Bottlers Nepal Limited: Rating downgraded and placed on Watch with Negative Implications

April 29, 2024

Summary of rating action

Instrument (Amount in NPR million)	Last rated amount	Current rated amount	Rating Action
Short-term loans*	3,373	3,373	[ICRANP] A1@**; downgraded and revised from [ICRANP] A1+&

** This includes both fund-based (Overdraft, Short-term loans, TR/Import Loans) and non-fund-based facilities (LC, Bonds and guarantees), with the total utilisation not exceeding the rated limits.*

*** The symbol '@' and '&' indicates 'Rating Watch with Negative Implications' and 'Rating Watch with Developing Implications' respectively. Please refer here for further details on rating watch and its implications.*

Rating action

ICRA Nepal has downgraded and revised the short-term loan rating of Bottlers Nepal Limited (BNL or the company) to [ICRANP] A1@ (pronounced ICRA NP A one) from [ICRANP] A1+& (pronounced ICRA NP A one plus). The rating watch has been revised to 'Watch with Negative Implications' from 'Watch with Developing Implications'.

Rationale

The rating actions mainly factor in the company's sizeable ongoing tax related litigations (two litigations claiming to the tune of ~NPR 12.8 billion, including taxes, fines and penalties) related to the offshore change in BNL's ownership in 2014. While the company had already received tax claim from Department of Revenue Investigation (DRI) for ~NPR 7.4 billion (capital gain taxes) during FY2022, Large Taxpayer Office (LTPO) has filed another claim to the tune of ~NPR 5.4 billion (on account of majority change in ownership, as per prevailing tax laws) since last rating, citing the same event. In the interim, the company also reported a sharp increase in debt levels (from mid-July 2023 onwards) to fund the sizeable deposit requirements, as a prerequisite to legally contest the claims made by the tax authorities. This has significantly impacted its financial profile and coverage metrics, which was further exacerbated by the seasonality in revenue/margins during 6MFY2024. While ICRA Nepal positively views the indirect support from The Coca Cola Company (TCCC, through counter guarantee to lending bank for the loans extended to furnish requisite deposit to tax authorities), funding modality of the ultimate tax obligations, as and when finally materialised, will remain the key rating monitorable.

Furthermore, the rating also remains constrained by the increase in the company's working capital cycle as reflected in a high working capital intensity (net working capital to operating income ratio) during 6MFY2024. This was mainly on account of inventory accumulation (mainly sugar and finished products too, amid the winter/off-season), increased deposit amount (for appealing the tax claim by LTPO), along with the seasonality induced decline in operating income for the period. BNL also faces vulnerability of profitability to adverse movement in raw material prices and forex risks, amid the unhedged forex exposure for raw material imports. Going forward, BNL's ability to improve the revenue momentum, its financial and liquidity profile would remain the key rating sensitivities.

Nonetheless, the rating continues to derive comfort from the company's strong operational profile and healthy financial profile, notwithstanding the seasonality induced moderations during 6MFY2024. BNL's capitalisation still remains robust with gearing (total debt to tangible net worth) of 0.6 times as of mid-January 2024, while its liquidity also continues to remain comfortable, characterized by healthy on-balance sheet liquidity as well as adequate headroom in drawing power, as on the same date. The strong brand recall of Coca Cola along with BNL's long track record (since 1979) reflects in the company's leadership position in the industry. The rating action further considers the company's strong ownership profile with ~76% stake held by The Coca Cola Southwest Asia Holdings Limited, followed by ~22% stake of Gorkha Brewery Private Limited (majority owned by the Carlsberg Group). The resultant combination of a strong board profile and an experienced management team has aided BNL's strong business performance throughout the years.

Key rating drivers

Credit strengths

Strong operational profile – The company, along with its majority-owned subsidiary Bottlers Nepal Terai Limited - BNTL (~91% stake), are the authorised bottlers of The Coca Cola Company (TCCC) in Nepal. TCCC is the owner of one of the biggest brands in the world i.e., Coca Cola. By virtue of this association, BNL has become the market leader in the domestic carbonated soft drink industry (on a consolidated basis with BNTL and Troika Traders Private Limited). The company's long presence in the industry (since 1979), the global brand image of Coca Cola, coupled with its extensive dealer network remain the positives. Accordingly, BNL reported CAGR in revenues by ~24% at the group level from FY2021 to FY2023 and its operating profit margins (OPM) also remained healthy (18-20%) over the same period. While the seasonality in sales has impacted the revenue/margins during 6MFY2024, the same is likely to be largely recovered by the end of FY2024, as seen in previous years. However, the company's ability to pass on the increased input prices in subsequent quarters will remain crucial, given the higher pressure seen in gross margins during 6MFY2024, as compared to similar period in earlier years.

Robust capitalisation profile – The company's capitalisation profile remains strong with gearing of 0.6 times as of mid-January 2024, while the total debt to OPBDITA metrics also remain decent at 3.8 times (notwithstanding the recent moderations, amid the rising debt and further exacerbated by lower margins during 6MFY2024). However, any major materialisation of the contested tax amount would stretch the company's capitalisation and coverage indicators and hence remains a key rating sensitivity.

