## Rating Rationale

## Baba Vegetable Oil Industries Private Limited

**Rating**

| Facility | Amount (Rs. In Million) | Rating[1] | Rating Action |
|---|---|---|---|
| Short Term Bank Facilities | 760.00 | CARE-NP A4+ [A Four Plus] | Assigned |
| **Total Facilities** | **760.00** | | |

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

**Detailed Rationale & Key Rating Drivers**

The ratings assigned to the bank facilities of BVOPL are constrained by leveraged capital structure at the end of FY20 (Provisional, refers to 12 months period ended mid-July 2020), working capital intensive nature of business leading to dependency on ad-hoc working capital limits from banks, raw material price volatility risk and foreign exchange fluctuation risk. The ratings also factor in susceptibility to price fluctuation of seasonal agro products, fragmented and competitive nature of industry, exposure to volatile interest rates and regulatory risk. The ratings however, derives strength from established and long track record of operations along with experienced management team, comfortable financial profile characterized by healthy growth in sales and profitability during FY20 (Prov.) and comfortable debt coverage indicators at the end of FY20. The ratings also factor in established distribution network, essential part of cooking leading to stable demand and steady growth in the revenues, locational advantage for both import & export and sizeable exports to India during last 2 years; albeit it is now restricted to a great extent. Ability of BVOPL to manage growth in operations & maintaining the profit margins and rationalization of its debt through efficient working capital management would be the key rating sensitivities. 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 the key rating sensitivities.

***Impact of COVID-19 on the business of the company***

With the outbreak of Coronavirus disease 2019 (COVID-19) recognised 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 since March 24, 2020 till June 14, 2020. However, GoN had provided relaxation in operation of companies dealing in essential items during the lockdown period. Considering the same, BVOPL had uninterruptedly continued its normal operations and revenue of the company was not impacted due to effects of lockdown.

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

**Detailed Description of the Key Rating Drivers**

**Key Rating Weaknesses**

***Leveraged capital structure at the end of FY20 (Prov.)***

The capital structure of the company was leveraged as reflected by overall gearing ratio of 3.05x at the end of FY20 which improved from 3.27x at the end of FY19 due to accretion of profit to net-worth. This was however, partially offset by high dividend despite increase in working capital loans in FY20.

***Working capital intensive nature of business leading to dependency on-adhoc working capital limits from banks***

The operations of BVOPL are working capital intensive as company imports its raw materials from various countries through Letter of Credit. BVOPL has to keep the inventory for smooth operations and extend credit to their customers, which lead to reliance on working capital limits. Company generally allows 1.5 to 2 months credit period to its customers and keeps inventory for around 1-1.5 months. Total average operating cycle of the company was 60 days in FY20 which improved from 71 days in FY19 as a result of lower collection period. The working capital intensity of the business had led to high reliance of the company on the bank finance for working capital requirements. The company has also been availing ad-hoc limits as and when required to fund its working capital requirement. The average utilization of working capital limits against DP remains high at above 85% in most instances.

***Raw material price volatility risk and foreign exchange fluctuation risk***

Crude soyabean, palmolein, sunflower oil and crude palm oil are the major raw materials for BVOPL 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 74% of the total operating income of the company during FY20 (Prov.). 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. BVOPL incurred foreign exchange loss of Rs. 51 Mn during FY20 as compared to loss of Rs. 12 Mn during FY19. 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 the key rating sensitivity.

***Susceptibility to price fluctuation of seasonal agro products***

Prices of crude oils are highly volatile in nature and being agro products are also 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. Further, the supply is dependent upon monsoon and climatic condition, exposing the fate of the company's operation to vagaries of nature.

***Fragmented and 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 fragmented and competitive nature of industry, the millers have low pricing power**.**

***Exposure to regulatory risk***

The operations of the AVPL are partially constrained by regulatory risk arising from various laws and policies of both Nepal and India. Earlier, before F/Y 2018-19, mustard oil, vanaspati ghee or other processed oil producing industries used to get 40 percent VAT refund at the end of the fiscal year. But the budget announcement for 2018-19 scrapped the provision. Further, ~71% of total revenue of the company during FY20, was from export of palmolien oil and soyabean oil to India. With this the company is further exposed to import regulations of India. Recently, India had cancelled permission to import over three lakh tonnes of refined palm oil from Nepal and Bangladesh.

