Baba Vegetable Oil Industries Private Limited

Ratings

Facilities/Instrument	Amount (Rs. in Million)	Ratings[1]	Rating Action
Short Term Bank Facilities	**2,500.00 (increased from 2,065.00)**	**CARE-NP A4 [A Four]**	**Revised from CARE-NP A3**
Total Facilities	**2,500.00 (Two Thousand Five Hundred Million Only)**		

** Details of Facilities in Annexure 1*

CARE Ratings Nepal Limited (CRNL) has revised the rating assigned to the short-term bank facilities of Baba Vegetable Oil Industries Private Limited (BVOPL) to 'CARE-NP A4' from 'CARE-NP A3'.

Detailed Rationale & Key Rating Drivers

The revision in the rating assigned to the short-term bank facilities of BVOPL takes into account declining financial performance trend in FY23 (Unaudited, FY refers to the twelve-month period ending mid-July) marked by higher-than-expected deterioration in its capital structure and weak debt service coverage indicators amid negative cash accruals. Despite sharp fall in operating income in FY23, BVOPL reported substantial spike in debt levels, resulting in a highly leveraged capital structure. Amid unfavorable business environment for exports to India, which has been the major revenue driver for the company, BVOPL's income prospects is likely to remain checked over the near-term. The rating also factors in working capital intensive nature of business marked by elongation in net operating cycle in FY23. The rating continues to remain constrained by reliance on exports to India for significant portion of its income, which in turn is dependent on the tariff arbitrage between direct import of crude edible oil in India vis-à-vis import of refined oils from Nepal. This exposes BVOPL to changes in tariff regimes by Government of India (GoI) for imports of various edible oils/crude leading to volatile operating performance. The rating also factors in susceptibility of BVOPL's business to price fluctuation of seasonal agro products, foreign exchange fluctuation risk, exposure to volatile interest rates, regulatory risk and competitive nature of industry.

The rating, however, continues to derive strength from BVOPL's established track record of operations along with experienced promoters and management team and reasonable domestic sales of the company. The rating also factors in the locational advantage of BVOPL's manufacturing facilities and the otherwise stable demand outlook for edible oil over the medium term offset to some extent by the volatility in export opportunities for Nepalese refiners over the near-term.

Going forward, the ability of BVOPL to manage growth in the operations by increased penetration in the domestic market leading to lesser dependency in the volatile exports business while maintaining profit margins will be the key rating sensitivities. Furthermore, the ability of the company to pass through changes in raw material prices to the customers and managing the foreign exchange fluctuation risks related to raw materials will also be the key rating sensitivities. Also, prolonged unfavorable change in the regulatory framework pertaining to trade regulations and tariff differentials with India adversely impacting exports prospects for substantially longer periods leading to a material decline in operating profile of the company on a sustained basis will also be a key rating sensitivity.

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

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Sharp decline in financial performance amid challenging business environment in FY23

BVOPL generates its revenue from sale of refined sunflower/palmolein/soyabean oil and soap oil. During FY23, total operating income (TOI) of the company declined by ~52% to Rs. 3,677 Mn majorly due to decline in export sales by ~60% amid reduced scope for arbitrage following the introduction of duty-free import scheme for soybean and sunflower crude by India. Raw materials of the company mainly being edible crude oils, dependent on prices in the international market, profitability of the company remains volatile over the period. The company incurred operational losses during FY23 on account of high input prices, which the company was not able to pass on to its customers amid stiff competition compounded by significant decline in the prices of edible oil. Consequently, the company incurred losses in inventory holding.

Overall gearing ratio of the company deteriorated to 4.58x at the end of FY23 from 1.20x at the end of FY22 majorly due to decrease in tangible net worth of the company amid losses occurred during FY23. Additionally, the company's total debt increased to Rs. 1,759 Mn as cash flow from operations dwindled. Furthermore, the company also made dividend payout of Rs. 200 Mn during FY23, which further impacted the net worth. The declining financial performance led to deterioration in debt service coverage indicators of the company in FY23. Interest coverage ratio deteriorated to negative ratio in FY23 compared to 13.67x in FY22 on account of PBILDT losses. Similarly, Total debt/ GCA for FY23 was negative compared to 1.18x in FY22 owing to negative cash accruals. As export opportunities to India remain slim, the company's financial risk profile is likely to remain impacted over the near-term amid muted income prospects.

