ICRA NEPAL

Indushankar Chini Udhyog Limited: Long-term ratings upgraded to [ICRANP] LB+; short-term ratings reaffirmed

December 28, 2020

Summary of rated instruments

Instrument*	Previous Rated Amount (NPR Million)	Current Rated Amount (NPR Million)	Rating Action
Long-term; Fund-based Limits	410.00	410.00	[ICRANP] LB+; upgraded from LB
Short-term; Fund-based Limits	1,337.50	1,337.50	[ICRANP] A4; reaffirmed
Short-term; Non-fund Based Limits	10.00	10.00	[ICRANP] A4; reaffirmed
Total	**1,757.50**	**1,757.50**	

* Instrument details are provided in Annexure-1.

Rating action

ICRA Nepal has upgraded the long-term rating of Indushankar Chini Udhyog Limited (ICUL) of NPR 410 million to [ICRANP] LB+ (pronounced ICRA NP L B plus) from [ICRANP] LB. ICRA Nepal has also reaffirmed the short-term rating of [ICRANP] A4 (pronounced ICRA NP A four) to the NPR 1,337.50 million fund-based limits and the NPR 10 million non-fund based limits of ICUL.

Rationale

The rating upgrade factors in the improvement in the outlook for the domestic sugar industry following the increased duty protection by the Government of Nepal (GoN). The significant increase in import duty for finished sugar (to 30% in FY2019 and 40% from FY2020 from 15% till FY2018) has supported the competitiveness of domestic millers and has offset the near-term threat from cheaper imports to a large extent. As domestic sugar production trails behind domestic consumption, the elevated import duty offers positive demand outlook for the domestic millers.

ICUL's financial profile, which deteriorated during the import-led crisis in FY2018, improved notably after the increased duty protection that helped in the liquidation of ICUL's inventory stockpile in FY2019 and FY2020. This resulted in improved sales, operating margin and debt coverage indicators for ICUL in last 12–18 months, in addition to easing the liquidity pressure on the company. The rating action also derives comfort from ICUL's long track record (operating since 1984), its strong promoter group and established sales channel.

The ratings, however, continues to be constrained by the moderate financial profile of ICUL, characterised by high gearing, weak liquidity and moderate debt coverage indicators despite the recent improvement. Although FY2020 financial indicators were supported by the pent-up sales, the sustainability of the same remains challenging, given the expected sub-optimal capacity utilisation expected over the near term amid raw material constraints. The cane availability declined sharply in FY2020 following delayed payment to the cane farmers in the previous harvests. This is likely to continue over the near term, which in turn could supress the sugar production and operating revenues for ICUL. This coupled with the high gearing could result in weak debt coverage indicators, thereby necessitating external funding support. The ratings also remain constrained by the company's high dependence on milling operations for its revenues. Although co-generation and distillery operations are likely to commence from FY2021 onward, the contribution from these are likely to remain nominal during the early years. ICUL's financial profile also remains vulnerable to any weakening in global sugar prices and/or reduction in duty protection from GoN, as it could affect the sales realisation and profit margins for the company.

Key rating drivers

Credit strengths

Long track record and experienced promoters – Incorporated in 1984, ICUL is among the established players in the domestic sugar industry. The company is involved in the production of white plantation sugar. The promoters have been involved in this sector for over three decades and are highly experienced. The promoters also have adequate financial strength, given their diversified stake across multiple ventures in trading, manufacturing, and financial services sectors[1]. The rating action also factors in the expectation of timely availability of funding support to ICUL from its promoters.

Positive demand outlook on account of duty protection – The GoN has increased the duty tariff on imported sugar significantly from the FY2018 level following the import-led crisis that affected the domestic sugar mills. Additionally, GoN introduced temporary quantitative restriction on sugar imports throughout FY2019, which reaffirmed the Government's stance of consistent policy intervention in favour of the industry. The GoN increased the customs duty on imported sugar from 15% till FY2018 to 30% in FY2019 and 40% from FY2020 onwards. Since the domestic sugar production remains lower than the national consumption of sugar[2], the increased duty protection remains a positive for the offtake of the domestic production.

Credit challenges

Weak financial profile – ICUL's financial profile remains weak despite the improvement driven by strong sales in FY2020, including pent-up sales from backlog sugar inventory. As of mid-July 2020, ICUL's gearing stood high at ~4.2 times with TOL/TNW[3] of 4.6 times. Although the strong sales in FY2020 supported the debt coverage indicators with DSCR of 1.7 times and interest coverage of ~3 times for the year, its sustainability remains challenging. It is further exacerbated by the decline in cane availability, which could supress the near-term revenue outlook for ICUL, given its high dependence on sugar sales for operating revenues.

The company's liquidity position remains stretched due to high working capital intensity and history of weak cash accruals (notwithstanding improvement in FY2020). This is also evidenced from sustained overutilisation of drawing power for working capital limit utilisation. Although the working capital intensity declined in FY2020 with the liquidation of the backlog inventory (pent-up sales), surge in working capital intensity cannot be completely ruled out in the medium term, given the working capital-intensive nature of business.

