Hulas Auto Craft Private Limited: [ICRANP] LBBB-/A3 reaffirmed with removal of Watch with Negative Implications

June 28, 2021

Summary of rating action

Instrument (Amount in NPR Million)	Last Rated Amount	Current Rated Amount	Ratings
Long-term loans	142.22	249.70	[ICRANP] LBBB-; reaffirmed and removed from Watch with Negative Implications
Short-term-loans	1,770.60	2,770.60	[ICRANP] A3; reaffirmed and removed from Watch with Negative Implications
Short-term-loans (within other limits)	(2,100.30)	(3,160.00)	
Total	**1,912.82**	**3,020.30**	

** Instrument details are provided in Annexure-1*

Rating action

ICRA Nepal has reaffirmed a long-term rating of [ICRANP] LBBB- (pronounced ICRA NP L triple B minus) to the enhanced long-term limits of Hulas Auto Craft Private Limited (HAC). ICRA Nepal has also reaffirmed a short-term rating of [ICRANP] A3 (pronounced ICRA NP A three) to the enhanced short-term loans (including non-fund-based limits) of HAC. The ratings have been removed from Watch with Negative Implications.

Rationale

The removal of Rating Watch with Negative Implications mainly factors in the improved credit profile of HAC, aided by its demonstrated ability to continue the sales growth momentum, despite the impact of the Covid-19 pandemic. While placing the ratings on watch in June 2020, the pandemic and the ensuing lockdowns were expected to result in a sales slowdown and hence impact on the company's financial and liquidity profile. However, the demand for two-wheelers (2Ws) has sharply increased in recent times, partly owing to the pent-up demand during the initial lockdowns along with the need to maintain social distancing and hence, the consumers' preference for own vehicles rather than using public transport. ICRA Nepal expects the revenue levels and capacity utilisation to remain healthy over the near term and hence the company's financial profile is likely to remain comfortable vis-à-vis the earlier estimates.

The rating action factors in the company's improved financial profile, aided mainly by the sharp sales growth in H1 FY2021. This, along with the improved operating margins and healthy net cash accruals has led to reduced gearing levels and improved its liquidity profile and debt coverage indicators. Though these indicators are likely to moderate to an extent with debt-funded additions to the depleted inventory levels as of mid-January 2021, the overall financial profile is expected to remain comfortable. ICRA Nepal also considers the company's strong operational profile as the sole assembler of Bajaj-branded vehicles, which has a strong market presence and demand outlook in Nepal, further strengthened by the pandemic-induced demand boost. This is also reflected in the sizeable market share and healthy revenue growth reported by HAC's sister concern and sole dealer i.e., Hansraj Hulaschand and Company (HHC). The ratings continue to draw comfort from the company being a part of the Golchha Organisation and its strategic importance in the group for improvement in margins of HHC.

The ratings are, however, constrained by the company's limited track record in auto assembly along with exposure to regulatory risks for the sustainability of its operations. HAC is highly dependent on the current excise duty refund regime for financially feasible operations. The rating is further constrained by HAC's rising working capital intensity and hence the increased reliance on working capital debt may impact its credit profile. Furthermore, the intense competition in the industry from established players along with the high dependence on variants from the 'Pulsar' model also remain rating concerns. In addition, the company's absence in the growing scooter segment limits revenue diversification. Going forward, HAC's ability to sustain the revenue growth and margins improvement while maintaining comfortable coverage indicators along with judicious working capital management practices, will remain the key rating sensitivities.

Key rating drivers

Credit strengths

Improved financial profile – HAC reported improved operating margins of ~3.6% in H1 FY2021 against ~2.7% in FY2019, aided by the economies of scale in revenues (~92% annualised growth in H1FY2021). Accordingly, the debt coverage ratios have improved with TD/OPBDITA of 0.5 times, net cash accruals/TD of 155% and interest coverage of 7.4 times in H1 FY2021 (4.2 times, 17% and 2.8 times, respectively in FY2019). Reduced cost of borrowings amid the excess liquidity in banking has also aided the improvement in interest coverage. The gearing has also sharply moderated to ~0.5 times as on mid-January 2021 (5.6 times as on mid-July 2020), with depleted inventory levels on account of the sharp upsurge in demand. Hence, ICRA Nepal expects the gearing to increase and remain at around 1.2-1.4 times over the medium term, despite the likely dividend pay-outs. Nonetheless, the interest coverage is expected to remain within the comfortable levels of ~4–6 times over the medium term and the overall financial profile is expected to remain satisfactory. HAC has also reported improvements in liquidity profile as reflected in ~20-30% cushion in its drawing power (~30% as of mid-April 2021), against the borderline utilisation earlier.

Strong operational profile – As of now, HAC is the only operational auto assembly unit in Nepal, which assembles Bajaj brand 2Ws and three-wheelers (3Ws) for the last four years. With gradual addition of newer models to its assembly line, HAC now assembles all models of Bajaj 2W (including Avenger which was started from FY2021) and all Bajaj 3Ws. Given the improved demand outlook for the 2W segment, HAC was able to swiftly increase its capacity utilisation to ~106% (aided by longer production shifts) in 2W segment in 9M FY2021 (~46% in FY2019). This corresponded to the entire sales requirement of HHC as against ~59% requirement met in FY2019. Since the capacity utilisation in 2Ws assembly is already high and 3W industry has saturated, HAC's incremental sales outlook would depend upon HHC's ability to continue its sales momentum. However, the strong market position of Bajaj in the 2W Nepalese 2Ws industry provides comfort. HHC has been the sole authorised dealer of Bajaj brand 2Ws in Nepal since 1998 and has been able to make Bajaj 2Ws the largest selling motorbike brand in Nepal. HHC's long track record, diverse dealer network and extensive experience in the automotive trading is likely to reflect in healthy sales prospects for HAC.

