Rating Rationale

Surya Nepal Private Limited

Rating

Facility/ Instrument	Amount (Rs. In Million)	Rating[1]	Rating Action
Short Term Bank Facilities	5,750.00	CARE-NP A1+ [A One Plus]	Reaffirmed
Total Facilities	**5,750.00**		

Details of Facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has reaffirmed rating of 'CARE-NP A1+' assigned to the short term bank facilities of Surya Nepal Private Limited (SNPL).

Detailed Rationale & Key Rating Drivers

The rating assigned to the bank facilities of Surya Nepal Private Limited (SNPL) derives strength from its strong brand equity, leadership position in market with a strong portfolio of offerings mainly in its cigarette business and experienced management in the related field. The rating factors in strong financial profile characterized by growth in the revenue, high profitability, minimal debt and strong liquidity backed by large liquid investments. The rating also derives comfort from the availability of significant business and management expertise to SNPL from its strong holding Company- ITC Limited (ITC) across all businesses. These strengths are partially offset by exposure of the cigarette business, which is the main profit earning business segment of SNPL to high taxation regime and stringent regulatory framework in Nepal on cigarettes making the business susceptible to regulatory changes. Ability of the company to actualize full revenue potential of cigarettes in midst of high taxation regime, difficult regulatory framework and the impact of future capital expenditure plans on the capital structure of the company remain the key rating sensitivities.

Impact of Covid-19 on the operations of the company

With the outbreak of Coronavirus disease 2019 (COVID-19) recognized as Pandemic by World Health Organization on March 11, 2020 which has affected Nepal as well, the Government of Nepal (GoN) had imposed travel restrictions and countrywide lockdown from March 24, 2020 till June 14, 2020. SNPL had suspended all its manufacturing activities from March 24, 2020 which however, resumed operations after the relaxation was provided by the Government of Nepal to the industries. As the COVID-19 continues to disrupt overall economic activities in the country, the company may face decline in sales due to subdued demand from the cigarette segment which is major contributor to the total revenue of the company. However, with presence of only short term loans in the books coupled with low level of utilization, the cash flows of the company are expected to be in a comfortable position to bear any negative impact on the financials of the company.

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

Detailed Description of the Key Rating Drivers

Key Rating Strengths

Strength and expertise derived from strong holding company- ITC Limited

ITC Limited, India holds 59% shares in SNPL. ITC is one of India's foremost private sector companies with a market capitalization of around 32 billion USD and Gross Sales Value of over 10 billion USD. Established in 1910, ITC operates in various business segments viz. FMCG (Cigarettes, Branded Packaged Foods, Education & Stationery Products, Personal Care Products, Safety Matches, Agarbattis), Hotels, Paperboards, Paper & Packaging and Agri Business. ITC is the largest cigarette manufacturer and seller in India. ITC's capability in terms of extensive research and development to create product and packaging solutions and its expertise and experience in cigarette business provides significant competitive advantage to SNPL. Further, ITC's Agri Business Division (ITC-ABD) procures tobacco leaf requirement of SNPL over and above the quantity procured by the Company from domestic sources.

Strong brand equity and leadership position in market

SNPL has been in the business of cigarette manufacturing for more than 30 years and has built successful brands like Surya Legend, Surya 24 Carat, Surya Luxury Kings, Shikhar Filter Kings, Khukuri Filter, Pilot Filter, Bijuli and Chautari to cater wide spectrum of consumer taste and preference. During FY19, the company enhanced its product portfolio with the launch of two more products Surya 24 Carat Arctic Burst and Shikhar Ice Rush. SNPL has significant market share and a strong presence across segments. As one of the leading FMCG Companies in Nepal, SNPL has a large distribution network in the country with warehouses spread across Nepal for its products which reach over more than 100 wholesale dealers directly dealing with the Company. Further, strong brand equity, state of the art manufacturing facilities, deep and wide distribution network and economies of scale provides a distinct source of competitive advantage making it very difficult for competitors to enter the national market and impact the leadership position of the company. Advertising restrictions imposed on electronic and print media makes it hard for any new entrant to gain brand awareness. Further, established brands which have generated a lot of brand loyalty and awareness would make it difficult for a new company to generate enough brand awareness to enter the market and acts as a barrier for new entrants in the market.

Experienced Management in the Related Field

SNPL is a professionally managed company under the overall guidance of its Board of Directors. Mr. Sanjiv Puri, the Chairman of SNPL, is also the Chairman & Managing Director of ITC. Mr. Puri, an alumnus of Indian Institute of Technology, Kanpur and Wharton School of Business, has held business leadership positions and also handled a wide range of responsibilities in manufacturing, operations and information & digital technology. Mr. Puri has also led SNPL as its Managing Director in the past. The top and senior management team is highly experienced in their respective field of operations. Mr. Abhimanyu Poddar, Managing director of SNPL, joined ITC in 1982 and has a total experience of 40 years. He is assisted by an experienced team across various functions.

