

## The Nepal Distilleries Private Limited: Long-term rating reaffirmed; short-term rating downgraded

August 21, 2023

### Summary of rating action

Instrument*	Last rated amount (NPR million)	Current rated amount (NPR million)	Rating Action
Fund-based; long-term limits	300	60	[ICRANP] LA-; reaffirmed and removed from Issuer Not Cooperating category
Fund-based; short-term limits	300	300	[ICRANP] A2; downgraded from A2+ and removed from Issuer Not Cooperating category
Non-fund-based; short-term limits	(150)#	300	[ICRANP] A2; downgraded from A2+ and removed from Issuer Not Cooperating category
<b>Total</b>	<b>600</b>	<b>660</b>	

#within fund-based limits

\*Instrument details are provided in Annexure-1

### Rating action

ICRA Nepal has reaffirmed the long-term rating of The Nepal Distilleries Private Limited (NDPL) at [ICRANP] LA- and downgraded the company's short-term rating to [ICRANP] A2 from [ICRANP] A2+. The ratings have been removed from Issuer Not Cooperating category.

### Rationale

The downgrade of the short-term ratings is mainly on account of the moderation in company's short-term liquidity profile caused by an increase in working capital requirement following the introduction of new Vodka line coupled with the slowdown in economic activities as well as the higher dividend withdrawals in FY2022 and FY2023. The liquidity gap in the balance sheet as a result of negative cash accrual for FY2023 was met through short-term working capital borrowings. NDPL's current working capital borrowing also remains higher than the working capital drawing power, which has lowered the liquidity cushion available with the company.

Other rating concerns include NDPL's major reliance on a single product (viz. Khukri XXX dark rum) and relatively small market size of the rum segment in Nepal which could limit the scalability. The seasonal nature of the rum segment also exposes the company to revenue volatility risks. While the company has added vodka line in its portfolio, its ability to offer diversification and scalability to the company's revenue profiles remains to be seen. Rating concern also arises from the regulatory risks associated with the liquor industry with the continuous increase in the excise duty on liquor and alcohol products which could lead to pricing/margin pressure or could moderate the demand for the company's products.

Nonetheless, the long-term rating continues to take comfort from the company's long-track record in the industry, strong market position and brand recall of Khukri XXX Rum (the flagship product of NDPL), and its established distribution network. The ratings also positively factor the strong debt-coverage indicators of the company supported by its healthy operating margins and relatively controlled working capital intensity (notwithstanding the uptick in FY2023). Further, the duty barrier on the import of finished liquor protects domestic players like NDPL against international brands and cheaper imports which remains a long-term positive.

## Key rating drivers

### Credit strengths

#### Strong positioning in rum segment

NDPL has over 6 decades of operational track record and Khukri XXX Rum is the oldest brand in the domestic rum market. Established brand, tested distribution network and traction with consumers developed over the years support NDPL's business prospects. NDPL has also reported a satisfactory revenue growth in the past five years (ending FY2023) with a CAGR of ~8.5%, despite marginal moderation in sales in FY2023. A market leader in the domestic rum segment, Khukri XXX accounts for major portion of rum sales in Nepal. NDPL's long track record and high tariff barriers for imported rum are the positives for the company.

#### Good financial profile despite rising gearing level

NDPL's financial position remains good with strong coverage indicators with DSCR of 2.1-3.4 times and Interest Coverage of 7.8-22.4 times in the past three years ending FY2023. While the increase in gearing levels in most recent period (TD/TNW of ~3.2 times as on mid-July 2023), has stretched the coverage indicators, the continuation of healthy profitability profile of the company remains a comfort for incremental coverage indicators. The company's sales have remained progressive and its operating profit margins has remained healthy and stable healthy despite the continuous rise in excise duty, which underscores the healthy demand for the company's flagship product (Khukri XXX rum) and the company's ability to pass on the increased cost to its customers.

#### Controlled working capital intensity

NDPL routes all its domestic sales<sup>1</sup> through its national distributor (a third party appointed under contract). Due to the short working capital cycle, NDPL has maintained a low working capital intensity in the past. The recent uptick in working capital intensity (NWC/OI of ~15% for FY2023 vs ~2% for FY2022) has been on account of increased inventory levels with the introduction of its new vodka product line which is yet to gain complete traction in the market.

Although the exposure to a single party (national distributor) for almost the entire sales raises concentration risk, it is partly mitigated by the strong Khukri XXX Rum brand.

