Daunne Agro Farm Private Limited: Ratings downgraded to [ICRANP] LB+/A4

February 12, 2024

Summary of rating action

Instrument* (Amounts in NPR million)	Last rated amount	Current rated amount	Rating action
Fund-based; long-term limits	757.39	1,075.48	[ICRANP] LB+; downgraded from [ICRANP] LBB-
Fund-based; short term limits	225.00	80.00	[ICRANP] A4; reaffirmed
Non-Fund based; short term limits	0.30	0.30	
Total	**982.69**	**1,155.78**	

* *Instrument details are provided in Annexure-1*

Rating action

ICRA Nepal has downgraded the long-term loan rating of Daunne Agro Farm Private Limited (DAF) to [ICRANP] LB+ (pronounced ICRA NP L B plus) from [ICRANP] LBB- (pronounced ICRA NP L double B minus), while reaffirming its short-term loan rating at [ICRANP] A4 (pronounced ICRA NP A four).

Rationale

The rating action mainly factors in the sizeable losses reported by DAF in the last two fiscal years leading to eroded capital base and hence a highly leveraged capitalization profile (gearing much higher than the central bank prescribed cap of four times). The company's sales realization has been weak while the input costs have reported volatility, resulting in negative operating profit margins (OPM) for FY2022 and FY2023, and thus muted debt service coverage indicators. While the OPM has reported improvements during H1FY2024, the company's steadily increasing debt levels (for setting up the farm and periodic capacity enhancements) has largely offset the impact. DAF's liquidity profile is also significantly stretched with sustained overutilisation of drawing power (181% as of mid-January 2024). The ratings are also constrained by the company's limited track record (operating since FY2020) and the consequent stabilization risk. Rating concerns also arise from the inherent risk in poultry business such as volatility in product prices, and vulnerability to environmental and biological conditions. Furthermore, the high industry competition and fragmentation has also been a challenge for DAF in terms of profitability and revenue growth.

Nonetheless, the ratings factor in DAF's experienced promoters, their established network in the poultry sector and their continued funding support to the company. The operational synergies emanating from the promoters' integrated network of businesses in the poultry sector continues to be factored in the ratings. ICRA Nepal also notes the strong revenue growth (~130%) recorded by the company in FY2023. Going forward, sustainability of the revenue/OPM trajectory and improvements in its financial and liquidity profile will remain the key rating sensitivity.

Key rating drivers

Credit strengths

Experienced promoters and established network in poultry sector – DAF was established as a vertical integration by its promoter group allowing it to form a complete network for production and distribution of eggs. The same promoter group also owns and operates Kisan Dana Udhyog Private Limited (KDU, also the largest shareholder of DAF), which manufactures mash feed for poultry (layers chicken) and trades in chicken eggs. Hence, the promoters of DAF have over two decades of experience and an established presence in the poultry sector. The presence of sister units within the group providing chicken feed and purchasing eggs produced by DAF results in operational synergies for all units involved. This is a positive from the standpoint of supply disruptions, operational efficiencies, and long-term profitability as well as scalability. DAF's revenue trajectory has been benefitted mainly because of the established sales and distribution network of its sister unit (KDU). This also underscores a relatively low offtake risk for DAF. Nonetheless, its sustainability over a longer-term remains to be seen.

Credit Challenges

Leveraged financial profile and weak coverage indicators – DAF has reported weak profitability (negative OPM and net margins) despite a healthy rise in revenues during FY023. The company's sales realisation has been low in relation to the company's cost of sales which has led to weak profitability. Furthermore, the company's initial capex for setting up the poultry farm and its capacity enhancement in the recent years have been financed through sizeable bank debt (~80% debt financing). This has resulted in a highly leveraged capital structure of DAF with gearing (total debt to tangible net worth) of ~7.2 times as on mid-January 2024. Despite improved OPM during H1FY2024, the relatively high leverage structure and hence sizeable interest costs has still resulted in net losses and sustained subpar debt servicing indicators since FY2022 onwards. While the shortfalls towards debt servicing have been managed through periodic equity infusions, the promoters' ability to continue similar support and/or improvements in the company's ability to improve its operational and financial profile, remains to be seen.

