Gharana Foods Private Limited: Ratings reaffirmed

August 24, 2020

Summary of rated instruments

Instrument (Amounts in NPR million)	Previous rated amount	Current rated amount	Rating Action
Long-term loans	54.7	62.3	[ICRANP] LBB-; reaffirmed for enhanced limit
Short-term loans	692.7	692.7	[ICRANP] A4; reaffirmed
Short-term loans; fund-based	7.6	-	Rating withdrawn
Total	**755.0**	**755.0**	

** Instrument details are provided in Annexure-1*

Rating action

ICRA Nepal has reaffirmed the ratings of [ICRANP] LBB- (pronounced as ICRA NP L double B minus) for the enhanced long-term loan of NPR 62.3 million and [ICRANP] A4 (pronounced ICRA NP A Four Plus) for the short-term loans of NPR 692.7 million (including non-fund-based limits) of Gharana Foods Private Limited (GFPL). ICRA Nepal has withdrawn the rating assigned to the short-term loan of NPR 7.6 million due to a reduction of the loan limits.

Rationale

The ratings reaffirmation factors the long track record of operations (since 2008) with extensive experience of the promoters in the agro-food industry and the stable demand outlook for wheat items; mainly so because wheat products form a part of the staple diet and are a major source of raw material for fast-moving consumer goods (FMCG) and the fast food sector across the country. The rating also derives comfort from the availability of a different pack size, incorporating both the business-to-business (B2B) and the business-to- customer (B2C) segment. The ratings also factor in GFPL's long-standing relations with its diversified client base, which has resulted in incremental business over the years and is also likely to support future revenue growth.

The ratings are, however, constrained by the leveraged financial structure of GFPL with gearing of ~2.96 times in FY2020 due to high working capital intensity of the business (NWC/OI[1] of ~43% in FY2020) resulting in a stretched liquidity position, modest coverage indicators and net profitability amid increased finance cost. Nonetheless, the working capital intensity is on the improvement track for the last three years ending FY2020 with improved debtor days in the same period. Further, an increase in the Agricultural Reform Fee (ARF) from 5% to 9% on import of wheat in the Nepal Government budget 2020-21, while maintaining the duty on import of the finished goods at the same level, created competitive pressure on Nepalese wheat processing from the imported finished product. This will have a direct impact on the company's B2B business segment as buyers have the purchasing power of a sizeable inventory on a regular basis. The rating is also constrained by the highly competitive nature of the industry, which limits the pricing flexibility of the industry participants, including GFPL. Moreover, the company's operations and profitability are also susceptible to the availability and pricing of raw material that remains affected by the monsoon and the climatic conditions as well as changes in governmental policy, both in India and Nepal. Similarly, the company's revenue growth and profitability are exposed to external factors such as low entry barriers and high industry fragmentation (with many organised and unorganised players).

Furthermore, the ratings are also constrained by the impact of the Covid-19 pandemic followed by the lockdown and GFPL's slow revenue growth and profitability in FY2020. Though the company's product profile is expected to have a slight impact in the post pandemic era, the overall economic environment is expected to have a bearing on GFPL's growth movements.

[1] Net working capital by operating income

Key rating drivers

Credit strengths

Long track record of operations coupled with extensive experience and commitment of the promoters - GFPL has been in operation since 2008 with continuous capacity upgradation. Its promoters have extensive experience having spent over four decades in the agro-food industry. The company has been promoted by three individual shareholders belonging to the same family (Mr. Shrichand Goenka 20%, Mr. Govind Prasad Goenka 20% and Mr. Vinay Kumar Goenka 60%). The promoters, along with other family members, are also involved in the company's day-to-day management. These factors are instrumental in driving GFPL's business in the days ahead.

Stable growth prospects - The company reported a revenue growth of approximately 12% in FY2020, moderated compared to the CAGR growth of around 40% in the past two years ending FY2019. The moderation was due to the pan-Nepal lockdown restraining the smooth flow of supply and the temporary shutdown of the industrial customers for approximately one-and-a -half months starting from March 24, 2020. However, the demand outlook is expected to remain stable with wheat products being the staple diet in various parts of the country. Further, they are also the primary raw material for FMCG food items and fast food sectors across Nepal, which is likely to drive sectoral demand. To cater to the increasing demand outlook of the industry, GFPL upgraded its installed capacity, added two product lines (*chakki aata* and *dalia*) a few years ago and increased the raw material storage capacity by 5000MT in FY2019. Nonetheless, amid increased competition in the industry, the demand may fluctuate within the players.

Diversified customer and supplier base - The company's established wide customer base largely comprises units from the FMCG sector, manufacturing and trading. The company's customer base consists of both the B2B and the B2C, mainly due to its diversified products (*maida, aata, chakki aata, suji, chokar* and wheat grit) as well as availability of packaging options ranging from 1kg to 50kg packs. This has so far catered to the various customer preferences, thus establishing both the B2B and the B2C customer bases. Also, the supplier base, consisting of local players as well as international players from India provides some comfort from the point of raw material availability. Nonetheless, local supplies are available only during the harvesting season, but in a limited quantity. The company fulfilled its wheat requirement of ~87% through import and the rest through local suppliers.

Credit challenges

Increased import threats of finished goods and competitive intensity limits pricing flexibility - The Government of Nepal has increased the ARF on the import of wheat (raw material) to 9% from 5%, effective from May 28, 2020 (w.e.f. that date). With this, the duty structure on the import of raw material and finished products are largely similar. With the presence of many players and low value-added nature of operations, the competitive pressure has been significantly increased, thus limiting the company's pricing flexibility. This is likely to either reduce the industry's operating margins or the volume of business, including GFPL's, amid the import-dependent operation for its raw materials. The concerns are accentuated by the fact that the largest selling product - *maida* (primarily B2B business), can now be directly imported by its large industrial customers. The industry is highly fragmented with many organised and unorganised players resulting in low entry barriers and low complexity of the work involved. These factors affect the company's pricing flexibility.

