

Sujal Dairy Private Limited: [ICRANP] LB+/A4 assigned

October 16, 2023

Summary of rating action

Instrument	Rated amount (NPR million)	Rating action
Fund-based; long-term limits	418.19	[ICRANP] LB+; assigned
Fund-based; long-term limits (within non-fund-based limit)	(120.0)	[ICRANP] LB+; assigned
Fund-based; short-term limits	359.50	[ICRANP] A4; assigned
Non-fund based; short-term limits	155.00	[ICRANP] A4; assigned
Total	932.69	

Instrument details are provided in [Annexure-1](#)

Rating action

ICRA Nepal has assigned a long-term rating of [ICRANP] LB+ (pronounced ICRA NP L B plus) to the long-term loan limits of Sujal Dairy Private Limited (SDPL), and a short-term rating of [ICRANP] A4 (pronounced ICRA NP A four) to the short-term limits of the company.

Rationale

The ratings remain constrained by the highly fragmented dairy industry given the presence of large number of unorganised players, which remains a drag to the scalability of organised players. SDPL is also affected by the limited pricing flexibility, as the purchase price from farmers is guided by the Government's minimum support price (MSP) norms, while selling price is largely driven by the state-owned Dairy Development Corporation (DDC) that operates with higher economies of scale. The business is also susceptible to the volatile milk availability which can drive-up the purchase price, further squeezing the margins of dairy companies like SDPL, as seen in the post-Covid years. All these translate into moderate operating margin and suppressed operational cash flows, which, coupled with SDPL's high gearing and high interest rate environment, has suppressed the company's debt coverage indicators and liquidity. The company's near-term gearing and coverage indicators are also likely to remain strained amid its future capex plans and the expected lag between the capex investment and commensurate revenue generation. As the capex has been continuous, the company's short-term liquidity has also been pressurised, reflected in the sustained overutilisation of the working capital drawing power. Being an agro-based industry, SDPL's business is also susceptible to agro-climatic risks.

Nonetheless, the ratings positively note SDPL's established operational track record of around two decades (established in 2005), the traction developed with the farmers and cooperatives over the years as well as SDPL's position as the largest private sector dairy player in the country. The ratings are also supported by the satisfactory revenue expansion of the company in the past five years (ending in FY2023) with a CAGR of ~11% and stable demand outlook for the company's products, supported by demand from household as well as various food-processing industries. The company's recent investment towards upgradation of production and distribution infrastructures remains a positive for the business scalability, resilience, and long-term profitability. The long track record, experience, and reputation of the promoters (Laxmi Group) in the Nepalese business sectors provide comfort.

Key rating drivers

Credit strengths

Established operational track record and experienced promoters – Established in 2005, SDPL has an operational track record of close to two decades. The promoters of SDPL belong to the Laxmi Group, which has a long track record and diversified business presence in sectors such as automobile, steel, FMCG, etc. SDPL was started when the Laxmi Group

acquired the dairy processing unit in Pokhara (Pokhara Milk supply Scheme-PMSS) of the state-owned Dairy Development Corporation (DDC), as part of the privatisation drive in Nepal. The established track record of operations since the privatisation and long experience of the promoters in the Nepalese business sectors remain credit positives.

Satisfactory revenue growth and stable demand prospects – SDPL has reported satisfactory revenue expansion with a CAGR of ~11% in the last five years ending in FY2023 and a YoY growth of ~9% in FY2023. Going forward, the demand outlook is expected to remain positive, given the growing demand from household as well as food-processing industries in Nepal. For FY2023, standard milk, whole milk, yoghurt and ice cream were the top products for SDPL collectively, accounting for ~2/3rd of its sales revenue, while the rest was accounted for by various other product verticals including paneer, ghee, skimmed milk powder, butter, etc.

Credit challenges

Intense competition in the industry – Although SDPL is the largest private sector dairy processor in Nepal, it faces tough competition from large number of unorganised players as well as state-owned DDC in the organised segment. DDC effectively sets the selling pricing of processed milk and dairy products for the entire industry, while competition from local unorganised players (that operates with low overhead) affects the purchase price of milk for SDPL. This limits the company's pricing flexibility which in turn impacts profitability. The perishable nature of the products, need to manage large number of stakeholder and upkeep of the processing and distribution network necessitates a high degree of resources. The resulting high operating leverage can only be offset through low financial leverage and/or high scalability. Given the high industry fragmentation and relatively higher geographical concentration of SDPL's business (catering mainly to the Pokhara and Kathmandu regions at present), the scalability of business is likely to take time. Meanwhile, the high financial leverage of the company is likely to continue pressurising the company's financial metrics.