**Key Rating Strengths**

***Established and long track record of operations along with experienced management team***

The company has been into processing of edible oil for more than 25 years 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 an experience of over two decades in trading of imported and processed edible oils. The company is managed under the overall guidance of its two member Board of Directors (BoD) which includes experienced businessmen/industrialist with wide experience in the food processing and trading sector. Mr. Prakash Kumar Mundara, Chairman & Director of the company, has an experience of more than 15 years in Jute, Chemicals, Agriculture and Edible Oil Industry.

***Comfortable financial profile characterized by healthy growth in sales and profitability during FY20 (Prov.)***

The company had moderate capacity utilization of ~57% in FY20 which improved from ~41% in FY19. Total revenue of the company increased by ~42% during FY20 to Rs. 3,092 Mn which also had seen substantial jump by 156% during FY19. Revenue during FY19 was boosted majorly due to company commencing export of palmolein oil and soyabean oil to India. Export of palmolein oil and soyabean oil together accounted for 71% of total sales during FY20. BVOPL earned PAT of Rs. 133 Mn in FY19 with margin of 6.13% which grew to Rs. 210 Mn in FY20 with PAT margin of 6.79%. The ability of BVOPL to manage growth in the operations & maintaining the profit margins and rationalization of its debt through efficient working capital management would be the key rating sensitivities.

***Comfortable debt coverage indicators***

Interest coverage ratio of the company was comfortable at 14.65x in FY20 which increased from 6.56x in FY19. This improvement in interest coverage ratio was due to growth in PBILDT of the company coupled with decline in interest cost due to company using more of low interest bearing dollar working loans to finance its working capital requirements. Also, as a result of increased GCA of Rs. 280 Mn during FY20, total debt/GCA improved to 3.06x during FY20 from 4.31x in FY19.

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

The demand prospect of oil industry is growing as oil is one of essential commodity for cooking. The company has been able to achieve CAGR growth of around 81% in quantity sold in the last three years ending FY20. 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 favourable business environment. Nepal has seen a steady growth in import of crude and refined edible oil over the years.

***Locational advantage for both imports and exports***

The plant site is located in Biratnagar around 15 kms from Indo-Nepal borders. Since all of the raw materials requirements of BVOPL are imported from various countries are unloaded on Indian ports, the factory's proximity to the border remains a positive point leading to savings in freight cost. Further, BVOPL also exports its products to India which accounted for 71% of total revenue in FY20. The factory's proximity to Indian border remains a positive point with regards to freight cost saving in export of goods.

***Sizeable exports to India during last 2 years; albeit it is now curbed to a great extent***

With an objective to curb imports and boost local refining, Department of Revenue, India had hiked the import duty on Crude Palm Oil to 44 per cent from 30 per cent and on Refined Bleached Deodorized palmolein to 54 per cent from 40 per cent with effect from March 1, 2018. However, as per agreement on SAFTA (South Asian Free Trade Area), lower tariff of 6% is imposed on import of refined palm oil from Nepal. With this companies in Nepal had been exporting palm oil to India taking advantage from duty arbitrage. In the same line, exports by BVOPL accounted for ~12% of the total value of export sales of palm oil and soyabean oil from Nepal.

**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, sunflower oil and palm 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.

**Brief Financial Performance during last 3 years is given below:**

*(Rs. In Million)*

| For the year ended Mid July, | FY18 | FY19 | FY20 |
|---|---|---|---|
| | Audited | Audited | Provisional |
| Income from Operations | 850 | 2,171 | 3,092 |
| PBILDT | 36 | 238 | 365 |
| PAT | 1 | 161 | 250 |
| Overall Gearing (times) | 5.85 | 3.27 | 3.05 |
| Interest coverage (times) | 1.20 | 6.56 | 14.65 |


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## 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 Loans | 20.00 | CARE-NP A4+ |
| Short Term Bank Facilities | Letter of Credit | 740.00 | CARE-NP A4+ |
| **Total** | | **760.00** | |