ICRA NEPAL

Jagdamba Spinning Mills Private Limited: [ICRANP] LBB/A4+ assigned

July 5, 2021

Summary of rated instruments

Instrument	Rated Amount (NPR million)	Rating action
Fund based; long-term limits	102.6	[ICRANP] LBB; assigned
Fund based; short-term limits	1,730.0	[ICRANP] A4+; assigned
Non-fund based; short-term limits	750.0	[ICRANP] A4+; assigned
Fund based; long-term limits (proposed)	810.0	[ICRANP] LBB; assigned
Total	**3,392.6**	

Instrument details are provided in Annexure-1

Rating action

ICRA Nepal has assigned a long-term rating of [ICRANP] LBB (pronounced ICRA NP L double B) to the existing fund-based long-term limits of NPR 102.6 million and the proposed fund-based long-term limits of NPR 810 million of Jagdamba Spinning Mills Private Limited (JSM). ICRA Nepal has also assigned a short-term rating of [ICRANP] A4+ (pronounced ICRA NP A four plus) to the existing short-term fund-based limits of NPR 1,730 million and the existing short-term non-fund-based limits of NPR 750 million.

Rationale

The assigned ratings factor in the company's adequate track record (operating from 2005) and its experienced promoters. JSM is a part of the Saurabh Group, which has more than 25 years of experience in the manufacturing/processing arena in Nepal, lately focussing mainly on the cement and steel industries. The ratings also factor in the company's improving operating revenues (notwithstanding the Covid-19 pandemic-induced decline in FY2020) and its steady operating profit margins. The ratings take comfort from JSM's moderate gearing levels with total debt (TD)/tangible net worth (TNW) of ~2 times as of mid-January-2021. This, coupled with the low interest rate regime (especially the lower interest rates on US dollar denominated import loans), results in satisfactory debt coverage indicators. The ratings favourably view the duty drawback as well as export incentives provided by the Government of Nepal (GoN) to export-based units (3% cash incentives for synthetic yarn exported by JSM), which support the profit margins of exporters and enhance their competitiveness in the international market.

However, the ratings are constrained by the high export dependence of JSM's sales revenue (~90% of sales from export for FY2020) and therefore its vulnerability to the trade policies and regulations of the importing nations. High export dependence also exacerbates the supply chain risk, especially during events such as the ongoing pandemic. The competitive edge of domestic spinning mills in Nepal emanates from the export incentives/duty drawback given to synthetic staple fibre exporters in exporting nations (mainly India, thereby making it profitable for synthetic staple fibre producers to export to Nepal instead of selling to Indian spinning mills), the preferential treatment to Nepalese yarn export by yarn-importing nations under regional trade agreements (by India) and the generalised system of preferences for least developed nations (by European nations). Therefore, the continuation of these frameworks will remain important for the sustainability of the business and profit margins of the spinning mills in Nepal.

Moreover, JSM is currently undertaking debt-funded capital expenditure (capex) for capacity expansion of its spinning mills, which is likely to increase its gearing levels over the medium term. Therefore, the company's ability to maintain its debt coverage indicators will depend on its ability to increase its revenue and maintain its margins. Rating concerns also arise from the customer concentration of JSM (top 10 customers accounted for ~79-88% of the sales between FY2018 and FY2020) signifying high dependence on a few counterparties. The ratings are also constrained by JSM's high debtor and inventory days (debtor days of 264 and inventory days of 79 in FY2020), leading to high working capital intensity (net working capital (NWC)/operating income (OI) of ~91% in FY2020). However, reputed counterparties remain a comfort against the default risk.

Although the long track record of yarn export from Nepal, the existence of relatively fewer spinning mills in operation in Nepal and the current favourable regulations of both synthetic fibre exporting nations and synthetic yarn importing nations are sources of comfort; any change in the regulations will remain a key rating sensitivity for JSM.

Key rating drivers

Credit strengths

Experienced promoters and strong group – JSM's promoters have more than 25 years of experience in the manufacturing sector in various large-scale industries. JSM is a part of the Saurabh Group, which has an established presence in various sectors with stakes in several large-scale industries such as cement and steel. The Group companies also include those involved in the production of tea, spun yarn, and synthetic woven fabrics among others. JSM was established by the Group in 2005 with the view of investing in an export-based business as well as for diversifying the portfolio.

GoN's policy of supporting export companies through various financial incentives – The Nepal Government, with the aim of reducing the country's current account deficit, has been providing various incentives to Nepali exporters. The GoN provides cash subsidies ranging from 3-5% of the value of export transactions for a select group of products, which includes synthetic yarn manufacturers. According to the scheme, exporters can avail a certain amount of their total export depending on the products exported and value addition. As a part of the incentive, JSM has been availing a cash incentive of 3% on the value of its exports. In addition, the GoN provides a refund on the taxes and duties paid during the import of raw materials and auxiliary raw materials for the products that are exported. This has helped JSM in maintaining its competitiveness against international competitors while maintaining respectable operating margins (OPM of 12.8% and 9.7% for FY2019 and FY2020, respectively).

Moderate capitalisation and satisfactory coverage indicators – JSM has maintained a satisfactory financial profile with moderate gearing and adequate coverage indicators. The company has a moderate gearing level with TD/TNW of ~2.0 times as of mid-January 2021, improving from ~2.9 times in FY2019. The coverage has remained satisfactory with the debt service coverage ratio (DSCR) ranging between 1.9 times and 2.8 times from FY2015 to FY2019 while the interest coverage was between 2 times and 3 times during this period, partly aided by the lower borrowing cost on US dollar denominated import loans. While the coverage indicators weakened in FY2020 due to the impact of the pandemic (DSCR of 1.2 times and interest coverage of 1.4 times), they improved in H1 FY2021 on the back of the improvement in the OI.