Leveraged financial structure, weak debt coverage indicators and liquidity concerns – The financial profile of SDPL remains modest with a high gearing of 8.2 times as of mid-July 2023 (excluding the revaluation reserve of NPR 103.28 million). The high gearing of the company, coupled with falling operating profitability (OPBDITA/OI) in the recent years, has weakened SDPL's debt coverage. Moreover, the short-term liquidity continues to be strained on a sustained basis, evident from the over-utilised working capital drawing power, which limits SDPL's ability to absorb any major liquidity shocks.

Susceptibility to agro-climatic risks – The dairy industry is susceptible to agro-climatic risks, which can affect the availability and prices of milk. Accordingly, SDPL's revenue and margins remain exposed to various exogenous factors affecting the availability and price of milk such as disease outbreak in cattle, volatility in feed prices, etc. Any changes in minimum support price also has a direct bearing on the financials of players like SDPL. Being an essential commodity, milk prices can also be subjected to price control by the Government, which can affect the profitability/liquidity of the market players.

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

Sujal Dairy Private Limited (SDPL), incorporated in 2005, is a dairy processor which produces wide range of products, such as standard milk, whole milk, yoghurt, ice cream, skimmed milk powder, butter, ghee, paneer, whole milk powder, etc. The company sells its products under the brands of Safal and Love Birds. The company's registered office and manufacturing unit is in Pokhara-1, Kaski, Gandaki.

SDPL is a part of the Laxmi Group and its major shareholders include Mr. Ganesh Bahadur Shrestha (the current Chairman), Mr. Sunil Shrestha, Mr. Anjan Shrestha, Mr. Niranjana Shrestha and Mr. Nirakar Shrestha, each with ~18%

stakes, while the remaining ~10% stake is held by M/S Sujal Food Private Limited, another unit under the Laxmi Group.

Key financial indicators

	FY2019 (Audited)	FY2020 (Audited)	FY2021 (Audited)	FY2022 (Audited)	FY2023 (Provisional)
Operating income (OI; sales in NPR million)	1,063	1,195	1,214	1,716	1,869
OPBDITA/OI (%)	7.6%	7.9%	6.4%	5.4%	5.0%
Total debt/Tangible net worth TNW* (times)	32.7	11.5	12.0	6.0	8.2
Total outside liabilities/TNW* (times)	48.7	20.5	18.8	7.5	11.8
Total debt/OPBDITA (times)	6.6	5.6	8.0	7.3	8.3
OPBDITA/Interest (Interest coverage; times)	1.7	1.8	1.8	1.8	1.1
DSCR (times)	1.2	1.1	0.9	0.8	0.6
Net working capital/OI (%)	18%	19%	25%	18%	17%
Current ratio	0.8	0.8	0.8	0.8	1.0

Source: Company data

* excluding revaluation reserves (NPR 103.3 million for FY2023)

Annexure-1: Instrument Details

Instrument	Rated amount (NPR million)	Rating action
Long-term limits		
Fund-based; Term loans / Hire-purchase loans	316.19	[ICRANP] LB+; assigned
Fund-based; Working capital term-loan	102.00	
Fund-based; Term-loans (within Letter of Credit)	(120.00)	
Total long-term limits (A)	418.19	
Short-term limits		
Fund-based; Overdraft, Trust receipt, Demand loans, Short-term loans	359.50	[ICRANP] A4; assigned
Non-fund-based; Letter of credit, Bank Guarantee	155.00	
Total short-term limits (B)	514.50	
Grand total (A+B)	932.69	

Analyst Contacts:

Mr. Sailesh Subedi, (Tel No. +977-1-4419910/20)

sailesh@icranepal.com

Mr. Devendra Dongol, (Tel No. +977-1-4419910/20)

devendra@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

All Rights Reserved.

Contents may be used freely with due acknowledgement to ICRA Nepal.

ICRA Nepal ratings should not be treated as recommendation to buy, sell or hold the rated debt instruments. The ICRA Nepal ratings are subject to a process of surveillance which may lead to a revision in ratings. Please visit our website (www.icranepal.com) or contact ICRA Nepal office for the latest information on ICRA Nepal ratings outstanding. All information contained herein has been obtained by ICRA Nepal from sources believed by it to be accurate and reliable. Although reasonable care has been taken to ensure that the information herein is true, such information is provided 'as is' without any warranty of any kind, and ICRA Nepal in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness or completeness of any such information. All information contained herein must be construed solely as statements of opinion and ICRA Nepal shall not be liable for any losses incurred by users from any use of this publication or its contents