Strong financial profile characterized by high profitability, minimal debt and strong liquidity backed by large liquid investments.

The company posted gross revenue from sale of products of Rs. 37,470 Million for the year ended FY19 as compared to Rs. 33,370 Million during the previous year, reporting a growth of 12.3%. Further, Net Sales (net of taxes) also grew by 4% in FY19 from Rs. 24,202 Mn in FY18 to Rs. 25,123 Mn in FY19. SNPL has demonstrated its ability to maintain healthy PBILDT margin in the business. Increase in the PBILDT and decline in deprecation charge lead to increase in net profit to Rs. 9,885 Million in FY19 as against Rs 9,177 Million in the previous year.

The company has not availed any long term debt from any Bank/Financial Institutions and total debt/ Equity ratio of the company improved to 0.04 times at the end of FY19 as compared to 0.10 times at the end of FY18 with sizeable unutilized working capital limits. As on July 16, 2019, SNPL had liquid investments of Rs. 7,816 Mn in addition to a cash balance of around Rs. 27 Mn. The RoCE of the company continues to be healthy. For the year ended July 16, 2019, the company declared dividend aggregating to Rs. 9,858 Mn.

Key Rating Weaknesses

High concentration of business on cigarette segment

Business of SNPL is highly concentrated on cigarette business. Although the company is also in other FMCG products like agarbatti, safety matches and branded packaged food products, the contribution is low in the total revenue of the company. In a scenario which adversely impacts the cigarette business of the company or successful entry of an established player in the market, the scope of SNPL to take recourse to other business segment is negligible.

Exposure of the cigarette business which is the main profit earning division to high taxation regime

The increase in excise duty announced in the budget for FY19-20, has resulted in an unprecedented increase in tax incidence on cigarettes. Further, in the budget announced for FY20-21, Health Risk Tax (HRT) has been doubled to Rs. 50 paise per cigarette from Rs. 25 paise per cigarette. The tax burden on cigarettes has further multiplied on account of increase in customs duty on import of certain raw materials for the tobacco industry. This has further increased the operating pressure on the legal cigarette industry. The cigarette industry is highly price elastic in nature and with a large number of cigarette consumers also consuming relatively low priced Smokeless Tobacco Products like Khaini, Gutkha etc., the steep increase in tax incidence on cigarettes as aforementioned will encourage the shift to cheaper and largely tax evaded tobacco products which can impact the revenue and profitability of the company.

Stringent regulatory framework in Nepal on cigarettes making the business susceptible to regulatory changes

The provisions of the Tobacco Products Control and Regulation Act (TOPCA) require cigarette packages to carry Graphic Health Warnings (GHW) covering at least 75% of the total surface area of the packet. In addition to this the Ministry of Health, Nepal has issued a new Directive which require manufacturers to print multiple pictorial warnings on at least 90% of the total surface area of the cigarette packet- largest in the world. Though the said directive has been challenged by the Company in the Supreme Court, this increased GHW which practically provides no space for use of trademark, has potential to provide a fillip to growth of smuggled international brands that do not carry statutory GHW as well as manufacturing of counterfeit look alike products of dubious quality which will depress the demand for domestic legal cigarettes.

Future capital expenditure plans; however proposed to be met through strong cash flows from the business

In order to diversify the business of the company, the management is planning to enter into the hotel business. While the company has capital expenditure plans, the effect of the same on the capital structure of the company is likely to be low, given the strong cash accruals from its current businesses, which is likely to fund most of the outgo. SNPL’s internal accruals are expected to remain sufficient to fund its capital expenditure requirements. Any large debt funded capital expenditure in future would impact the financial profile of the company.

About the Company

SNPL started operations in 1986. ITC Limited, India holds 59% shares in SNPL and is its holding company. Further, 39% shares are held by a group of Nepali individual and institutional shareholders and remaining 2% shares is held by British American Tobacco (Investments) Limited, UK. SNPL is the largest private sector manufacturing enterprise in Nepal and is currently engaged in the business of Cigarettes, Safety Matches, Agarbatti and Confectionery in Nepal.

Brief Financial Performance during the last 2 years is as follows:

(Rs. In Million)

For the year ended Mid July,	FY18 (A)	FY19 (A)
Income from Operations	24,228	25,137
PBILDT	15,415	16,189
PAT	9,177	9,885
Overall Gearing (times)	0.10	0.04
Interest coverage (times)	671.98	273.61

**Audited*

Analyst Contact	**Relationship Contact**
Ms. Shalini Sanghai shalini.sanghai@careratingsnepal.com Tel No.: +977-01-4445473	Mr. Sajan Goyal sajan.goyal@careratingsnepal.com Tel No.: 9818832909/+977-01-4445472/3/4

Annexure 1: Details of the Facilities rated

Nature of the Facility	Type of the Facility	Amount (Rs. Million)	Rating
Short Term Bank Facilities	Working Capital Loan	5,750.00	CARE-NP A1+
Total		**5,750.00**	