Vatsal Impex Private Limited: Rating placed on Watch with Negative Implications

March 27, 2024

Summary of rating action

Instrument* (Amount in NPR million)	Last rated amount (NPR Million)	Current rated amount (NPR Million)	Rating Action
Short-term loans: non-fund- based	1,280.0	1,280.0	[ICRANP] A3 @**; placed on watch with negative implications
Short-term loans; fund-based	520.0	520.0	
Total	**1,800.0**	**1,800.0**	

** Instrument details are provided in Annexure-1*

***The symbol '@' denotes rating on 'Watch with Negative Implications'. Please refer here for further details on rating watch and its implications.*

Rating action

ICRA Nepal has placed the ratings of Vatsal Impex Private Limited (VIPL or the company) on Watch with Negative Implications, as indicated by short-term rating of [ICRANP] A3 @ (pronounced ICRA NP A three).

Rationale

The rating watch with negative implications, factors in the uptick in VIPL's working capital cycle (working capital intensity[1] increased to ~36% in FY2023 from ~23% in FY2022) resulting in a higher utilization of working capital loan, while the company has reported a decline in revenue. This has stretched the company's debt coverage metrices as well as its liquidity profile which is reflected in borderline utilization of the company's drawing power (~95% utilization as on mid-July 2023). VIPL's ability to control its working capital cycle and debt level commensurate to the reduced revenue level or ramp up the revenue commensurate with the current debt level will have a bearing on the incremental debt coverage metrices, liquidity and overall financial profile and will remain a major monitorable for resolving the rating watch. Rating concerns also arise from the non-exclusive nature of agreement between VIPL and the original equipment manufacturer (OEM) and the lack of long-term distributorship contract. Product innovation by the OEM will also have a bearing on VIPL's financial profile amid the rapid changes in technology creating obsolescence risk and intense industry competition from the importer of other brands.

Nonetheless, the rating considers VIPL's good market positioning as the authorised distributor of leading smartphone brand i.e. Xiaomi for Kathmandu region[2], and the company's decent profitability indicator driven by OPM[3] of ~7% in FY2023, despite decline in sales. VIPL's extensive sales network of ~14 dealers and over 100 retailers as of mid-July 2023 across Kathmandu region is also a rating positive. The rating further takes comfort from the promoter group viz. Sharda Group, that has a business presence across multiple sectors in the country.

Going forward, the company's ability to align its working capital cycle, debt, and revenue level to ensure comfortable coverage indicators and liquidity profile will remain the key rating sensitivities.

[1] *Net working capital to operating income ratio (NWC/OI)*
[2] *VIPL's distributorship area consists of four districts: Kathmandu, Bhaktapur, Lalitpur and Kavrepalanchowk.*
[3] *Operating Profit Margin*

Key rating drivers

Credit strengths

Experienced and resourceful promoters – VIPL is a part of the Sharda Group, which has an established presence in various lines of businesses in Nepal. The promoters and management team of VIPL comprises of seasoned professionals with adequate industry experience.

Good brand recognition of Xiaomi and established sales channel – VIPL is the authorised distributor of leading smartphone brand (Xiaomi) for the Kathmandu region. Xiaomi has a strong presence in budget and mid-range segment in Nepal and remains among the most imported phones in the country. This coupled with the established sales channel of VIPL, comprising of ~14 dealers and over 100 retailers in its operating geographies as on mid-July 2023, remains a positive for the operational profile of the company. Although Xiaomi remains the flagship brand for VIPL, it also has other brands i.e. EZVIZ (mainly security cameras and accessories), POCO phone, Fitbit and Ticwatch smart watches, which offers some diversification to the product portfolio.

Margin improvement in FY2023 supporting coverage indicators – VIPL reported dip in revenues by ~37% in FY2023 (~7% degrowth in FY2022) due to demand moderation and import restrictions. Despite the sales dip, the company's OPM improved from ~4% in FY2022 to ~7% in FY2023 (~5-6% in earlier years). This helped the company maintain adequate coverage indicators with ICR of 2.6 times during FY2023 (4.1 times in FY2022) despite decline in sales in FY2023. However, incremental coverage indicators will depend on the company's ability to manage its working capital debt in sync with the revenue and operating cashflows.