Working capital intensive nature of business

The operations of the company are working capital intensive in nature. BVOPL needs to keep sufficient inventory for smooth operations and extend credit to their customers, which lead to reliance on working capital limits. Company generally allows one to two months credit period to its domestic customers. Company used to generally receive advance payment for exports. However, amid decline in export sales coupled with higher credit period to domestic customers, the average collection period increased to 56 days during FY23 from 23 days during FY22. Average inventory holding of the company increased to 68 days in FY23 from 24 days in FY22. Furthermore, the company receives credit period of around 1-2 months from the suppliers. Combining all, total operating cycle of the company increased to 61 days in FY23 from 26 days in FY22. The working capital intensity of the business had led to high reliance of the company on the bank finance for working capital requirements.

Raw material price volatility risk and foreign exchange fluctuation risk

BVOPL's major raw materials include crude soyabean oil, crude sunflower oil and crude palm oil which are imported from various countries. The prices of the BVOPL's raw materials are market linked and determined on a periodic basis, thus exposing the company to the volatility in the prices of raw materials which has a bearing on its profitability margins. The raw material cost contributed around 98% of the total operating income of the company during FY23.

Further, the total raw material requirement is met through imports and the prices of the same are linked to USD, for which the company is exposed to the foreign exchange fluctuation risk which company doesn't hedge. BVOPL incurred foreign exchange loss of Rs. 47 Mn during FY23 (FY22: Rs. 30 Mn). The ability of the company to pass through changes in raw material prices to the customers and managing the foreign exchange fluctuation risks related to raw materials will be crucial from its profitability perspective.

Exposure to regulatory risk

The operation of BVOPL is vulnerable to regulatory risk arising from various laws and policies of the importing and exporting countries coupled with the domestic policies of Nepal. BVOPL's exports revenue (~66% of total sales in FY23), relies on the tariff arbitrage in India between direct imports of crude by Indian millers vis-à-vis imports of refined edible oil from Nepal. BVOPL, like many millers in Nepal, tries to exploit the tariff differential, which keep changing for different edible oils every year as per the policies of the GoI. Furthermore, over the past few years, there have been several changes in government policies, either domestic or international regarding import/export of edible crude sometimes limiting and at other times enhancing refiners like BVOPL's ability to export to India. BVOPL's revenue profile is thus susceptible to regulatory policies relating to tariff barriers (differential trade tariffs among South Asian Free Trade Area), non-tariffs barriers (restriction on the quality of imports), international freight rates etc. Any sustained unfavorable change in policies by local governments impacting exports of refined oils or procurement of crude could have a bearing on the financial profiles of the refiners like BVOPL.

Competitive nature of industry

Import and processing/refining of edible oils is highly fragmented due to presence of several organized/ unorganized players owing to low entry barrier and low technology and capital requirement. Low product differentiation of BVOPL's product results in high competition from other players including traders. Considering the competitive nature of industry, the millers have low pricing power. Agro products are also seasonal in nature with production dependent on various factors such as monsoon and climatic condition, exposing the fate of the company's operation to vagaries of nature.

Exposure to volatile interest rate risk

Relatively high debt levels led to high interest outgo of Rs. 100 Mn for BVOPL in FY23 (FY22: Rs. 66 Mn). The company operates under a floating interest rate regime, wherein a premium is added to the monthly base rate, and the interest rate is adjusted accordingly on a monthly basis. The base rates of banks and financial institutions (BFIs) in Nepal are subject to volatility, influenced by the liquidity available in the system, causing fluctuations in interest rates. The company is vulnerable to the impact of these changes, and higher-than-anticipated interest rates could potentially narrow the company's profit margins. Since the capital structure of the company is highly leveraged, the funding from banks is exposed to the volatility of interest rates.

