

Daunne Flour Mills Private Limited

Rating

Facility/Instrument	Amount (Rs. in Million)	Ratings ¹	Rating Action
Long Term Bank Facilities	221.95	CARE-NP B+ [B Plus]	Assigned
Short Term Bank Facilities	340.30	CARE-NP A4 [A Four]	Assigned
Total Facilities	562.25		

Details of Facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has assigned rating of 'CARE-NP B+' to the long term bank facilities and 'CARE-NP A4' to the short term bank facilities of Daunne Flour Mills Private Limited (DFMPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of DFMPL are constrained by its below average financial risk profile marked by modest scale of operations with low net profits, highly leveraged capital structure with weak debt service coverage indicators, elongated operating cycle marked by high working capital loan utilization. The ratings also factor in the susceptibility to price fluctuation of seasonal agro products, fragmented and competitive nature of industry, exposure to volatile interest rates, and exposure to regulatory risk.

The ratings, however, derive strength from established track record of operations backed by experienced promoters and management team, wheat being one of the major Nepalese diet leading to stable demand outlook, decent product diversification along with own brand, and established marketing setup with locational advantage for raw materials.

Going forward, the ability of the company to manage growth in operations while improving the profit margins and rationalization of its debt through efficient working capital management would be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Below average financial risk profile marked by low net profits and modest, albeit increasing, scale of operations

Over FY19 - FY21 (FY refers to the twelve-month period ending mid-July), DFML's total operating income grew from Rs. 451 Mn to Rs. 722 Mn with a Compounded Annual Growth Rate of 26.52% backed by increased sales volume amid sustained demand. Despite growing sales, PBILDT margin of the company has marginally improved in FY21 and stood at 7.71% as compared to 7.38% in FY20. The improvement in margins was on account of change in product mix and economies of scale. Furthermore, despite growing income, the company's net profits have been quite low, impacted mainly by higher interest expense. Amid growing scale of operations the company's utilization of short term bank facilities has been increasing leading to higher interest outgo year on year. This has led to modest PAT of Rs. 0.10 Mn during FY21, which had decreased from Rs. 0.22 Mn during FY20. The ability of DFMPL to rationalize its debt through efficient working capital management would be critical for its profitability.

Highly leveraged capital structure with weak debt service coverage indicators

DFMPL has a highly leveraged capital structure with overall gearing ratio of 4.09x at the end of FY21. The company has leveraged capital structure mainly attributed to higher working capital requirements which has been met through bank borrowings. Interest coverage ratio of the company was also modest at 1.36x in FY21. Other debt service coverage indicators

¹Complete definitions of the ratings assigned are available at www.careratingsnepal.com and in other CRNL publications.

such as total debt to gross cash accruals remained weak and stood high at above 30x for FY21. A limited gearing headroom could constraint the company from raising addition debt, when required. Furthermore, increased reliance on bank borrowings results in higher interest outgo, squeezing the company's returns.

Elongated operating cycle leading to high reliance on borrowings

The operations of the DF MPL are working capital intensive in nature marked by total operating cycle of 148 days in FY21. Majority of wheat requirement is met through domestic purchase from wheat traders where company receives credit period for around one month. Due to seasonal nature of raw materials, DF MPL needs to maintain inventory for around 3-4 months for smooth operations. Average inventory days was 106 days in FY21, which increased from 63 days in FY20. The company also needs to allow upto three months credit period to its customers, which led the average debtor turnover days to be 75 days in FY21. This led to high reliance of the company on the bank finance for working capital needs. The average utilization of fund-based working capital limit against sanctioned limit was around 86% for nine months ending mid-April, 2022.

Susceptibility to price fluctuation of seasonal agro products

DF MPL deals in various wheat products, whose prices are highly volatile in nature. Agro products are seasonal in nature with production and prices dependent on various factors like area under production, yield for the year, demand supply scenario and inventory carry forward of last year. Furthermore, the supply is dependent upon availability of seed, impacts of pests, monsoon during the particular year as well as overall climatic condition, exposing the fate of the company's operation to vagaries of nature.

Fragmented and competitive nature of industry

The flour-milling industry is highly fragmented due to presence of several organized/ unorganized players owing to low entry barrier due to low technology and capital requirement. The presence of local small scale millers capable to process wheat into comparable products, large millers have low pricing power. Furthermore, Nepal being a traditionally agriculture-based nation, wheat flour and allied products for household consumption are produced in domestic level as well.