Leveraged financial structure with high working capital intensity - The gearing has improved compared to FY2019 but still remains high at ~3 times as of mid-July 2020. Improvement has been reported in recent days following the injection of the share capital of NPR 20 million in FY2020 and the gradual repayment of the term loans. However, being a working capital-intensive industry, GFPL's working capital cycle was stretched at ~175 days, resulting in high working capital intensity of 43% for FY2020.

Modest debt-servicing ability despite improvement in recent years – The debt service coverage ratios (DSCR) improved after a major dip in FY2018 with improving profitability in the last two fiscals. The DSCR and the interest coverage ratio (ICR) were 1.33 and 1.74 times for FY2020, an improvement compared to 1.1 and 1.6 times respectively in FY2019. Better operational efficiency with increased business volume has resulted in a good profitability profile despite a slight decline in its operating margins. However, the margins are likely to get squeezed with the increased duties on import of wheat -

its sole raw material. Further, likely operational disturbances due to the Covid-19 pandemic could also impair the company's profitability and debt-servicing ability in the near term. GFPL's ability to maintain adequate coverage indicators, going forward, amidst such a scenario remains a key monitorable.

Susceptibility to agro-climatic risks resulting in vulnerability of revenues and profitability - The flour-milling industry is susceptible to agro-climatic risks, which can affect the availability of wheat under adverse weather conditions. Wheat being an agro-commodity, its price and availability are dependent upon the harvest, which in turn, is dependent on rainfall and other climatic conditions. Fluctuations in supply, in turn, expose the company to price-volatility risks amid low custom tariff on import of finished goods and low raw material storage capacity. Thus, ensuring adequate wheat availability at affordable prices remains critical for the sustainability of the company's operations and profitability.

Frequent change in Government policies for affect cost - Government policies such as changes in tax provisions and any other provision could also have a bearing on the performance of all industry players, including GFPL. Such recent instances of changes in Government regulation, like the increased ARF on the import of wheat, withdrawal of 25% VAT refund policy on *maida* sales (w.e.f. start of FY2019) and bringing a*ata* sales within the VAT brackets (w.e.f. start of FY2020). Increased ARF leads to a likely reduction in the operating margin amid import-dependent operations. The withdrawal of 25% VAT refund policy on *maida* has reduced its operating profit by 1.5%-2% as seen in the past. Also, the imposition of VAT on a*ata* would be increasing its financing needs and cash flows.

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 March 2008, Gharana Foods Private Limited (GFPL) is a manufacturing unit that produces *maida, aata, chakki aata, suji,* bran and grit from wheat grains under the brand name of Gharana. The company was established by a group of three family members back in 2008. The plant is situated at the Siddharthanagar Municipality of Rupandehi District, Province No-5, Nepal. The total installed capacity is around 200MT per day and the utilisation is around 48% for FY2020. Its primary raw material - wheat - is procured mainly from India for most of its requirement (~87% in FY2020) and the the rest is procured from the suppliers in the local market.

Key Financial Indicators

Amount in NPR million	Audited			Provisional
	FY2017	FY2018	FY2019	FY2020
Operating Income	492	722	963	1,078
OPBDIT/OI (%)	8.6%	8.1%	10.7%	9.6%
Gearing (times)	3.4	3.6	3.8	3.0
OPBDITA/Interest (times)	1.8	1.4	1.6	1.7
DSCR (times)	1.2	1.0	1.1	1.3
NWC/OI (%)	66.6%	48.9%	47.4%	42.7%
Total Outside Liabilities/TNW (times)	3.5	3.6	4.1	3.1
Total Debt/OPBDITA (times)	9.9	7.5	5.0	4.8

Annexure-1: Instrument details

Instrument (Amounts in NPR million) *	Current rated amount	Rating Action
Non-fund-based facilities; Short-term		
Short-term limits (A)	**692.68**	**[ICRANP] A4; Reaffirmed**
Fund-based; CCR/ICCAD/STDL *	480	
Fund-based; Revolving Pledge Loan (within CCR/ICADD Limit)	(100)	
Fund-based; Demand Loan	150	
Fund-based; Overdraft (OD)	50	
Non-fund based; Bank Guarantee	0.3	
Fund-based; Short term unallocated	12.38	
Long-term Limits (B)	**62.32**	**[ICRANP] LBB-; Reaffirmed for enhanced limit**
Long term loan existing limit	44.32	
Long term (fund based), unallocated	18	
Grand total (A+B)	**755**	

Analyst Contacts:

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

Ms. Kushum Bhattarai (Tel No. +977-1-4419910/20)
kushum@icranepal.com

Relationship Contacts:

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

About ICRA Nepal Limited:

ICRA Nepal Limited, the first credit rating agency of Nepal, is a subsidiary of ICRA Limited (ICRA) of India. It was licensed by the Securities Board of Nepal (SEBON) on October 3, 2012. ICRA Nepal is supported by ICRA Limited through a technical support services agreement, which envisages ICRA helping ICRA Nepal in areas such as rating process and methodologies, analytical software, research, training, and technical and analytical skill augmentation.

Our parent company, ICRA Limited, was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment information and credit rating agency. Today, ICRA and its subsidiaries together form the ICRA Group of Companies.

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