Stretched liquidity profile – The company has reported sustained increase in debt levels over the years, mainly for its initial and expansion capex. In addition to the heavy reliance on debt, the company also relies significantly on creditors to manage its liquidity pressures, as evident from the creditor days of 122 as of mid-January 2024. Despite the sizeable creditor float (mainly the sister concern), the company also continues to reported sustained overutilisation of its drawing power (181% as of mid-January 2024), which raises further concerns on its liquidity profile.

Inherent risk in poultry business – The revenue stream of DAF is exposed to inherent risks in poultry and related businesses such as relatively unpredictable output, volatile realizations and vulnerability of margins to the movement in raw material prices (feeds, etc). However, these risks are partly mitigated by the presence of sister units as backward and forward linkages (in feed manufacturing and selling of eggs). The revenues and profitability of the company is also susceptible to disease outbreaks. Although DAF has made sizeable investment in infrastructure, such as closed-house method of raising chicken, adequate bio-security mechanism, etc., the risk of disease outbreak remains.

High competition and fragmented industry – While DAF is among the large commercial egg producer in Nepal, it still faces tough competition given the low entry barriers and high industry fragmentation (with many unorganized players). This was also reflected in muted OPM in last two fiscal years. However, the presence of the Nepal Egg Producers Association (wherein DAF has a representative) provides some control over the egg prices for the large players like DAF.

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

Link to the applicable criteria:
[Corporate Credit Rating Methodology]

Link to the last rating rationale:
[Daunne-Agro-Farm-Private-Limited-BLR Surveillance_September 2022.pdf]

About the company

Incorporated in March 2018, Daunne Agro Farm Private Limited (DAF) is involved in poultry farming of 'Layer Chicken' and production of eggs. The company is promoted by 40 institutional and individual shareholders, with the largest shareholder being Kisan Dana Udhyog Private Limited (KDU) holding ~29.4% stake in DAF. KDU is involved in the production of mash feed (for layer chickens) and in trading of eggs and is a major supplier of raw materials for DAF. Mr. Raghunath Bhatta is the chairman of DAF and Mr. Binod Pokharel is its managing director. The factory and the registered office of the company is in Binai Triveni-3, Nawalpur District of Gandaki Province of Nepal.

Key financial indicators

	FY2020 (Audited)	FY2021 (Audited)	FY2022 (Audited)	FY2023 (Audited)	H1FY2024 (Provisional)
Operating income (OI; Revenues in NPR million)	81	546	500	1,148	623
OPBDITA/OI (%)	2.7%	11.5%	-0.9%	-1.2%	7.3%
Total debt/Tangible net worth TNW (times)	3.3	2.8	3.6	6.8	7.2
Total outside liabilities/TNW (times)	3.8	3.2	4.5	7.6	9.6
Total debt/OPBDITA (times)	209.2	9.2	-189.5	-74.0	11.6
OPBDITA/Interest (Interest coverage; times)	0.5	2.2	-0.1	-0.2	0.9
DSCR (times)	0.6	1.9	0.2	-0.1	0.6
Net working capital/OI (%)	66.4%	18.3%	26.2%	20.2%	19.1%

Source: Company data

Annexure-1: Instrument Details

Instrument (Amounts in NPR million)	Last rated amount	Current rated amount	Rating action
Long Term Loan Limits (A)	**757.39**	**1,075.48**	[ICRANP] LB+; downgraded from [ICRANP] LBB-
Fund-based (Term Loans and hire-purchase)	757.39	825.48	
Permanent working capital loan	-	250.00	
Short Term Loan Limits (B)	**225.30**	**80.30**	[ICRANP] A4; reaffirmed
Fund-based (Overdraft)	65.00	20.00	
Fund-based (Demand Loan)	160.00	60.00	
Non-fund based (Bank guarantee)	0.30	0.30	
Grand Total (A+B)	**982.69**	**1,155.78**	

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About ICRA Nepal Limited:

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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

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