

Rating Rationale

V. G. Automobiles Private Limited

Rating

| Facility | Amount (Rs. In Million) | Rating ¹ | Rating Action |
|----------------------------|---------------------------------------|----------------------------------|---------------|
| Long Term Bank Facilities | 3.10 | CARE-NP BBB- [Triple B Minus] | Reaffirmed |
| Short Term Bank Facilities | 1,238.50 (Increased from 1,188.50) | CARE-NP A3 [A Three] | Reaffirmed |
| Total Facilities | 1,241.60 | | |

Details of Facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has reaffirmed rating of ‘CARE-NP BBB-’ assigned to the long term bank facilities and ‘CARE-NP A3’ assigned to the short term bank facilities of V. G. Automobiles Private Limited (VGAPL).

Detailed Rationale & Key Rating Drivers

The rating assigned to the bank facilities of VGAPL derives strength from experienced and resourceful promoters and company being part of Vishal Group of Companies; moderate track record of operations; established brand and sole distributor of Suzuki Motorcycle India P Ltd., Atul Auto Limited and Motul Lubricants in Nepal. The rating also derives comfort from established dealer network and moderate financial risk profile marked by growth in revenue and moderate debt service indicators during FY19 (refers to 12 months’ period ended mid-July 2019). The ratings, however, are constrained by leveraged capital structure, working capital intensive nature of operation, cyclical nature of the auto industry and high competition from other automobile players. The rating is also further constrained by exposure to volatile interest rates and exposure to regulatory risk related to automobile industry. Ability of the company to maintain the profitability, scale up its operations and improve its overall solvency position remain the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Strengths

Experienced and resourceful promoters

VGAPL derives strength from its strong promoter group belonging to Vishal Group of companies which have a strong presence in Nepal through their group entities in trade, manufacturing, hospitality, insurance and banking. Along with VGAPL, Vishal Group of companies is also dealing with other automobiles’ sole distributorship/ dealership for more than 8 years and have a wide dealer network of automobile distributorship. The other companies in the group are having authorized distributorship of Volkswagen¹ cars, Kobelco construction equipment and Renault cars in the country.

¹Complete definitions of the ratings assigned are available at www.careratingsnepal.com

The day to day operations of the company are managed by Mr. Nikunj Agrawal, who is Managing Director of the company. Mr. Agrawal supervises the operations of the automobile distributorship / dealership in the Group and has an experience of more than a decade through various entities in the same. He is also a director of NIC Asia Bank Limited. The promoters have infused additional equity amounting Rs. 40 Mn during FY19 to support increased operations of the company.

Moderate track record of operations

VGAPL was incorporated in September 2013 and started commencing its commercial operation as a distributor of Suzuki Motorcycle India Private Limited's (SMIPL) motorbikes and spare parts in Nepal. In the beginning of FY18, the company started operating as an exclusive distributor of Atul Auto Limited's three wheeler vehicles and its spare parts. Further, the company also started selling Motul lubricants in Nepal from November 2017 onwards. Thus, the company is having moderate track record of six years into operations.

Established brand and sole distributor of Suzuki Motorbikes, Atul Auto Vehicles and Motul Lubricants

VGAPL is presently, the sole authorized dealer in Nepal for SMIPL, Atul Auto Limited and Atlantic Lubricants & Specialities Private Limited. SMIPL is a subsidiary of one of the world's leading two-wheeler manufacturer, Suzuki Motor Corporation, Japan. During April to November 2019, SMIPL's overall cumulative sales including exports stood at 5,64,041 units, an increase of ~23% over the last year. During FY18, VGAPL entered into agreement with Atul Auto Limited, India as an exclusive assembler and distributor of three wheeler vehicles in Nepal. Atul Auto Limited is operating for more than 30 years and is one of the major player in the three wheeler industry in India. Further, VGAPL started selling Motul Lubricants in Nepal under distributorship agreement with Atlantic Lubricants & Specialities Private Limited. Being authorized dealer for various products from reputed companies provides VGAPL with high client base and large demand catering opportunity.

Established dealer network

VGAPL has established dealer network with total of 61 dealers for two wheelers, 23 dealers for three wheelers and 28 dealers for Motul lubricants. Additionally, the company owns three showrooms along with one service centre for two wheelers segment. The company sold 6,112 vehicles through dealers (including 935 three wheelers) and 735 vehicles through owned showrooms during FY19.