Availability of raw materials – Sugar mills in Nepal (including ICUL) were operating at sub-optimal capacity in the past because of raw material (sugarcane) constraints. As such, the availability of cane to support the operation of mills also remains a concern. The concerns are further exacerbated by the volatile financial profile of the millers, which affects the timeliness of payments to cane farmers, thereby impacting raw material availability for the next season. The cane availability for FY2020 was affected by the delayed payments to the farmers in FY2018 and FY2019. ICUL's capacity utilisation for crushing operations declined sharply to 50% in FY2020 from 65–75% in the previous two years. Moreover, as the cane price is decided by the Government, which includes Government subsidies for cane farmers, the Government's ability to continue to subsidise cane payments for supporting the industry will be a key monitorable. Thus, the industry will remain dependent on Government policies.

Competition from imports and concentrated revenue profile – The sales realisation for local players is determined by the landed cost of imported sugar. The large-scale advantage available with big players in the exporting nations (mainly India) and the consequent low cost of production partly offset the impact of the high customs duty in importing nations like Nepal. Therefore, over the near term, import will remain a major threat for domestic sugar producers. The continuation of a high import tariff and/or other import barriers will have a significant impact on the domestic players.

ICUL's revenue profile remains concentrated as its revenues continue to be driven by sugar sales (in addition to nominal proceeds from the sales of by-products viz. molasses and bagasse). Although ICUL's 3 MW co-generation unit and a 30-KLPD[4] distillery unit are expected to commence operation from FY2021, the revenue accruals from these units are likely to

[1] *Mr. Rajesh Kedia, the Chairman of ICUL, is also a promoter director in Siddhartha Bank Limited (rated A- for issuer rating by ICRA Nepal)*
[2] *As per 2018 study*
[3] *Total outside liabilities/Total net worth*
[4] *Kilo Litre per day*

remain moderate during the project stabilisation phase.

Industry cyclicality – As sugarcane is an agro-commodity, it is exposed to industry cyclicality (for example, years of weak monsoon resulting in a sharp correction of production) and agro-climatic risks like damage from pests, untimely precipitation, weather conditions, etc. that affect the cane recovery rate. This also remains a rating concern.

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

Indushankar Chini Udhyog Limited (ICUL) was incorporated in 1984 as a public limited company. It is among the large players in domestic sugar manufacturing segment with installed sugarcane crushing capacity of 4,500 TCD (tonne crushed per day). IUCL manufactures and sells the M-30 grade white plantation sugar under the brand name RajHans. The company's distribution channel comprises wholesale dealers that pass on the sugar to retail traders and finally to consumers.

IUCL is a family-owned business, wherein Mr. Rajesh Kumar Kedia and his family members hold the entire equity stake. The company's only sugar manufacturing unit is located in the Hariwan city of Sarlahi District in South Eastern Nepal. The sugarcane required for the manufacturing process is procured mostly from the local farmers of Sarlahi and the adjoining districts of South Eastern Nepal. The company plans to commission a 3-MW co-generation unit from crushing year 2020 (FY2021) for which the power purchase agreement with the Nepal Electricity Authority has been signed. ICUL also plans to start a 30-KLPD distillery unit from crushing year 2020 (FY2021).

Key financial indicators

	FY2018 (Audited)	FY2019 (Audited)	FY2020 (Provisional)
Operating Income-OI (NPR million)	1,092.1	2,147.3	3,137.6
OPBDITA[5]/OI (%)	-2.0%	1.4%	10.5%
Total Debt/Tangible Net Worth (TNW; times)	5.8	17.8	4.2
Total Outside Liabilities/TNW (times)	9.4	29.1	4.6
Total Debt/OPBDITA (times)	-62.7	49.9	3.1
Interest Coverage (times)	-0.4	0.2	2.9
DSCR[6] (times)	-0.1	0.2	1.7
NWC[7]/OI (%)	93.0%	46.7%	18.2%
Current Ratio (times)	0.98	0.90	1.04

Source: Company data

[5] *Operating profit before depreciation, interest, tax and amortization*
[6] *Debt service coverage ratio*
[7] *Net working capital intensity*

Annexure-1: Instrument Details

Instrument	Previous Rated Limit (NPR in Million)	Current Rated Limit (NPR in Million)	Rating Action
Long-term, fund based			
Term loan	410.0	410.0	[ICRANP] LB+; upgraded from LB
Total long term, fund based (A)	**410.0**	**410.0**	
Short-Term Loans			
Fund based (OD/TR/DL/STL)	1,337.5	1,337.5	[ICRANP] A4; reaffirmed
Non-fund based (LC)	(50.0)	(50.0)	[ICRANP] A4; reaffirmed
Non-fund based (BG/PB/APG)	(20.0)	(20.0)	[ICRANP] A4; reaffirmed
Non-fund based (BG)	10.0	10.0	[ICRANP] A4; reaffirmed
Total short term, fund/non-fund based (B)	**1,347.5**	**1,347.5**	
Grand total (A+B)	**1,757.5**	**1,757.5**	

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

Mr. Akendra Joshi, (Tel No. +977-1-4419910/20)
akendra@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, 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