Pioneer Moto Corp (Pvt.) Ltd.: Rating reaffirmed

August 17, 2020

Summary of rated instruments

Instrument (Amounts in NPR million)	Previous rated amount	Current rated amount	Rating Action
Short-term loans; non-fund- based	165	365	[ICRANP] A4+@[1]; reaffirmed for enhanced limit
Short-term loans; fund-based	830	1,150	[ICRANP] A4+@; reaffirmed for enhanced limit
Short-term loans (proposed)	520	-	Rating withdrawn
Total	**1,515**	**1,515**	

** Instrument details are provided in Annexure-1*

Rating action

ICRA Nepal has reaffirmed the rating of [ICRANP] A4+@ (pronounced ICRA NP A Four Plus) for the short-term loans of NPR 1,515 million (including non-fund-based limits) of Pioneer Moto Corp (Pvt.) Ltd. (PMC).

Rationale

The rating reaffirmation factors in the company's improving scale of operations post the addition of Nissan vehicles' dealership from FY2018. Healthy sales growth within the Nissan segment has supported the company's revenues amid the declining sales in the Datsun segment for the last few years. Additionally, newer launches in the Nissan segment with better margins have helped improve PMC's operating margins in the recent periods. The rating further takes comfort from the fact that PMC is promoted by the Sharda Group, which has a diversified presence across multiple business sectors in the country. The consequent financial flexibility is reflected in the form of short-term advances and equity infusion by the promoter, as per business requirements. ICRA Nepal expects continued financial support from the promoter Group in case of exigencies.

Nonetheless, the continuation of the rating 'Watch with Negative Implications' is because of the expected economic impact of the Covid-19 pandemic and its bearing over the demand momentum for the automobile industry. This is also evident from the sales decline (~20%) in FY2020, with a similar trend expected over the near term. Hence, the negative operating leverage is likely to create pressure on the margins, increase working capital intensity and affect the capitalisation and coverage indicators. PMC's liquidity profile also remains stretched with the working capital borrowings generally exceeding the drawing power. The rating is also impacted by the company's moderate capitalisation with a gearing of ~4.5 times as of mid-July 2020, along with stretched coverage indicators (Total debt/OPBDITA of ~5.3 times and interest coverage of ~1.5 times for FY2020). 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 rating is also constrained by the intense competition from established players/brands in the automobile dealership industry, wherein PMC is a relatively new player. The rating is also impacted by the increased taxes for the passenger vehicle (PV) segment as well as the tighter financing norms, which can be seen impacting demand growth. Going forward, the company's ability to attain adequate sales level amid the current challenges, improve its capitalisation and coverage indicators and increase revenue diversification through new models/segments will remain the key rating sensitivities.

[1] *Denotes rating on watch with negative implications*

Key rating drivers

Credit strengths

Improving market presence and healthy sales growth – PMC is the sole authorised dealer of the Datsun and the Nissan brand vehicles in Nepal since 2014 and 2017 respectively. Datsun vehicles reported good sales growth in initial years and thereafter were in a declining trend in the last three fiscals, primarily due to lack of new launches. Nonetheless, addition of the Nissan dealership provided revenue diversification opportunities and aided the sales levels. The Nissan vehicle segment reported a good growth of ~44% in FY2019, while the Datsun vehicle sales declined by ~14% (32% decline in FY2018) and hence overall sales in FY2019 increased by ~19%. With a similar sales trend, the share of revenues from Nissan increased to ~73% in 9M FY2020 from ~58% in FY2018. However, the revenues are now mostly dominated by Nissan Kicks, which accounted for ~60% of the vehicle sales in 9M FY2020. Going forward, the company's ability to diversify its revenue streams by adding new models/segments would remain a key monitorable.

Financial flexibility as part of the Sharda Group – PMC is a part of the reputed Sharda Group, which has an established presence in various lines of businesses in Nepal. In the recent past, the promoters provided timely financial assistance in the form of equity and short-term loans to ease liquidity pressure and support working capital, which lent additional comfort. ICRA Nepal expects the promoter group to provide timely financial support in case of financial exigencies.

Improvement in operating margins and profitability indicators - PMC has been able to improve its operating margins over the years (to 6.6% for FY2020 from 5.7% for FY2018), primarily supported by the increasing share of revenues from Nissan vehicles, which have relatively better margins. Additionally, the high-margin servicing and spare parts business is expected to grow gradually with increasing years of dealership. Net margins also improved to 1.6% after witnessing a declining trend in the last few fiscals. However, PMC's margins have remained volatile in the past, which remains an area of concern and hence the sustainability of recent improvement in margins remains to be seen.

Credit challenges

Externalities brought on by Covid-19 could affect key operating parameters – The ongoing global pandemic is expected to have a significant impact on the country's economic growth. With the expected economic slowdown due to the pandemic, revenues are likely to remain subdued over the near to medium term. Discretionary purchases like cars are likely to witness deferment in the near term and hence impact the demand for the automobile sector. The resultant negative operating leverage is likely to create pressure on PMC's sales, margins and liquidity.

