Siddhartha Oil Industries: [ICRANP] A4+ assigned

July 12, 2021

Summary of rated instruments

Instrument*	Current Rated Amount (NPR million)	Rating action
Short-term loans	790.3	[ICRANP] A4+; assigned

**Instrument details are provided in Annexure-1*

Rating action

ICRA Nepal has assigned a short-term rating of [ICRANP] A4+ (pronounced ICRA NP A four plus) to the short-term loans of Siddhartha Oil Industries (SOI or the company).

Rationale

The assigned rating factors in SOI's long track of operation in the Nepalese edible oil manufacturing business (since 1999), its experienced promoters and their good traction in the domestic market. The rating assigned also derives comfort from the company's healthy revenue growth (despite the Covid-19 disruptions) and improved profit margins in the last 12-18 months. The ratings also factor in SOI's adequate financial profile characterised by a low gearing and good debt coverage indicators, mainly in the last 12-18 months, following the improvement in operating profit margins. The debt coverage indicators also remain supported by a lower interest environment and use of the US dollar-denominated import loans (trust receipt loans) for working capital financing. ICRA Nepal also positively notes steady demand outlook for edible oil in the country, along with capacity enhancement by the company to cater to future demand growth.

The assigned ratings, however, are constrained by SOI's stretched working capital position in H1 FY2021 due to delayed recovery from debtors and increased lead time for inventory procurement amid disruption in the global supply chain arrangements following the Covid-19 outbreak. This has resulted in an increase in the working capital intensity (NWC/OI) to ~50%[1] in H1 FY2021 vis-à-vis ~30% in FY2020, necessitating the requirement for higher working capital loans. Similarly, the liquidity position of the company also remains a key rating concern as evidenced by the occasional overutilisation of drawing power in the recent quarters. The liquidity concerns could remain elevated as the company has distributed interim dividend in H1 FY2021, thereby further increasing its reliance on the external funds, which also remains a rating concern. Rating concerns also include SOI's small scale of operation with regional concentration, making it vulnerable to any increase in competitive intensity in the region, impacting its revenue profile and profitability. The assigned rating also factors in the risk of changes in import regulations as the company imports all its raw material while a major portion of the oil cake is exported to India. Similarly, SOI also remains exposed to forex risk on unhedged US dollar-denominated import loans, supplier risks, price volatility in agricultural commodity and agro-climatic risks.

Going forward, SOI's ability to increase its scale of operation, protect its profit margins, reduce its working capital cycle, and maintain adequate liquidity to avoid overutilisation of drawing power, will remain the key rating sensitivities.

Key rating drivers

Credit strengths

Long track record of operation and experienced promoters – Established in 1999, SOI is one of the established players in the Nepalese oil-processing industry, primarily focusing on the Lumbini province of the country. The company's adequate track record of operation coupled with extended promoter's experience in the edible oil business remains a positive from the rating perspective.

[1] *This includes ~NPR 435.35 million included as advances and deposits in H1 FY2021 provisional financials.*

Healthy financial and revenue profile – SOI's operating revenue has witnessed healthy growth over the years (CAGR 19% over the last 4-years ending FY2020), albeit from a low base. SOI's FY2020 sales increased by ~32% vis-à-vis FY2019 despite the Covid-19 pandemic, which remains a positive. Robust demand in the regional market has helped SOI generate healthy revenue over the years. Similarly, its operating profit margins improved in FY2020 and H1 FY2021, largely supported by an increase in the price of edible oil and oil cake, whereas the net profit margins also improved on account of interest savings on USD TR loans used to finance oilseed imports. Further, the company's financial profile also remains good characterised by a low gearing level (TD/TNW) of ~1.5 times, supported by profit retention over the years (notwithstanding the expected impact of the interim dividend in H1 FY2021). Increasing margins and low interest expenses, after availing USD TR loans from FY2020, have helped in maintaining adequate interest coverage ratio at ~8x for FY2020.

Stable demand outlook – Mustard oil is extensively used in Nepal for cooking purposes, which helps generate a good demand. Further, with low oilseed production in the country, scope for players like SOI remains high to bridge the demand gap through import. This remains a positive for the long-term demand of the edible oil. Similarly, demand for oil cake also remains good, supported by export to India for agricultural purposes and the local animal feed industry. The stable demand outlook is also aided with the extensive presence of the company in the regional market. Moreover, capacity enhancement by the company to ~120 tonne per day from ~60 tonne per day also remains a positive.