Part of the Golchha Organisation with experienced promoters – HAC is a unit of the Golchha Organisation that has had an extensive presence (around eight decades) across diversified business sectors, mainly in manufacturing and trading, in the country. HAC is a backward integration for its sister concern and sole dealer of Bajaj brand 2Ws viz. Hansraj Hulaschand and Company (HHC). Mr. Shekhar Golchha holds a majority stake across both these units and represents the boards of both units as the chairman. HHC is a relatively strong company as reflected in its ratings of [ICRANP] LBBB+/A2, and it has been providing requisite financial support to HAC so far. Since lower costs associated with local assembly has helped HHC in improving its margins, HHC is expected to continue supporting HAC in case of exigencies.

Credit challenges

Limited track record and high working capital intensity – The company started commercial operations of its assembly line from FY2018 for 2Ws and around mid of FY2019 for 3Ws. HAC's working capacity intensity (net-working capital to operating income; NWC/OI) has been increasing in recent years, which stood at ~21% for FY2020 (~-13% for FY2018, aided by advances from HHC). Though this has moderated to ~8% as of mid-January 2021, this is not expected to be sustainable as the reduction was due to the sharp increase in sales volume leasing to much lower inventory levels. With the requisite build-up of inventory, NWC/OI is again expected to increase, leading to sizeable working capital requirement. With the commensurate increase in bank debt levels, the company's profitability is likely to be impacted to an extent and hence its ability to control the working capital intensity would remain critical.

Increased dependence on variants from a single model – Since the company's sales are dictated by the sales of HHC, variants of the Pulsar model contribute to sizeable chunk of 9M FY2021 revenues at ~87%. The concentration has increased from ~82% in FY2019, increasing the product concentration risks. The revenue share from 3W segment has remained largely stagnant at ~4% amid industry-wide signs of stagnancy in this segment. Hence, product concentration risk remains high for the company. Furthermore, the absence of the company in the growing scooter segment also remains a concern in terms of incremental revenue diversification, amid intense industry competition in the 2W segment.

Exposed to regulatory risks – For its assembly operations in Nepal, HAC receives a rebate of 25% on the applicable excise duty on imports of completely knocked down (CKD) units. This has made the operations of HAC financially feasible. Applicable excise duty is currently 40% for 2Ws up to 150CC (i.e. key selling segment for HAC with ~53% share in 9MFY2021 revenues; duty increases progressively thereafter) and 55% on 3Ws. Any adverse changes in the duty structure by the Government could create operational challenges for HAC.

Analytical approach: For arriving at the rating, ICRA Nepal has applied its rating methodology as indicated below.

Links to applicable criteria:
Corporate Credit Rating Methodology

About the company

Established in 2013, Hulas Auto Craft Private Limited (HAC) is the authorised assembling unit of Bajaj brand two-wheelers and three-wheelers. The assembled vehicles are solely sold to its sister concern, Hansraj Hulaschand and Company Private Limited (HHC), the authorised distributor of those products for Nepal. HAC's registered office is in Ganabahal, Kathmandu, Nepal with the assembly unit in Ramgram, Nawalparasi. The company is a part of the Golchha Group which has operations across various manufacturing and trading sectors in Nepal. As of now, the company's shares are held by Mr. Shekhar Golchha (80%), followed by Mr. Akash Golchha (20%). Mr. Shekhar Golchha is the sole director of the company.

Key financial indicators

	FY2018 (Audited)	FY2019 (Audited)	FY2020 (Audited)	H1 FY2021 (Provisional)
Operating income (OI; NPR million)	614	5,206	7,605	7,295
OPBDITA/OI (%)	0.80%	2.65%	2.49%	3.64%
Total debt/tangible net worth (TNW; times)	2.18	2.23	5.63	0.53
Total outside liabilities/TNW (times)	4.26	6.61	6.04	1.64
Total debt/OPBDITA (times)	38.37	4.10	9.10	0.50
Interest coverage (times)	0.35	2.81	1.63	7.44
DSCR (times)	0.78	1.81	1.31	4.48
Net working capital/OI (%)	-16%	8%	21%	3%

Source: Company data

Annexure-1: Instrument details

Instrument (Amounts in NPR Million)	Limits last rated	Current limits	Rating Action
Long-term limits (A)	**142.22**	**249.70**	[ICRANP] L BBB-; reaffirmed and removed from Watch with Negative Implications
Fund-based facilities; Term Loan	142.22	249.70	
Short-term limits (B)	**1,770.60**	**2,770.60**	[ICRANP] A3; reaffirmed and removed from Watch with Negative Implications
Fund based - working capital loans	560.30	740.00	
Fund based limits (within non-funded limits)	(1,290.00)	(1,970.00)	
Non-fund-based limits	1,210.30	2,030.60	
Non-fund-based limits (within funded and non-funded limits)	(810.30)	(1,190.00)	
Total limits (A+B)	**1,912.82**	**3,020.30**	

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About ICRA Nepal Limited

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