and others. The revenue base in the last two fiscals was supported by good growth in the 3W segment (~55% CAGR) while the 2W segment reported largely stagnant sales levels. Nonetheless, 2W sales picked up in H1 FY2020 (~12% growth compared to H1 FY2019) after introduction of revised models of Pulsar, which remains a positive. This is also likely to compensate for the expected stagnancy in the 3W segment henceforth. Overall, the growth outlook is expected to remain adequate, despite the challenges in the country's automobile sector.

Healthy margins and comfortable financial profile – HHC's operating margins remain healthy at ~7.5% for FY2019, which have been mainly aided by sizeable scale economies. In recent years, the margins were further supported by the company deriving an increasing portion of the Bajaj 2W and 3W from the assembly unit of the Group i.e. HAC. In FY2019, ~59% of the 2W sales and ~12% of the 3W sales were assembled by the sister concern. This proportion has progressively increased to ~96% for 2W sales and 100% for 3W sales in H1 FY2020. HAC receives a rebate of 25% in applicable excise duty for assemblage within the country. This lowers the costs when compared to imported finished vehicles. Hence, it has allowed the company to improve its gross margins on the one end while pricing the products competitively on the other end. This, along with the sizeable revenue base, has led to comfortable coverage indicators with an interest cover of ~3.2 times and DSCR of ~2.8 times for FY2019.

Part of the Golchha Organisation – HHC is a unit of the Golchha Organisation that has a long presence (around eight decades) across diversified business sectors, mainly in manufacturing and trading, in the country. The presence of sister concern, Hulas Autocraft Private Limited that assembles Bajaj 2W and 3W in Nepal, has allowed for improvements in HHC's gross margins in recent years. Furthermore, the presence of fully owned financing unit, Hulas Investment Private Limited, provides support to the sales of HHC, especially in the 3W segment (~60% of 3W sales by HHC in FY2018 and FY2019 were financed by the sister concern).

Credit challenges

Intense competition and high dependence on variants from a single model – The company faces stiff competition from the dealerships of other established players like Honda and Yamaha, as well as from an increasing number of newer entrants in the 2W segment. HHC's product concentration risk is also high with the variants from its popular model Pulsar accounting for ~60-62% of the company's revenues in the last three fiscals (FY2017-FY2019), which has further increased to 68% in H1 FY2020. Furthermore, the company's absence in the growing scooter segment also remains a concern in terms of incremental revenue diversification.

Working capital intensive operations – Being a working capital-intensive industry, short-term working capital loans account for the almost the entire debt of HHC. The company's working capital intensity (net working capital as a portion of operating income; NWC/OI) further increased in FY2019 to ~29% from ~25% in FY2018. HHC reported an increased inventory-holding period and stretched debtor days (~53 days in FY2019 from ~35 days in FY2018) leading to an elongated working capital cycle. The increased debtor levels could be linked to the tight liquidity in banking as well as the higher credit period offered during the peak sales season. The volatility witnessed in the working capital intensity in recent periods and the rising interest rates could also have a bearing on the company's profitability.

[1] *Based on vehicle registration data published by Department of Transport Management, Nepal*

Increased taxes, revised financing norms and high borrowing rates could impact revenues – Automobiles have been a highly-taxed commodity in Nepal with a sharp tax increment since FY2019. Additionally, a reduced loan-to-value (LTV) on the bank financing of vehicles at 50% by the banking sector regulator might deter prospective customers. As certain parts of the 2W sales are financed by banks, slower loan disbursements amid the current tight liquidity conditions in banking could impact sales growth. Moreover, bank interest rates have increased swiftly in the last two years, which coupled with the inherent cyclicality in the automotive demand, could constrain HHC's revenue growth.

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

Links to applicable criteria:
Corporate Credit Rating Methodology

About the company

Established in 1959, Hansraj Hulaschand and Company Private Limited (HHC) is the authorised dealer of Bajaj two-wheelers and three wheelers, KTM brand two-wheelers, TVS brand tyres and Servo lubricants for Nepal. Its registered office is in Biratnagar, Morang. The company operates through three showrooms of its own in Kathmandu (one Bajaj showroom and two KTM showrooms), along with 148 regional dealerships. HHC is a part of the Golchha Group, which has a long and diverse presence across various manufacturing and trading sectors in Nepal. As of now, the company's shares are held by 19 members of the Golchha family with a major stake held by Mr. Shekhar Golchha (53.8%) while the rest of the shareholders hold 3.75% or less. Mr. Shekhar Golchha is the Chairman of the company.

Key financial indicators

	FY2016 (Audited)	FY2017 (Audited)	FY2018 (Audited)	FY2019 (Audited)	H1 FY2020 (Provisional)
Operating income (OI; NPR million)	12,421	18,547	20,809	21,696	12,699
OPBDITA/OI (%)	6.85%	7.43%	5.46%	7.45%	7.94%
Total debt/Tangible net worth (TNW; times)	1.30	1.45	1.42	2.01	1.86
Total outside liabilities/TNW (times)	1.80	1.75	1.85	2.58	2.07
Total debt/OPBDITA (times)	2.14	2.15	3.12	3.02	2.71
Interest coverage (times)	7.29	8.13	3.27	3.25	3.27
DSCR (times)	5.69	6.50	2.38	2.79	2.72
Net working capital/OI (%)	22%	23%	25%	29%	27%

Source: Company data

Annexure-1: Instrument details

Instrument	Limits (NPR million)	Ratings
Fund-based facilities; Long-term		
Hire Purchase (within funded limits)	(12.1)	[ICRANP] LBBB+; Assigned
Fund-based facilities; Short-term		
Demand Loan	545.0	[ICRANP] A2; Assigned
Import Invoice Financing	1,250.0	[ICRANP] A2; Assigned
Overdraft	95.0	[ICRANP] A2; Assigned
Short Term Loan	1,940.0	[ICRANP] A2; Assigned
Trust Receipt/Demand Loan	1,460.0	[ICRANP] A2; Assigned
Short-Term Loan (within funded limits)	(300.0)	[ICRANP] A2; Assigned
Trust Receipt Loan (within funded limits)	(30.0)	[ICRANP] A2; Assigned

Instrument	Limits (NPR million)	Ratings
Import Loan (within funded limits)	(8.5)	[ICRANP] A2; Assigned
Total Fund-based-Short term (A)	**5,290.0**	
Non-fund-based facilities; Short-term		
Letter of Credit	500.0	[ICRANP] A2; Assigned
Letter of Credit (within funded limits)	(30.0)	[ICRANP] A2; Assigned
Total Non-fund-based-Short term (B)	**500.0**	
Total limits (NPR Million) (A+B)	**5,790.0**	

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About ICRA Nepal Limited

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