### Credit challenges

#### Limited product diversification and product seasonality

NDPL's portfolio currently consists of the Khukri XXX rum brand and its two minor variants (all dark rum) and the newly introduced vodka and white rum. The company's sales have been derived predominantly by Khukri XXX brand. This makes NDPL's business highly dependent on a single product. Further, the annual sales pattern of distillery-based liquor is highly skewed with most of its sales revenue generated in the winter months. Any impact on the operation/sales during those periods have a disproportionately high impact on the company's financial profile. Although the market position of NDPL in the rum segment remains strong, the competitive intensity in distillery-based liquor remains high, which will remain a monitorable.

While the addition of vodka in NDPL's product portfolio is expected to improve the company's diversification and scalability prospects, its impact remains to be seen.

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<sup>1</sup> Nominal exports being made to countries like Japan, Korea, Singapore, Korea, Belgium, Australia, etc.

### Regulatory risk

The government's high import tariff on finished liquors provides duty protection to the domestic spirit industry. Being a duty-protected industry, NDPL remains exposed to any import tariff-related regulation change. Reduction or removal of import duty/ tariff could have a significant impact on the company's incremental revenue profile, profit margin and debt coverage indicators. Also, liquor remains one of the highest taxed commodities in Nepal with the excise tariff increasing steadily year-on-year, including a ~4% hike in excise duty for FY2024. Continued increase in tariff and competitive pressure could diminish NDPL's ability to pass on the incremental cost to the consumers, which could reduce profit margins over longer term. Further, any restriction by the regulatory agency in promotion, sales and distribution of liquor could have an impact on the incremental outlook for NDPL.

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

### Link to previous the rating rationale:

[The-Nepal-Distilleries-Pvt.-Ltd.- Ratings-placed-on-Issuer-not-Cooperating-category\\_June\\_2023.pdf](#)

### Links to applicable criteria:

[Corporate Credit Rating Methodology](#)

## About the company

Nepal Distilleries Private Limited (NDPL) is a privately held company incorporated in November 1961 as a partnership firm and subsequently converted into a private limited company in August 1980. An old player in the domestic spirits industry of Nepal, NDPL's is a manufacturer of the 'Khukri XXX Rum'. The company has a dominant market share and enjoys strong brand recognition in the Nepalese rum market.

Currently, NDPL's shares are held by Mr. Sharad Tibarewala and Mr. Basant Chaudhary (through private investment companies<sup>2</sup>) in the ratio of 80:20. The company has a single manufacturing unit that does the blending and bottling.

## Key financial indicators

	FY2019 (Audited)	FY2020 (Audited)	FY2021 (Audited)	FY2022 (Audited)	FY2023 (Provisional)
Operating income (OI; NPR million)	1,487	1,118	1,556	1,904	1,866
OPBDITA/OI (%)	30.6%	29.4%	37.3%	33.9%	24.8%
Total debt/Tangible net worth (TNW*; times)	2.1	3.2	1.6	0.9	3.2
Total outside liabilities/TNW* (times)	2.8	6.0	2.5	1.8	4.5
Total debt/OPBDITA (times)	1.6	1.5	0.9	0.6	1.5
Interest coverage (times)	5.7	5.1	15.2	22.4	7.8
DSCR (times)	2.0	1.4	2.8	3.4	2.1
Net working capital/OI (%)	2.7%	-13.5%	-1.7%	2.4%	15.5%
Current ratio	0.9	0.4	0.7	0.7	0.6

\* TNW is excluding revaluation reserves (Revaluation reserves of NPR 539.5 million as on mid-July-2022)

Source: Company data

<sup>2</sup> MCKT Holdings Pte Ltd represented by Mr. Tibarewala holds 75% stake, B.L.C. Holdings Private Limited represented by Mr. Chaudhary holds 20% stake and Mr. Tibarewala has a direct stake of 5%.

## Annexure-1: Instrument Details

Instrument	Last rated amount (NPR Million)	Current rated amount (NPR Million)	Rating Action
<b>Long-term limits</b>			
Fund-based, Long-term loan	300	60	[ICRANP] LA-; reaffirmed and removed from Issuer Not Cooperating category
<b>Total long-term limits -A</b>	<b>300</b>	<b>60</b>	
<b>Short-term limits</b>			
Fund-based, Short-term (Cash-credit/TR)	300	300	[ICRANP] A2; downgraded from A2+ and removed from Issuer Not Cooperating category
Non-fund based, Short-term (LC/BG)	(150)	300	
<b>Total short-term limits -B</b>	<b>300</b>	<b>600</b>	
<b>Grand total (A+B)</b>	<b>600</b>	<b>660</b>	

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### About ICRA Nepal Limited:

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