Moderate financial risk profile marked by growth in revenue, moderate debt service indicators, however, leveraged capital structure

Financial risk profile of the company is characterised by increasing scale of operations and moderate debt service coverage indicators. VGAPL has low profitability margins given trading nature of the company. VGAPL derives its total income from sale of vehicles, servicing, and sale of spare-parts, accessories and lubricants. In FY19, income from sale of vehicles contributed ~89% of the total income, while the balance income was derived from servicing and sale of spare parts, accessories, lubricants etc. The total income of VGAPL grew by ~26% during

FY19 on account of overall increase in business operation of the company. The PBIDLT of the company increased by ~53% and PBILDT margin improved to ~11% in FY19 mainly due to growth in sales of high margin yielding products especially in lubricants and three wheeler segment. The increase in the PBILDT also led to increase in PAT by ~75% to Rs. 80 Mn in FY19 and PAT margin to ~4%. Also, the company has moderate interest coverage ratio of 2.43x in FY19.

VGAPL has a leveraged capital structure mainly on account of higher bank borrowings to fund its working capital requirements. However, the overall gearing ratio improved from 4.76x at the end of FY18 to 3.44x at the end of FY19 on back of increase in networth through capital infusion and accretion of profits to reserves which was partially offset by increase in working capital loans in FY19.

Key Rating Weaknesses

Working capital intensive nature of operation

Automobile dealership business has inherent high working capital intensity due to high inventory holding requirements and credit to the dealers. The company has to maintain fixed level of inventory for display and high level of inventory to guard against supply shortages as the supply is totally dependent upon imports. This apart, the vehicle manufacturers/ suppliers deliver the vehicles against letter of credit. Thus, the business depends heavily on working capital borrowings and inventory funding channels. During FY19, VGAPL has inventory holding period of 96 days and high operating cycle of 183 days. The average utilization of working capital limit was moderate during FY19.

Cyclical nature of the auto industry and high competition from other automobile players

The demand for motorbikes is inherently vulnerable to the economic cycles and is highly sensitive to interest rates. Demand for automobiles increases during high economy growth rate period and low interest rate regime and vice-versa. Also, there is stiff competition from other automobile dealerships in Nepal. There are large number of players operating in market for two wheelers like Bajaj, Hero, Honda, TVS, Yamaha etc.; for three wheelers like Bajaj, TVS, Piaggio etc. and for lubricants like Castrol, Mobil etc. Due to high competition, dealers are forced to pass on discount and exchange scheme to attract customers.

Exposure to volatile interest rates

Nepalese banking sectors are fixing lending interest rate based on quarterly base rate and interest rate will be changed accordingly on quarterly basis. Due to tight liquidity in the market, the interest rate has been high and volatile during the last 12 months. Therefore, funding from Bank and Financial Institutions is exposed to volatile interest rate.

Exposure to regulatory risk related to automobile industry

The automobile industry is still taken as luxury items in Nepal and this segment also belongs to highly taxed goods in Nepal. Further, there has been overall decline in the automobile industry in FY19. Additionally, vide

circular dated November 6, 2018, the Central Bank has decreased cap on bank financing to 50% of value of vehicle used for personal purpose which could slow down demand growth in the industry.

About the Company

V.G. Automobiles Private Limited was incorporated in September 13, 2013 by Mr. Nikunj Agrawal and his relatives. The company started its operations as a sole authorized distributor for SMIPL for their two wheeler vehicles and spare parts in Nepal. During FY18, the company also started selling three wheeler vehicle & spare parts of Atul Auto Limited and Motul Lubricants in Nepal.

Brief financials of VGAPL for last three years ending FY19 are given below:

| For the year ended Mid July | FY17 | FY18 | FY19 |
|-----------------------------|-----------|-----------|-----------|
| | (Audited) | (Audited) | (Audited) |
| Income from Operations | 1,162 | 1,488 | 1,880 |
| PBILDT | 87 | 131 | 200 |
| PAT | 23 | 46 | 80 |
| Overall Gearing (times) | 5.71 | 4.76 | 3.44 |
| Interest Coverage (times) | 1.87 | 2.17 | 2.43 |

(Rs. Million)

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|--|---|--|
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Annexure 1: Details of the Facilities rated

| Nature of the Facility | Type of the Facility | Amount (Rs. In Million) | Rating |
|---------------------------------------|-----------------------|-------------------------|--------------|
| Long Term Bank Facilities | Term Loan | 3.10 | CARE-NP BBB- |
| Short Term Bank Facilities | Working Capital Limit | 708.50 | CARE-NP A3 |
| Short Term Bank Facilities (Proposed) | Working Capital Limit | 150.00 | CARE-NP A3 |
| Short Term Bank Facilities | Non-Funded Limit | 380.00 | CARE-NP A3 |
| Total | | 1,241.60 | |