Credit challenges

Stretched working capital intensity in recent period raises liquidity concern – SOI's working capital intensity (NWC/OI) has increased to ~50% in H1 FY2021 from ~30% in FY2020. This surge in NWC/OI is largely due to the increase in debtor days amid irregularity in debtor realisation due to the Covid-19 pandemic. Similarly, increase in inventory holdings to support growing demand and increased capacity has also resulted in high NWC/OI in the recent period. This resulted in increased reliance on bank borrowings to finance SOI's working capital requirement. Difficulties in regular debtor realisation coupled with increasing working capital requirement raises short-term liquidity concerns, which is also evident from the over utilisation of drawing power in H1 FY2021. Moreover, with the promoters planning to withdraw dividend from the company, liquidity concerns could further aggravate in future.

Small scale of operation and increased competition – Despite being an experienced player in the industry, SOI's scale of operation remains relatively small with an operating income of ~NPR 861 million in FY2020. The company largely caters to the regional market close to its factory located in Rupandehi district.

Moreover, presence of large-sized oil mills/refineries in the industry along with low entry barriers for new players make the industry highly competitive and fragmented. Being a low margin and high-volume nature of business, any further entry of new large-scale players in the region could pose a threat to the incremental revenue and profitability margins of SOI.

High import reliance, exposure to associated forex risk – As local production of mustard oilseed is unable to fulfil the domestic requirement, SOI imports its entire oilseed requirement from countries like Australia, Canada, and Ukraine. Increased reliance on import has also led to supplier concentration risk, party mitigated by a long trading history with the counterparty. Complete reliance on imported raw materials exposes SOI to various supply chain bottlenecks and price volatility caused by change in global commodity prices. Similarly, increased reliance on import also exposes the company to forex risks arising from currency fluctuations as its USD TR loans remains largely unhedged.

Exposure to regulatory risk – Being an essential commodity, the edible oil industry remains prone to regulatory changes. Currently, custom duty levied on import of processed oil is ~15% while import of mustard seed is charged at ~9-10%[2]. Any regulatory changes in custom duty resulting in cheaper oil import or dearer in oilseed import can affect SOI's overall profitability and financial profile. Moreover, as a significant portion of the oil cake is exported to the Indian market, SOI also remains exposed to any trade regulation change by the Indian Government.

[2] *Import by the factory for further processing and selling (oil) is subject to 50% discount on the mentioned import duty rates.*

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

Promoted by the Siddhartha Group, Siddhartha Oil Industries (SOI) is involved in the production of edible mustard oil, under the brand name 'Tez', and oiled cake. SOI was established in 1999 as a partnership firm. The company procures raw materials from countries like Australia, Canada and Ukraine and sells finished/by-products in the local and the Indian market.

SOI has its corporate office in Siddharthanagar, Rupandehi and manufacturing unit in Gurwania, Rupandehi. The business is closely held by three partners, Mr. Jagadish Kumar Agrawal, Mr. Rajesh Kumar Agrawal, and Mr. Shyam Sundar Agrawal, holding 30%, 40% and 30% stakes in the company, respectively.

Key financial indicators

	FY2018 (Audited)	FY2019 (Audited)	FY2020 (Audited)	H1 FY2021 (Provisional)
Operating income-OI (sales in NPR million)	563.2	650.4	861.0	596.8
OPBDITA/OI (%)	5.0%	4.6%	9.6%	10.5%
Total debt/Tangible net worth (TNW; times)	1.4	0.7	1.3	2.4
Total outside liabilities/TNW (times)	1.4	0.8	1.5	2.8
Total debt/OPBDITA (times)	7.3	3.8	2.6	3.5
Interest coverage (times)	1.3	1.5	7.9	20.5
DSCR (times)	1.4	1.5	5.2	16.2
NWC/OI (%)	46%	24%	30%	50%
Current ratio	1.6	2.1	1.6	1.3

Source: Company data

Annexure-1: Instrument Details

Instrument	Current Rated Amount (NPR Million)	Rating Action
Short term limits		
Fund based limits (Overdraft)	40.0	[ICRANP] A4+; assigned
Non-fund based limits (Letter of credit/Custom Guarantee)	750.3	
Total short-term limits	790.3	

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About ICRA Nepal Limited:

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