Key Rating Strengths

Established track record of operations along with experienced promoters and management team

The company has been into processing of edible oil for more than two decades and has developed a market for itself in domestic as well as export markets through its long-standing presence in this sector. BVOPL also derives strength from its established promoters belonging to the Debenara group of Nepal. The group is involved in diversified manufacturing, trading and other businesses. The promoters of company have experience of over two decades in trading and processing of edible oils. BVOPL is managed under the overall guidance of Mr. Prakash Kumar Mundara and Mr. Suresh Kumar Rathi. Mr. Prakash Kumar Mundara, Chairman, has an experience of more than 15 years in chemicals, agriculture and edible oil industry etc. Mr. Suresh Kumar Rathi, Director, has an experience of over 15 years and is involved in various trading and manufacturing sectors including agricultural products, soap and chemicals etc. The BOD is further supported by other experienced management team members.

Essential part of cooking leading to stable demand and steady growth in the revenue

The demand prospect of edible oil industry in Nepal is growing as oil is one of essential commodity for cooking. Further, with demand being higher than domestic production and slowdown in domestic agriculture production, large volume of edible as well as crude oil is being imported in Nepal giving importers like BVOPL a favorable business environment. Despite decline in export sales, comfort is taken from the decent scale of BVOPL's domestic business although a near-term decline in profitability exacerbated by intense competition, the company's credit risk profile is expected to remain resilient enough to ride out the near-term dip in scale of operations and profitability.

Locational advantage for both imports and exports

The plant site is located in Biratnagar around 15 kms from Indo-Nepal borders. Since the procurement of raw materials is mainly in the form of imports and routes through Indian ports. The factory's proximity to the border remains a positive point leading to savings in freight cost. Furthermore, BVOPL also exports its products to India which accounted for 66% of total revenue in FY23. The factory's proximity to Indian border remains added advantage with regards to freight cost saving in export of goods.

Industry Outlook

Amid change in duty structure (lower/zero import duty) by Government of India (GoI) on imports of various crude edible oils, Nepalese refiners' income levels in FY23 dropped substantially compared to the high growths reported over FY21-FY22 which was supported by surging exports to India of palmolein and soybean oil. Nepal's exports of edible oil to India has declined substantially compared to previous years. According to Department of Customs and the Trade and Export Promotion Center (TEPC), exports of edible oils to India from Nepal have declined by 72% year-on-year in FY23. Hence, refiners like BVOPL are likely to remain impacted over the near term as export opportunities to India remain slim. However, refiners with a decent domestic presence are expected to fare better than the majorly export oriented player. BVOPL's domestic sales of over Rs. 1,000 Mn sales annually is likely to support the earning profile of the company to some extent in the interim.
Although, upward revision in import duty of various crude edible oils in India, when that happens, is likely to again open opportunities for Nepalese refiners. Nonetheless, exports will remain contingent upon the intermittent changes in related policies of GoI, resulting in a volatile income level for refiners like BVOPL going forward as well.

About the Company

Baba Vegetable Oil Industries Private Limited (BVOPL) is a private limited company incorporated on September 22, 1993 for processing/refining of edible oils, having plant in Katahari, Morang, Nepal. Currently, the total installed capacity for refined soyabean, palmolein and sunflower oil is 45,000 MTPA. BVOPL sells these edible oils under the brand name of "Siddha Baba" in the domestic market. The company sales its products across all major places in Nepal through its sales depot located at Biratnagar, Kathmandu and Pokhara and also exports to India.

Financial performance

(Rs. In Million)

Particulars	FY21 (A)	FY22 (A)	FY23 (UA)
Income from Operations	5,519	7,592	3,677
PBILDT Margin (%)	12.60	12.53	Negative
Overall Gearing (times)	1.69	1.20	4.58
Interest coverage (times)	31.25	13.67	Negative
Current Ratio(times)	1.36	1.25	1.01
Total Debt/Gross Cash Accruals(times)	1.88	1.18	Negative

A: Audited, UA: Unaudited

Annexure 1: Details of the Facilities Rated

Nature of the Facility	Type of the Facility	Amount (Rs. in Million)	Rating
Short Term Bank Facilities	Fund Based/Non-Fund Based	2,500.00	CARE-NP A4 [A Four]
Total		**2,500.00**	

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About CARE Ratings:

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