Agni Incorporated Private Limited: Ratings reaffirmed for revised limits and withdrawn for reduction in limit

August 10, 2020

Summary of rated instruments

Instrument (Amounts in NPR million)	Previous rated amount	Current rated amount	Rating Action
Long-term loans; fund-based	(50)	278	[ICRANP] LA@[1]; Reaffirmed
Short-term loans; fund-based	3,149	3,149	[ICRANP] A1@; Reaffirmed
Short-term loans; non-fund-based	3,308	3,308	[ICRANP] A1@; Reaffirmed
Short-term loans; fund and non-fund-based	1,785	-	Rating withdrawn
Total	**8,242**	**6,735**	

** Instrument details are provided in Annexure-1*

Rating action

ICRA Nepal has reaffirmed the long-term rating of [ICRANP] LA@ (pronounced ICRA NP L A) to the enhanced long-term loan limits (NPR 278 million) of Agni Incorporated Private Limited (AIPL). ICRA Nepal has also reaffirmed a short-term rating of [ICRANP] A1@ (pronounced ICRA NP A One) for its reduced short-term loans (NPR 6,457 million, including non-fund-based limits). Furthermore, ICRA Nepal has withdrawn the rating assigned to the short-term loan of NPR 1,785 million due to reduction of loan limits.

Rationale

The rating action factors in the company's long track record (>25 years) in the Nepalese automobile dealership industry as an authorised dealer of Mahindra pickups, utility vehicles (UV) and tractors. The company continues to have a strong market position in the UV segment, given the good demand outlook for its top selling models (Scorpio and Bolero). The rating also takes into consideration the company's comfortable financial position with low gearing levels and adequate coverage indicators, despite some decline in the recent periods with slowdown in sales. With sizeable profit retention/capitalisation over the years, AIPL's gearing was low at ~0.6 times as on mid-June 2020, while the interest cover of 7.08 times for 11M FY2020 also remained comfortable. The rating also takes comfort from AIPL's robust return indicators with healthy operating margins at ~10.2% for 11M FY2020. ICRA Nepal also positively views the company's adequate liquidity cushion with average working capital loan utilisation of only ~60% of the drawing power. Additionally, the experience of promoters/management, along with the secured debtor mechanism (receivables largely backed by letter of credits (LC)), further supports the rating action.

Nonetheless, the continuation of the rating watch with negative implications is because of the expected negative impact of the Covid-19 pandemic on the Nepalese economy. AIPL's sales were already showing signs of stagnancy on account of economic cyclicality as the most vehicles sold by the company are used for commercial purposes. The pandemic is likely to further slow down the economic growth and hence, may result in demand contraction and lower sales for the automobile dealership industry. Hence, the resultant lower scale economies are likely to create pressure on the margins, increase working capital intensity[2], and deteriorate the capitalisation and coverage indicators. The company's ability to judiciously manage the working capital intensity and the cash flows for the near to medium term would remain critical.

The ratings are also constrained by the rising competitive pressures for AIPL's top two models, which together account for over 90% of total sales. Further, the ratings continue to be impacted by the increased taxes for the passenger vehicle (PV) segment, along with tighter financing norms, which have lowered the demand outlook. Going forward, AIPL's ability

[1] *Denotes rating on watch with negative implications*
[2] *Net working capital as a percentage of operating income (OI)*

to attain healthy sales level amid the current challenges, diversify its revenue streams, and maintain/improve its profitability and capitalisation, will remain the key rating sensitivities.

Key rating drivers

Credit strengths

Long track record and strong market presence; experienced management – AIPL is the sole authorised dealer of utility vehicles (part of PV segment), pickups (part of commercial vehicle (CV) segment) and tractors of Mahindra & Mahindra Limited for Nepal since 1991. Established track record and strong brand recall has resulted in strong market positioning for AIPL, especially in the UV and the pickup segment. The demand basically emanates from the suitability of these vehicles for the Nepalese geography, durability, competitive pricing, and relatively low range of competing models. AIPL has adequate presence across the country through nine showrooms of its own and 24 regional dealership outlets. The company's experienced promoters/management remains a comfort in terms of incremental business performance.

Comfortable financial profile – AIPL's operating margins remain healthy at ~10.2% in 11M FY2020, despite the decline from ~14% levels from FY2016 to FY2018. The margins have witnessed moderation due to negative operating leverage because of slowdown in underlying automotive industry. However, the company has maintained high equity levels resulting in low gearing at mostly <1x (0.6 times as of mid-June 2020). Coverage indicators (TD/OPBIDTA) also remain comfortable at 1.9 times, with interest cover of ~7.1 times and DSCR of ~4.2 times for 11M FY2020. Nonetheless, AIPL's ability to control any further sharp reduction in margins and its stance on dividend payouts would remain crucial for its capital structure.

