Rating Rationale

Narayani Oil Refinery Udhyog Private Limited

Rating

Facilities	Amount (Rs. In Million)	Rating[1]	Rating Action
Short Term Bank Facilities	4,650.00	**CARE-NP A3 [A Three]**	Assigned
Total Facilities	**4,650.00**		

Details of Facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has assigned rating of 'CARE-NP A3' to the short-term bank facilities of Narayani Oil Refinery Udhyog Private Limited (NOPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to bank facilities of NOPL derives strength from established track record of operation, experienced management team, comfortable financial performance with healthy growth in sales and profitability during FY20 (Provisional, refers to 12 months period ended mid-July 2020), moderate capital structure and comfortable debt service coverage indicators at the end of FY20. The rating also factors in established distribution network, stable demand of edible oil, sizeable exports of palmolein oil to India during last 2 years; albeit it is now curbed to a great extent and locational advantage being located near to the border. The ratings, however, are constrained by working capital intensive nature of business, susceptibility to price fluctuation of seasonal agro products, fragmented and competitive nature of industry. The rating is also constrained by raw material price volatility risk, foreign exchange fluctuation risk, exposure to regulatory risk and exposure to volatile interest rates. Ability of NOPL 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 also 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, NOPL had uninterruptedly continued its normal operations and revenue of the company was not impacted due to lockdown.

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

Detailed Description of the Key Rating Drivers

Key Rating Strength

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

The company has been into processing and marketing of edible oil for more than 30 years and has developed a 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 like cement manufacturing, edible oil refinery and import and trading of fertilizers. The company is managed under the overall guidance of its six members Board of Directors (BoD) which includes experienced businessmen/industrialist with wide experience in the food processing and trading sector. Day to day operations of the company is handled by Mr. Nikhil Chachan, who have been director of this company since last six years. The Directors of the company are supported by a team of experience professionals in running the day to day operations.

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

The company had moderate production capacity utilization of ~52% in FY20 which improved from ~34% in FY19. The company seen high increase in total revenue during FY19 and FY20 majorly due to commencement of export in substantial quantity of palmolein oil and soyabean oil to India. Palmolein oil and soyabean oil together accounted for 61% of total sales during FY20, out of which export sales of Palmolein oil and soyabean oil comprised 33.5% of total sales. PBILDT margin of the company was 4.91% in FY18 which grew to 7.62% in FY19 and further improved to 13.39% in FY20 (Prov). NOPL achieved healthy PAT margin of 2.59% during FY19 which improved to 8.33% during FY20. The ability of NOPL to manage growth in the operations & maintaining the profitability margins and rationalization of its debt through efficient working capital management would be the key rating sensitivities.

Moderate capital structure, however comfortable debt coverage indicators

The capital structure of the company was moderate as reflected by Overall gearing ratio of 2.38x at the end of FY20 which improved from 7.54x at the end of FY19 due to infusion of additional capital and accretion of profit to net-worth despite increase in working capital loans. Any dividend pay-out from the reserves and surplus will negatively impact the capital structure of the company. Interest coverage ratio of the company was comfortable at 13.68x in FY20. Also, as a result of improved profitability during FY20, total debt/Gross Cash Accruals improved to 3.14x during FY20 from high of 11.14x in FY19.

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

The demand prospect of edible oil industry is growing as edible oil is one of essential commodity for cooking. The company has been able to achieve CAGR growth of around 40% 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 NOPL a favourable business environment.

Locational advantage for both imports and exports

The plant site is located in Bara District, Nepal around 4 kms from Birgunj dry port. Since all of the raw materials requirements of NOPL 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, NOPL also exports its products to India which accounted for 36% 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 and on Refined Bleached Deodorized palmolein to 54 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 NOPL accounted for ~9% of the total value of export sales of palm oil and soyabean oil from Nepal during FY20. However, total contribution of export sales of palmolein oil to total export sales was 71% in FY19 which reduced to 59% in FY20 following the restriction imposed effective from January 08, 2020.

Established distribution network

NOPL sells its products through whole sellers in bulk throughout Nepal. The company has sales depot in Itahari and Pokhara whereas main selling activities are done through the Birgunj office. Export to India is majorly in the north-Eastern part of the country in West Bengal, Bihar, Uttar Pradesh, Rajasthan and Delhi.

Key Rating Weakness

Working capital intensive nature of business

The operations of the company are working capital intensive in nature as company imports its raw material from various countries through Letter of Credit. NOPL 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, average debtors turnover days was 52 days during FY20. The company keeps inventory for around 1 month. Further, the average creditors period allowed to the company during FY20 was at 10 days. Total operating cycle of the company was 65 days in FY20 which improved from 88 days in FY19 as a result of lower collection and inventory holding 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 average utilization of working capital limits against sanctioned limit is around 71% for 12 months period ended mid-July, 2020.

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 NOPL which are imported from various countries. The prices of the NOPL'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 84% 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. NOPL incurred foreign exchange loss of Rs. 83 Mn during FY20 as compared to loss of Rs. 42 Mn during FY19. However, company enters into forward contracts to mitigate exchange fluctuation risk. 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 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 during the particular year as well as overall 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 NOPL'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

NOPL is partially constrained by regulatory risk arising from various laws and policies from both Nepal and India. Earlier, before FY19, 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, 33.5% of total revenue of the company during FY20, was from export of palmolein oil and soyabean oil to India. With this 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 under South Asian Free Trade Agreement (SAFTA). This has impacted exporter of palm oil in Nepal to India.

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 operation for more than 30 years. Currently, the total installed capacity for refined soyabean, palmolein, vegetable oil, mustard oil, sunflower oil and palm oil is 117,000 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 during last 3 years:

(Rs in Million)

Particulars	**FY18**	**FY19**	**FY20**
	Audited	**Audited**	**Provisional**
Income from operations	4,237	5,403	8,169
PBILDT	208	412	1,094
PAT	28	140	680
Interest Coverage ratio (times)	1.87	2.97	13.68
Overall gearing (times)	7.25	7.54	2.38

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Annexure 1: Details of the Facilities rated

Nature of Facility	Type of Facility	Amount (Rs. Million)	Rating
Short Term Bank Facilities	Fund Based Limit	2,927.98	**CARE-NP A3**
Short Term Bank Facilities (Proposed)	Fund Based Limit	605.00	**CARE-NP A3**
Short Term Bank Facilities	Non-Fund Based Limit	1,084.00	**CARE-NP A3**
Short Term Bank Facilities (Proposed)	Non-Fund Based Limit	33.02	**CARE-NP A3**
Total		**4,650.00**	