

Khilung Kalika Agro Farm Private Limited

Rating

Facilities/ Instrument	Amount (Rs. in Million)	Ratings ¹	Rating Action
Long Term Bank Facilities	352.88	CARE-NP B+ [Single B Plus]	Reaffirmed & Removal from Issuer Not Cooperating
Short Term Bank Facilities	292.40	CARE-NP A4 [A Four]	Reaffirmed & Removal from Issuer Not Cooperating
Total Facilities	645.28 (Six Hundred Forty Five Million and Two Hundred Eighty Thousand Only)		

* Details of Facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has reaffirmed the rating of 'CARE-NP B+' assigned to the long term bank facilities and 'CARE-NP A4' assigned to the short term bank facilities of Khilung Kalika Agro Farm Private Limited (KKPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of KKPL continue to remain constrained by its working capital intensive nature of operations, weak financial risk profile marked by it fluctuating scale of operations, with highly leveraged capital structure, weak debt service coverage indicators. The ratings also factor in the company's presence in competitive nature of industry, exposure to inherent risk in poultry sector and exposure to volatile interest rates.

The ratings, however, continue to derive strengths from experienced management in the related field, growing distribution network, high growth prospects of the industry and government support for agriculture based industry.

Going forward, the ability of the company to profitably scale up its operations while efficiently managing the working capital requirements leading to improved capital structure and debt service coverage indicators will be the key rating sensitivities.

Detailed description of the key rating drivers

Key Rating Weaknesses

Working capital intensive nature of business

Poultry business requires to maintain adequate inventory level of parent birds and raw materials stock to feed the birds in different growing stages. This leads to a high inventory period, which stood at 238 days during FY21 (Audited; refers to the twelve-month period ended mid-July 2021). KKPL's collection period was moderate at 11 days during FY21 with KKPL allowing around 15-20 days' credit periods to its customers. Based on the long business relationship, the company receives a payable period of around three months from its suppliers; Despite a reasonable collection and creditor days, KKPL's net operating cycle of the company was high at 161 days in FY21 owing to the substantially high inventory holding (PY: 168 days). The high working capital requirements were met largely through bank borrowings which normally results in average utilization of over 90% of its sanctioned working capital limits.

Weak financial risk profile

KKPL derives its revenue from sale of sales of eggs, retired layers and fertilizers. Company's total operating income has been fluctuating over the past three years due to outbreak of disease which has affected the operations of business. KKPL's Total

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

Operating Income (TOI) declined 44% year on year in FY20 followed by 175% growth in FY21 and 3% y-o-y decline in FY22 (Provisional; refers to the twelve-month period ended mid-July 2022). During FY22, the company achieved total operating income of Rs. 452 Mn which slightly declined from Rs. 465 Mn in FY21.

In FY21, PBILDT margin increased to 16.19% from 4.60% during FY20. However, KKPL achieved very nominal net profitability on account of higher interest and depreciation in FY21. Furthermore, KKPL's profitability in FY21 was also impacted by an abnormal loss (related to various diseases to Poultry) of Rs. 16 Mn in FY21 (PY: Rs. 92 Mn).

The capital structure of the company stood leveraged as on mid-July 2021 with overall gearing at 3.45x. The company had negative networth of the balance sheet date of FY20 on account of losses. Tangible networth of the company improved to Rs. 150 Mn during FY21 with infusion of Rs. 200 Mn from the directors coupled with increase in reserves with accretion of profits. Although interest coverage ratio of the company improved to 1.86x in FY21 from 0.18x in FY20 amid improved PBILDT generation, total debt/ GCA remained substantially high at above 26x.

Fragmented and competitive nature of industry

The poultry industry is highly competitive and fragmented with many regional unorganized players. Low capital intensity and low entry barrier facilitates easy entry of new players leading to increase in competition. Due to the stiff competitive, the pricing of poultry products remains volatile and also varies from place to place. Furthermore, inherent risk such as perishable nature of product, constraints in transportation, cost of feeds, diseases affect poultry business. Besides this, ability to continuously maintain and improve product quality is key factor to sustain and capture market share in poultry sector.