Adequate liquidity buffer and secured debtor mechanism – AIPL generally has good financial flexibility with relatively low dependence on working capital borrowings, which could help it in managing the expected liquidity pressures over the near to medium term. As of mid-June 2020, the company had utilised only ~60% of its drawing power and hence, has surplus drawing power of ~NPR 1.7 billion. Additionally, it follows secured debtor sales mechanism through LCs only, which assures on time recoveries, albeit elongated in the recent periods due to the extended pandemic-induced lockdowns.

Credit challenges

Stagnant sales in last few years; Covid-19 to impact revenue streams – AIPL has witnessed largely stagnant sales levels in the last three fiscals. This was mainly on account of the tightening liquidity in the banking sector and stringent financing norms for PV segment (including capping of loan to value at 50% and debt service to gross income at 50%). Amid the elongated lockdown and the rising competition, the company's revenues reported a marked decline in FY2020 to ~NPR 8.9 billion sales in 11M FY2020 against ~NPR 16 billion in the earlier three fiscals. Moreover, with the expected economic slowdown due to the pandemic, revenues are likely to remain subdued over the near to medium term. Dampening of Government revenues due to Covid-19 and increased expenses for the health sector could result in reduced development activities across the country. This would significantly impact the demand outlook in the CV segment, which contributes to over 50% of the revenues for the company. The PV segment was already under stress with increased taxes and stringent financing norms, resulting in lower sales support from this segment (~40% for FY2019 against ~50% for FY2017). These could create pressures over profitability and debt coverage indicators over the medium term.

Intense competitive pressure and high dependence on top selling models – The automobile dealership industry is highly fragmented with stiff competition from dealerships of incumbents like TATA (from TATA Motors Limited), Maruti Suzuki and Hyundai, among others. There has been increased competition with several new entrants as well as competing models from TATA and Isuzu in the pickup segment, impacting AIPL's sales of pickup models. AIPL has high dependency on select models, especially Bolero and Scorpio, which accounted for ~90% of sales during 9M FY2020, reflecting high product-concentration risk.

Increased working capital intensity – Being a working capital-intensive industry, short-term working capital loans account for almost AIPL's entire debt. Given the expected increase in the inventory-holding period, the overall working capital requirement is likely to increase in the near to medium term, which will result in moderation of coverage indicators. This is also evident from the increased working capital intensity in the recent periods (~34% for 11M FY2020 as against ~15% for FY2017), leading to higher working capital debt.

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

Links to applicable criteria:
[Corporate Credit Rating Methodology]

About the company

Incorporated in 1991, Agni Incorporated Private Limited (AIPL) is the sole authorised dealer of Mahindra automotive products (utility vehicles, passenger vehicles and tractors) for Nepal. Mr. Cabinet Shrestha, Ms. Susan Vaidya Shrestha and Mr. Arjun Prasad Sharma are the shareholders as well as the directors of the company. AIPL has presence across the country through an extensive network comprising nine showrooms/sales outlets of its own and 24 regional dealerships outlets.

Key financial indicators

	FY2017 (Audited)	FY2018 (Audited)	FY2019 (Audited)	11M FY2020 (Provisional)
Operating income (OI; NPR million)	16,375	16,259	16,352	8,963
OPBDITA/OI (%)	14.14%	14.20%	10.86%	10.15%
Total debt/Tangible net worth (TNW; times)	0.34	0.27	0.49	0.60
Total outside liabilities/TNW (times)	0.74	0.69	0.81	1.07
Total debt/OPBDITA (times)	0.41	0.37	0.89	1.93
Interest coverage (times)	12.70	17.12	9.72	7.08
DSCR (times)	8.05	5.37	7.31	4.19
Net working capital/OI (%)	15%	18%	21%	34%

Source: Company data

Annexure-1: Instrument details

Instrument (Amounts in NPR million)*	Previous rated amount	Current rated amount	Rating Action
Fund-based facilities; Long-term			
Term Loan and Hire Purchase Loan	(50)	278	[ICRANP] LA@; Reaffirmed for enhanced limit
Total Fund-based-Long term (A)	**-**	**278**	
Fund-based facilities; Short-term			
Trust Receipt Loan/Import Loan/ Local Document Purchase Loan/ Demand Loan/Overdraft	3,149	3,149	[ICRANP] A1@; Reaffirmed
Short-term; fund-based facilities	1,053	-	Rating Withdrawn
Total Fund-based-Short term (B)	**4,202**	**3,149**	
Non-fund-based facilities; Short-term			
Letter of Credit/ Bank Guarantee	3,308	3,308	[ICRANP] A1@; Reaffirmed
Short-term; non-fund based facilities	732	-	Rating Withdrawn
Total Non-fund-based-Short term (C)	**4,040**	**3,308**	
Total Limits (A+B+C)	**8,242**	**6,735**	

**There are some interchangeable funded and non-funded facilities within the above rated limits*

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About ICRA Nepal Limited

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