Credit challenges

Sales largely dependent on exports; vulnerable to trade policies/regulations of importing countries – The synthetic yarn (mainly polyester) manufactured by JSM is largely exported to nations, mainly India and Turkey, with minimal sales to customers in the domestic market. Although local sales have grown in recent years, the same remains miniscule compared to export revenues that accounted for ~95-96% of the company's sales revenue in FY2018 and FY2019 and ~90% in FY2020. Nepalese synthetic yarn manufacturers like JSM benefit from provisions like the low-to-nil customs duty benefit provided to Nepali products under the Generalised System of Preferences provision of nations such as Turkey to support nations belonging to the Least Developed Nations Category (LDC). Accordingly, the yarn exported from Nepal is subjected to 0% customs duty in Turkey. Also, a preferential customs duty of ~6% is levied by India on yarn imports from Nepal, as per the South Asian Free Trade Area (SAFTA) provisions, which are eligible for input credit in the case of import made under the bonded warehouse mechanism to be used in the production of textiles for export. Therefore, the sustainability of JSM's business will depend on the continuation of the current favourable provisions. Any negative changes could erode the competitive ability of yarn exporters in Nepal and could deteriorate their financial profiles.

Stretched working capital cycle and high working capital intensity – JSM has a stretched working capital cycle because of high debtor and inventory days, which lead to high working capital intensity. This is also reflected in its NWC/OI of ~63% in FY2019, which spiked to ~91% in FY2020 with a cash cycle of 314 days because of the pandemic. Despite the improvement in 6M FY2021, the NWC/OI remained high at ~80% with a cash cycle of ~160 days for the period, necessitating sizeable working capital financing through bank loans. However, the low interest rates on US dollar denominated import loans from domestic banks to finance the import of supplies and similar loans against export receivables have kept JSM's interest rate in check.

Concentrated customer base – JSM's customer concentration has remained high with the top 10 customers accounting for ~79-88% of its sales in the last three years (FY2018-FY2020), which shows high dependence on a few counterparties. The company's main customers are textile manufacturers and distributors in India and Turkey. This leaves its revenues as well as its debt-coverage ability vulnerable to the potential loss of any major customer. Furthermore, the high customer concentration results in high debtor concentration with the top 10 debtors accounting for ~93% of the total debtors for FY2020. Although the reputed nature of the counterparties, JSM's long-standing relations with them and adequate documentation during the import-export process to establish the legal right over the receivable amount remain a comfort, the lack of adequate debtor security mechanisms poses 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

Established in 2005, Jagdamba Spinning Mills Private Limited (JSM) manufactures fibre-based yarn products, namely polyester yarn, polyester viscose blended yarn and acrylic yarn. Its registered office and production plant is in Kamahariya VDC-4, Rupandehi. The company is a part of the Saurabh Group, which has operations across various manufacturing, processing and trading sectors in Nepal including cement and steel manufacturing. JSM's shareholders are Mr. Bishnu Prasad Neupane, Mr. Baibabh Neupane, Mr. Durga Prasad Neupane and Mr. Chandra Tandan with stakes of 20%, 20%, 50% and 10%, respectively. Mr. Bishnu Prasad Neupane is the Chairman of the company.

Key financial indicators

	FY2017 (Audited)	FY2018 (Audited)	FY2019 (Audited)	FY2020 (Audited)	6M FY2021 (Provisional)
Operating income (OI; NPR million)	1,611	1,620	2,172	1,276	776
OPBDITA/OI (%)	11.6%	17.1%	12.8%	9.7%	17.3%
Total debt/Tangible net worth (TNW; times)	3.1	3.0	2.9	2.3	2.0
Total outside liabilities/TNW (times)	3.8	4.1	3.8	3.1	3.0
Total debt/OPBDITA (times)	5.4	4.2	4.4	7.9	3.6
Interest coverage (times)	2.2	3.0	2.7	1.4	4.3
DSCR (times)	2.2	2.8	2.4	1.2	2.6
Net working capital/OI (%)	52%	81%	63%	91%	80%
Current ratio	0.9	1.1	1.1	1.3	1.3

Source: Company data

Annexure-1: Instrument details

Instrument	Rated Amount (NPR million)	Rating Action
Fund Based; Long-term Limits		
Medium-term loan	102.6	[ICRANP] LBB; assigned
Total Fund Based; Long-term Limits (A)	**102.6**	
Total Fund Based; Short-term Limits		
Overdraft	360.0	[ICRANP] A4+; assigned
Pre-export financing (PXL) loan	126.0	
Trust receipt	424.0	
Working capital loan	820.0	
Total Fund Based; Short-term Limits (B)	**1,730.0**	
Non-fund Based; Short-term Limits		
Bank guarantee	220.0	[ICRANP] A4+; assigned
Letter of credit	530.0	
Total Non-fund Based; Short-term Limits (C)	**750.0**	
Fund Based; Long-term Limits – Proposed		
Long-term loan	810.0	[ICRANP] LBB; assigned
Total Fund Based; Long-term Limits – Proposed (D)	**810.0**	
Grand total (A+B+C+D)	**3,392.6**	

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About ICRA Nepal Limited:

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