Exposure to volatile interest rates and regulatory risk

Nepalese banking sector has a floating interest rate regime, where a certain premium is added to the quarterly base rate and interest rate is changed accordingly on quarterly basis. The base rates of the banks and financial institutions (BFIs) are impacted by available liquidity in the system which leads to change in interest rates. The volatility in interest rate is more evident currently on account of the ongoing liquidity stress in the economy, with substantial upward pressure on interest rates in the last 2-3 quarters.

The earnings of the company are also susceptible to regulatory policies relating to tariff barriers and export policies of India, which is the major supplier of wheat to Nepal. India has restricted exports of wheat with effect from May 14, 2022 which is expected to increase the global wheat prices and affect the availability of raw materials to flour manufacturers like DF MPL. Around 40% of DF MPL's total procurement in FY21 was from India. The changing regulation could impact on the profitability of the wheat processing/trading companies in Nepal. This will remain a key monitorable aspect.

Key Rating Strengths

Established track record of operations backed by experienced promoters and management team

DF MPL has an established track record of almost a decade. The company is managed under the overall guidance of its seven-member board of directors which includes experienced businessmen with wide experience in the manufacturing and trading sectors. The board is led by Mr. Ganesh Prasad Pokharel, Chairman, who has over a decade of experience in the

manufacturing and trading industry. The board of directors is aptly supported by a management team led by Mr. Sunil Sharma Bohora, General Manager, who has been involved in DF MPL for the last six years and has an experience of more than two decades in the top level management of various manufacturing companies.

Established marketing setup and product diversification

DF MPL has an established distribution network centered at major cities in western and central region of Nepal. As on mid-April 2022, the company had a customer base of more than 300 customers, including corporate buyers who are manufacturers of food items derived from refined flour. The product portfolio of DF MPL includes maida, aata, chakki aata, choker, suji and daliya, catering to the demand of diverse customer base. Majority of sales is derived through sale of maida to industrial buyers who are manufacturers of food items like pasta, noodles, biscuits, etc. Company has targeted aata, suji and daliya to household consumers which it sells via traders/distributors. The company sells its products under the brand name of "Daunne Gold" which is an established name in the Nepalese market and provides competitive advantage to the company against new players entering the industry.

Wheat being one of the major Nepalese diet leading to a stable demand outlook

The demand prospect of wheat industry is likely to remain stable, notwithstanding the near-term supply constraint, as wheat products are considered one of major diets of Nepalese consumers. In addition, wheat products carry special traditional values in Nepal, and are used in preparing culturally valued foods especially during festive seasons. Due to availability of its products with varied packaging option ranging 1 kg to 50 kg, DF MPL has been able to attract household consumers, in addition to industrial buyers.

About the Company

Daunne Flour Mills Private Limited (DF MPL) is a private limited company incorporated on August 30, 2013 for processing of wheat for production of refined flour (maida) and allied products. The company has its manufacturing facility in Ramgram-11, Nawalparasi, Nepal. The company has a refined flour (maida) mill having installed capacity of 180 Metric Ton Per Day (MTPD) and flour (atta) mill having installed capacity of 60 MTPD as on mid-April, 2022. DF MPL sells these products under the brand name of "Daunne Gold" to various household and industrial customers mainly in western and central region of Nepal.

Brief financials of the company

For the year ended Mid-July	FY19 (Audited)	FY20 (Audited)	FY21 (Audited)
Income from Operations	451	672	722
PBILDT Margin (%)	3.83	7.38	7.71
Overall Gearing (times)	15.80	8.57	4.09
Interest Coverage (times)	0.82	1.28	1.36
Current Ratio (times)	0.67	0.83	0.98
Total Debt/Gross Cash Accruals (times)	Negative	46.65	30.67

Annexure 1: Details of the Facilities rated

Nature of the Facility	Type of the Facility	Amount (Rs. in Million)	Rating
Long Term Bank Facilities	Fixed Term Loan	221.95	CARE-NP B+
Short Term Bank Facilities	Fund Based Limit	340.00	CARE-NP A4
Short Term Bank Facilities	Non-Fund Based Limit	0.30	CARE-NP A4
Total		562.25	

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