Vulnerability of the industry's performance to outbreaks of flu and other diseases

KKPL will be involved in the sales of eggs, retired layers and fertilizers. Poultry business remains susceptible to inherent risk, such as diseases like Bird Flu which could impact sales of poultry feeds. Intermittent outbreaks of bird flu have affected exports since 2006. Such disease outbreaks affect poultry industry and movement of poultry products across the country. These avian flu outbreaks could lead to a drastic fall in demand followed by crash in poultry prices. Such scenario could pressurize the company's revenue flows as well as profitability.

Exposure to volatile interest rate

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) in Nepal remain quite volatile as they 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. Increased bank rates announced in the Monetary Policy for FY23 is likely to add to the upward pressure on interest rates, which is also evident in the recent rate hike taken by BFIs in September 2022. Any further significant rate hikes could put increased interest burden on the company, squeezing its profitability and impacting its liquidity position. Therefore, funding taken by the company from BFIs is subject to volatile interest rate.

Key Rating Strengths

Experienced promoters and directors in the related field

KKPL has five board of directors, chaired by Mr. Ganga Prasad Aryal. Before incorporating the company, he was engaged in similar business in individual capacity. Mr. Shovakanta Dhakal, managing director, has a long standing experience in diversified sectors like banking, hotels, tourism, agriculture, poultry, renewable energy etc. He is also involved in Janakpur Agro Farm Private Limited as managing director and in Om Agro Private Limited as chief executive officer.

Growing distribution network

KKPL sells its products (eggs, retired layers and organic manures) in the market via whole-sellers and is mainly concentrated in Bagmati, Lumbini and Gandaki provinces out of seven provinces in Nepal. It has year on year growing customer network of 197 dealers as on mid-July 2022. Growing and established network improves the bargaining capacity of the company and lends supports to market of its products.

High growth prospects of the industry

As per the National Economic Survey 2020/21, the production of meat has increased by 54.6% to 552,000 metric tons in FY20 with egg production of 1.49 billion units. Furthermore, the production of meat has annualized growth of 3.53% and the production of egg stood at 1.09 billion units in 8MFY22 (refers to the eight-month period ended mid-March 2022). The Poultry industry for the country has seen increasing trend in production and productivity backed by increasing trend of consumer favoring white meat, increasing inflow of tourists and rapid urbanization, changing food habits of urban inhabitants and availability of poultry meats and eggs in all urban centers and even in small market areas. Poultry industry is relatively insulated from the economic cycle and given the current consumption trend, the demand for poultry products are likely to remain stable over the medium-term.

Favourable Government policies towards poultry industry

Government of Nepal (GoN) has put restrictions on import of poultry items in Nepal from other countries as an initiative to protect domestic poultry sector and to attain self-sufficiency in the poultry sector. Since the industry remains susceptible to inherent risk, federal government has issued Bird Flu Control regulation, 2022 to carry out control mechanism to mitigate bird flu spread remaining in line with the Animal Health Livestock Services Act, 1998. The act will focus on standard mechanism accessing prior diagnosis of contamination and enforce strict restriction on transport of poultry products.

About the Company

Khilung Kalika Agro Farm Private Limited (KKPL) is a private company incorporated on March 14, 2014 having registered office located in Syangja, Nepal. KKPL is engaged in layer poultry farming and wholesale trading of eggs. The company has five breeding sheds, each with 51,000 layers' capacity as on mid-July 2022. It sells its products like eggs, retired layers and fertilizers to the customers located in Bagmati, Lumbini and Gandaki provinces.

Brief financial performance of KKPL during last 3 years is given below:

(Rs. In Million)

Particulars	FY19(A)	FY20 (A)	FY21 (A)
Income from Operations	303	169	465
PBILDT Margin (%)	27.99	4.60	16.19
Overall Gearing (times)	5.8	Negative	3.45
Interest coverage (times)	2.41	0.18	1.86
Current Ratio(times)	1.29	0.99	0.99
Total Debt/Gross Cash Accruals(times)	11.22	Negative	26.16

A: Audited

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	352.88	CARE-NP B+
Short Term Bank Facilities	Fund Based /Non-fund Based	292.40	CARE-NP A4
Total		645.28	

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