Narayani Oil Refinery Udhyog Private Limited

Rating

Facilities/Instrument	Amount (Rs. in Million)	Rating[1]	Rating Action
Short Term Bank Facilities	**5,174.00**	**CARE-NP A4 [A Four]**	**Revised from CARE-NP A3**
Total Facilities	**5,174.00 (Five Thousand One Hundred Seventy-Four 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 Narayani Oil Refinery Udhyog Private Limited (NOPL) 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 NOPL takes into account sharp decline in financial performance of the company in FY23 (Audited, FY refers to the twelve-month period ending mid-July) marked by cash losses, deterioration in its capital structure and weak debt service coverage indicators. Despite sharp fall in operating income in FY23, NOPL reported substantial spike in debt levels, resulting in a highly leveraged capital structure. Amid challenging environment for exports to India, which has been the major revenue driver for the company, NOPL's income prospects is likely to remain checked over the near-term. The rating also factors in elevated operating cycle of the company leading to high reliance in working capital borrowings. 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 NOPL 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 NOPL'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 NOPL'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 NOPL'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 the company 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 export environment in FY23

NOPL generates its revenue from sale of refined sunflower/palmolein/soyabean oil. During FY23, total operating income (TOI) of the company declined by ~41% year-on year to Rs. 6,411 Mn due to decline in export sales by ~84% amid reduced scope for arbitrage following the introduction of duty-free import scheme for edible crude oil (sunflower/palmolein/soyabean oil) by India. Raw materials of the company mainly being edible crude oils depend on prices in the international market leading to volatile profitability of the company over the period. Decline in export sales, stiff competition in domestic market and high input prices which the company was not able to pass on to its customers led to PBILDT losses of Rs. 919 Mn in FY23. The company thus reported cash losses in FY23 (FY22: positive GCA of Rs. 622 Mn).

Capital structure of the company was leveraged with overall gearing ratio of 3.01x at the end of FY23, deteriorating from 0.78x at the end of FY22 on account of substantial uptick in short-term borrowings in addition to dilution of tangible net worth amid net losses in FY23.The declining financial performance led to deterioration in debt service coverage indicators of the company in FY23 as losses at PBILDT level led to negative coverage indicators. 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. NOPL has to keep enough inventory for smooth operations owing to long lead times and extend reasonable credit to its customers amid increased competition, which results in an elongated operating cycle and leads to reliance on borrowings to fund working capital requirements. The company generally allows up to two months credit period to its customers; average collection period days was 67 days during FY23 (FY22:50 days). Furthermore, the company keeps inventory for around one month. Creditor days, however are relatively low of around 4 days in FY23 (FY22: 4 days), resulting into elongated operating cycle of 101 days in FY23. Operating cycle elongated from 81 days in FY22 on account of elevated collection periods further added by overall stressed economic environment in addition to increased competition in domestic market. The working capital requirements were met through bank borrowings with average utilization of around 77% of its sanctioned working capital limits for twelve months period ended mid-February 2024.

Raw material price volatility risk and foreign exchange fluctuation risk

The company is exposed to inherent risk related to volatility in the exchange rate on timing difference and different currencies between receipt of export remittance and crystallization of import liabilities. Crude soyabean, palmolein, sunflower oil and crude palm oil are the major raw materials for NOPL which are imported from various countries. The prices of the NOPL's raw materials are linked to market forces 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 ~ 99% of the total operating income of the company during FY23. Furthermore, 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. NOPL incurred foreign exchange loss of Rs. 58 Mn during FY23 (FY22: Rs. 94 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 NOPL is vulnerable to regulatory risk arising from various laws and policies of the importing and exporting countries coupled with the domestic policies of Nepal. NOPL's exports revenue (export revenue declining from ~49% of total sales in FY22 to 13% of total sales in FY23), relies on the tariff arbitrage in India between direct imports of crude edible oil by Indian millers vis-à-vis imports of refined edible oil from Nepal. NOPL, 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 oil sometimes limiting and at other times enhancing refiners like NOPL's ability to export to India. NOPL'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. Thus, any sustained unfavorable change in policies by local governments impacting exports of refined oils or procurement of crude oil could have a bearing on the financial profile of the refiners like NOPL.

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 NOPL'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 coupled with elevated interest rates led to high interest outgo of Rs. 246 Mn for NOPL in FY23 (FY22: Rs. 145 Mn). NOPL's interest rates are based on floating interest rate regime, where a certain premium is added to the monthly base rate and interest rate is changed accordingly on monthly 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 changes in interest rates. High debt levels, higher interest rates than envisaged could result in squeezed margins of the company, impacting its liquidity profile.

Key Rating Strengths

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

NOPL has been into processing and marketing of edible oil for more than three decades and has developed an established market for itself in domestic as well as export markets through its long-standing presence in this sector. NOPL is part of Chachan family group which is one of the established business groups in Nepal. The group is involved in various businesses including cement manufacturing, edible oil refinery and trading of fertilizers. The company is managed under the overall guidance of its six-member Board of Directors (BoD) which includes experienced businessmen/industrialists with wide experience in the food processing business. Day to day operations of the company is handled by Mr. Nikhil Chachan, who has been a director in the company since last seven years. The BOD is supported by a team of experience professionals across various functions.

Locational advantage for both imports and exports

The plant site is located in Bara District, Nepal around 4 kms from Birgunj dry port. Since most of the raw materials requirements of NOPL are imported from various countries and unloaded on Indian ports, the factory's proximity to the border remains a competitive advantage leading to savings in freight cost. Furthermore, NOPL also exports its products to India which accounted for ~49% of TOI in FY22, however declined to ~13% of TOI in FY23. The factory's proximity to Indian border remains a positive point with regards to freight cost saving in export of goods.

Essential part of cooking leading to stable demand in domestic market

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 crude or refined oil is being imported in Nepal giving importers like NOPL a favorable business environment. Despite decline in export sales, comfort is taken from the decent scale of NOPL's domestic business (~Rs. 5.5 Bn domestic sales in FY22-FY23) 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.

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 NOPL 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. NOPL's domestic sales of over Rs. 5.5 Bn annually for last consecutive three years 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 NOPL going forward as well.

About the Company

Narayani Oil Refinery Udhyog Private Limited (NOPL) is a private limited company incorporated on September 20, 1989 for processing/refining of edible oils, having plant in Lipanimal, Bara District, Nepal. The company has been in operations for over three decades. Currently, the total installed capacity for refined soyabean, palmolein, vegetable oil, mustard oil, sunflower oil and palm oil is 1,28,500 MTPA. NOPL sells these edible oils under the brand names of "Trishakti", "Smile", "Aarogya", "Shree" "Neelmani", "Kundan" and "Nilkamal" in the domestic market.

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

(Rs. In Million)

Particulars	FY21 (A)	FY22 (A)	FY23 (A)
Income from Operations	10,659	10,948	6,411
PBILDT Margin (%)	14.81	6.47	Negative
Overall Gearing (times)	2.38	0.78	3.01
Interest coverage (times)	23.42	4.87	Negative
Current Ratio(times)	1.30	1.83	1.75
Total Debt/Gross Cash Accruals(times)	2.96	2.49	Negative

A: Audited

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	5,174.00	CARE-NP A4 [A Four]
Total		**5,174.00**	

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