Weak capitalisation profile and stressed coverage indicators – PMC's capital structure remains weak with gearing of ~4.5 times as of mid-July 2020, despite recent improvements (~6.2 times as on mid-July 2018). The debt coverage indicator has also deteriorated with a total debt/OPBDITA of ~5.3 times for FY2020 compared with ~4.0 times for FY2018. Furthermore, an increase in the debt levels and rising finance costs in the last two years has lowered the company's interest cover, which remained modest at ~1.5 times for FY2020 with DSCR of ~1.4 times (~1.7 times and ~1.5 times respectively in FY2018). PMC's capital structure and coverage indicators are likely to remain stretched over the medium term, given the thin cash accruals and expected elongation in working capital cycle (higher working capital debt).

Limited track record and intense competitive pressure – PMC has been in the auto dealership business since 2014 and hence has a relatively limited track record in the business as compared to other large dealerships in the country. The Nepalese automobile dealership industry in the PV segment is dominated mainly by dealerships of incumbent OEMs like Maruti Suzuki and Hyundai etc. Stiff competition constrains pricing flexibility, especially for dealerships having limited presence in the market.

High working capital intensity and stretched liquidity – Being a working capital-intensive business, most of the funding requirements in the automotive dealership are for current assets financing. PMC's inventory-holding periods were already in an increasing trend (64 days for FY2019 against 47 days for FY2018), which further deteriorated to 93 days due to the impact of the pandemic. This, along with elevated debtor days (77 days for FY2020, increasing from 41 days in FY2018), has resulted in increased working capital intensity (NWC/OI of ~38% for FY2020) and hence higher debt requirements. Additionally, the liquidity profile remains modest with working capital borrowings remaining higher compared to the drawing power at times (~108% as of mid-July 2020; ~103% a year ago). However, the promoter group has provided support in the form of fresh equity injection (NPR 50 million) in FY2019 and advances in FY2020 (NPR 50 million).

Stringent financing norms for PVs could further hinder demand growth – Passenger vehicles were already a highly taxed commodity in Nepal, which witnessed a further sharp increment in taxes from FY2019 onwards. Additionally, the cap on bank financing at 50% set by the banking sector regulator, along with the debt service-to-gross income ratio requirement of 50% or better, could deter prospective customers. This, coupled with the inherent cyclicality in auto dealership, could constrain the revenue growth for PMC. However, the improving liquidity and declining interest rates in banking, following the announcement of the expansionary Monetary Policy, could remain a positive.

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 August 2014, Pioneer Moto Corp (Pvt.) Ltd. (PMC) is Nepal's sole authorised dealer for Nissan and Datsun Brand vehicles. PMC was promoted by Mr. Sandeep Kumar Sharda, who is also the sole shareholder and managing director of the company. PMC is also involved in selling genuine spares/accessories and servicing of the Nissan and Datsun brand vehicles. PMC has three showrooms/sales outlets of its own (two in Kathmandu and one in Biratnagar) and 13 dealership outlets across major cities of Nepal.

Key financial indicators

	FY2017 (Audited)	FY2018 (Audited)	FY2019 (Audited)	FY2020 (Provisional)
Operating income (OI; NPR million)	1,574	2,724	3,239	2,596
OPBDITA/OI (%)	6.28%	5.67%	4.20%	6.65%
Total debt/Tangible net worth (TNW; times)	7.78	6.22	6.09	4.50
Total outside liabilities/TNW (times)	9.83	9.88	6.75	5.15
Total debt/OPBDITA (times)	4.76	4.00	7.29	5.30
Interest coverage (times)	2.17	1.67	1.23	1.50
DSCR (times)	1.90	1.51	1.18	1.39
Net working capital/OI (%)	33%	26%	33%	38%

Source: Company data

Annexure-1: Instrument details

Instrument (Amounts in NPR million) *	Previous rated amount	Current rated amount	Rating Action
Fund-based facilities; Short-term			
Trust Receipt Loan/ Demand Loan/ Working Capital Loan/ Overdraft	830	1,150	[ICRANP] A4+@; Reaffirmed for enhanced limit
Proposed short term limits	520		Rating Withdrawn
Total Fund-based-Short term (A)	**1,350**	**1,150**	
Non-fund-based facilities; Short-term			
Letter of Credit/ Bank Guarantee	165	365	[ICRANP] A4+@; Reaffirmed for enhanced limit
Total Non-Fund-based-Short term (B)	**165**	**365**	

Instrument (Amounts in NPR million) *	Previous rated amount	Current rated amount	Rating Action
Grand total (A+B)	**1,515**	**1,515**	

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

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About ICRA Nepal Limited

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