Adequate liquidity – BNL usually has surplus drawing power and a healthy balance sheet liquidity. With the generally high net cash accruals, the company had a sizeable liquidity cushion in form of unutilised drawing power (~35%) and cash reserves of ~NPR 342 million as of mid-January 2024. The resultant financial flexibility is expected to be adequate to manage any near-term operational liquidity pressures. BNL also enjoys liquidity support from the group in the form of extended credit period (mainly for concentrate).

Strong promoter profile and experienced directors/management – Majority of the company's shares (~76%) are held by Coca-Cola Southwest Asia Holdings Limited while Gorkha Brewery Private Limited holds ~22% stake as a local partner (remaining ~2% shares held by public shareholders). The established/resourceful background of the promoters along with the experienced board/management profile remain positives for incremental business outlook.

Credit challenges

Sizeable contested tax liabilities – The company has sizeable contested tax liabilities to the tune of ~NPR 12.8 billion related to the majority ownership change in 2014. This is in addition to the core operations related contested tax liabilities of ~NPR 1.8 billion (related to value added tax, income tax and excise, of which 1/3rd has been deposited). While the company is contesting the claims made by tax authorities (the tax claim made by DRI is currently in high court proceedings, while the tax claim made by LTPO is currently being contested in Revenue Tribunal), overall tax claim remains significantly higher vis-à-vis the company's net worth or annual operating profits. Hence, any major crystallization of these liabilities would pressurize the company's liquidity and financial profile. In case of such an event, ICRA Nepal expects direct funding support from TCCC Group, in addition to the guarantee support so far, which has led to a sharp rise in debt levels. ICRA Nepal would continue to monitor the incremental developments in regards of these cases and the actual quantum of tax liabilities (as and when the same is finalized) and their funding modality, would remain the key rating sensitivities.

Elongation in working capital cycle – BNL reported a sharp spike in its working capital intensity during FY2023 to ~25%, after it had to provide NPR 1.35 billion[1] in deposit to tax authorities (funded entirely by bank debts, which in turn was secured by the TCCC Group's indirect guarantee to the lending bank). Amid the revenue/demand slowdown in

[1] *i.e. 25% of tax claims made by LTPO; a further 25% deposit was provided in form of bank guarantee to LTPO.*

6MFY2024, the inventory levels spiked, thereby leading to further spike in working capital intensity to ~38%. This has led to further increase in debt levels and major moderation in coverage indicators as evident in borderline DSCR of 1.0 times for 6MFY2024. While the spike is expected to gradually decline over the near term, any major/sustained elongation could give rise to higher working capital financing needs and hence erode the liquidity cushion and/or gearing levels.

Margin vulnerability to changes in raw material prices – BNL's profitability is vulnerable to fluctuations in the prices of various raw materials mainly the sugar, concentrate etc. Since raw material costs form a major part of the company's cost structure, international price increases have pushed up the raw material consumption to ~55-56% of net operating income in recent years, as opposed to ~48-50% in earlier years. Hence, its ability to timely pass on the increase in input costs would remain critical for its operations. Additionally, unfavourable exchange rate fluctuations might further impact the profitability as the forex exposures are largely unhedged.

Susceptible to adverse changes in Government regulations – The carbonated soft drinks industry is susceptible to adverse regulatory changes and modifications in consumer preferences. Additionally, the seasonality in revenue impacts the company's capacity utilisation, cash flow pattern, and profit margins. The demand of aerated beverages is contingent upon the taste and preferences of consumers. With a shift towards a healthy lifestyle, there is a possibility of moderation in demand for aerated beverages. Both these factors can impact the company's revenue/ margins and could affect the longer-term financial profile of the company.

Link to the previous rating rationale:
Rationale_BNL_BLR-Survelliance_July-2023

Analytical approach: For arriving at the rating, ICRA Nepal has considered the consolidated financials of BNL and applied its rating methodology as indicated below.

Link to the applicable criteria:
Corporate Credit Rating Methodology

About the company

Incorporated in 1979, Bottlers Nepal Limited (BNL) along with its subsidiary (Bottlers Nepal (Terai) Limited) are the authorised bottlers of The Coca-Cola Company (TCCC) in Nepal. BNL produces and sells carbonated non-alcoholic beverages under the brand names - Coca-Cola, Sprite, Fanta and Kinley. Majority of BNL's shares (~76%) are held by M/s Coca-Cola Southwest Asia Holdings Limited (formerly known as Coca-Cola SABCO (Asia) Limited), followed by Gorkha Brewery Private limited (22%), while the rest consists of public shareholders. The company's shares are listed in the Nepal Stock Exchange Limited.

Key financial indicators – Group

	Audited			Provisional
	FY2021	FY2022	FY2023	6MFY2024
Operating income-OI (Sales in NPR million)	8,294	12,524	12,641	4,599
OPBDITA/OI (%)	20.1%	19.1%	18.0%	11.1%
Total debt/Tangible net-worth-TNW (times)	0.7	0.3	0.5	0.6
Total outside liabilities/ TNW (times)	1.5	1.2	1.2	1.4
Total debt/OPBDITA (times)	1.8	0.7	1.3	3.8
Interest coverage (times)	6.4	14.7	10.0	3.3
DSCR (times)	1.9	3.0	2.6	1.0
Net-working capital/OI (%)	5.6%	7.1%	25.0%	38.0%

Source: Company Data

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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 licenced 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, and technical and analytical skill augmentation.

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