Credit challenges

Stretched working capital intensity and moderation in liquidity profile – VIPL witnessed a sharp increase in working capital intensity to ~36% for FY2023 (from ~23% for FY2022). This was mainly due to the rise in debtor days to ~102 days (from ~52 days as on mid-July 2022) and sharp dip in sales. The surge in working capital intensity has increased VIPL's reliance on bank loans to finance the increased working capital requirements. Accordingly, VIPL's TD/OPBDITA continued to remain elevated in FY2023. While debtor security mechanism for the company remains relatively comfortable, the buildup of debtor, nonetheless, is likely to pressurize its liquidity profile. The stress on liquidity is also evident from borderline utilization of working capital drawing power at ~95% as on mid-July 2023. The ability of the company to align its cash cycle with the revenue level will have a bearing on its incremental gearing and coverage metrices and will remain a key monitorable.

Limited track record and geographical concentration risk– VIPL has been in the smartphone distributorship business since 2012 as a distributor of Videocon and Purple brand mobile phones. These brands were dropped in FY2016 after the new distributorship agreement with Xiaomi. VIPL was the country's sole distributor of Xiaomi brand for two years till FY2018, after which an additional distributor was appointed for Xiaomi products outside the Kathmandu region. This has increased the geographical concentration risk for VIPL's business.

Supplier risk and risk of obsolescence – Supplier risk also remains a concern for VIPL as the company's revenue remains largely driven by Xiaomi brand of mobile phones and accessories (~80% of revenues during FY2023). The nature of agreement between VIPL and OEM is not exclusive or long-term. This also remains a rating sensitivity.

The smartphone industry is characterised by rapid technological changes and is fiercely competitive. Revenue and growth prospects of importers like VIPL will depend on the product innovation and price competitiveness by OEM. The obsolescence risk remains heightened given the presence of multiple importer/products in the Nepalese market.

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

Links to the previous rating rationale:
Rationale- Vatsal Impex Private Limited- Bank Loan Rating Surveillance-January 2023

About the company

Established in 2012, Vatsal Impex Private Limited (VIPL) is the authorized distributor of Xiaomi products in the Kathmandu region along with EZVIZ products, TICWATCH and FITBIT in Nepal. Its registered office is in Thapathali, Kathmandu with sales channel primarily comprising of ~14 dealers and over 100 retailers as on mid-July 2023.

The company is a part of the Sharda Group, which has operations across various manufacturing, trading, banking, and housing sectors in Nepal. As of now, the company's shares are held by three individuals in equal proportion, with a majority stake from Sharda family. Mr. Binit Kumar Sharda is the chairman and Mr. Nitesh Kumar Mungada is the managing director of the company.

Key financial indicators

	FY2019 (Audited)	FY2020 (Audited)	FY2021 (Audited)	FY2022 (Audited)	FY2023 (Audited)
Operating income (OI; Sales in NPR million)	1,165	2,130	5,443	5,040	3,169
OPBDITA/OI (%)	5.0%	5.8%	6.1%	4.4%	7.0%
Total debt/Tangible net worth (TNW; times)	1.5	0.9	1.5	2.6	2.1
Total outside liabilities/TNW (times)	1.7	1.8	1.8	2.9	2.2
Total debt/OPBDITA (times)	2.9	0.9	1.6	3.6	3.7
Interest coverage (times)	2.8	4.2	15.0	4.1	2.6
DSCR (times)	2.8	4.2	15.0	4.1	2.6
Net working capital/OI (%)	22%	9%	14%	23%	36%
Current ratio	1.5	1.5	1.6	1.4	1.5

Source: Company data

Annexure-1: Instrument details

Instrument (Amount in NPR million)	Last rated amount	Current rated amount	Rating action
Short term, non-fund based (A)	**1,280.0**	**1,280.0**	[ICRANP] A3@; placed on Watch with Negative Implications
LC (sight)/Bank Guarantee	1,280.0*	1,280.0*	
Short term, fund based (B)	**520.0**	**520.0**	
Demand Loan/OD/TR/STDL/OC Limits	520.0	520.0	
Grand total (A+B)	**1,800.0**	**1,800.0**	

** Includes fund based short term limits of NPR 400 million; total fund-based limits to remain within 920 million.*

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About ICRA Nepal Limited

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