

## Rating Rationale

### Dugar Brothers & Sons Private Limited

#### Rating

Facility	Amount (Rs. In Million)	Rating <sup>1</sup>	Rating Action
Short Term Bank Facilities	4,150.00	CARE-NP A4+ [A Four Plus]	Assigned
<b>Total Facilities</b>	<b>4,150.00</b>		

CARE Ratings Nepal Limited (CRNL) has assigned rating of ‘CARE-NP A4+’ to the short term bank facilities of Dugar Brothers & Sons Private Limited (DBS).

#### Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of DBS are constrained by leveraged capital structure marked by weak debt service coverage indicators at the end of FY20 (Provisional, refers to 12 months period ended mid-July 2020), impact of Covid-19 on the operations of the company resulting into decline in revenue, however with improvement in the profitability and growth in sales in two wheeler segment. The ratings also factor in cyclical nature of the construction equipment and auto industry coupled with high competition from other players, working capital intensive nature of operations, exposure to regulatory risk related to construction equipment and automobile industry and exposure to volatile interest rates.

The rating however, derives strength from experienced and resourceful promoter group, long track record of operations with strong group presence in automobile dealership and growth in margins and profitability of the company in FY20. The rating also factor in established brand and sole authorized distributorship of Mahindra & Mahindra (M&M) construction equipment’s and commercial vehicles and Piaggio Two wheelers with significant market share in Nepalese market and established marketing and dealer network across the country. Ability of the company to profitably scale up its operations and effective management of working capital with improvement in debtor’s realisation and liquidity position of the company will remain 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. With lockdown imposed, the operations of the company were significantly impacted resulting into decline in revenue during FY20. Major impact in sales was on the construction equipment however, sales of two wheeler passenger vehicles witnessed growth in FY20. The expected economic slowdown due to the ongoing pandemic and the resulting impact on demand in automobile sector is likely to keep the near term revenue growth subdued in the construction and heavy equipment segment. However, demand in passenger two wheeler segment is expected to surge on account of people avoiding public vehicles for commute and

<sup>1</sup>Complete definitions of the ratings assigned are available at [www.careratingsnepal.com](http://www.careratingsnepal.com)

adherence to social distancing norms. With the opening up lockdown, the operations, revenue and profitability of the company is expected to be on the recovery path from the negative impact of Covid-19 in current financial year 2021.

### **Detailed Description of the Key Rating Drivers**

#### **Key Rating Weaknesses**

##### ***Leveraged capital structure marked by weak debt service coverage indicators***

The company has not availed any term loan from Banks/Financial Institutions, however it has availed loan from its promoter director to fund the operations of the company. Debt: Equity ratio of the company improved from 2.32x at the end of FY19 to 0.39x at the end of FY20 due to substantial payment of loan from director coupled with infusion of equity of Rs. 70 Mn in FY20. Overall gearing ratio of the company also stood high at 10.25x at the end of FY19 which improved to 5.83x at the end of FY20 majorly due to reduction in promoter loan and increase in net-worth due to accretion of profit coupled with equity infusion. This was partially offset by increase in working capital borrowing of the company. Interest coverage ratio of the company was moderate at 1.33x in FY20. Total debt to GCA of the company was high at 27.34x in FY20 which however improved from 55.73x at the end of FY19 due to increase in GCA generated by the company during the year.

##### ***Financial risk profile marked by decline in revenue, however with improved profitability in FY20***

Total revenue of DBS declined by ~24% during FY20 on account of negative impact of Covid-19 on the operations of the company which has directly impacted the sales of commercial vehicles and construction equipment due to low level of construction activities on account of economic slowdown. Despite decline in sales in FY20, PBIDLT and PBILDT margin of the company improved in FY20 over FY19 due to improvement in the price realisation of the vehicles which has directly added to the margins of the company. With improvement in PBILDT, PAT of the company improved in FY20 over FY19. During 4MFY20, the company has achieved total sales of Rs. 945 Mn.

##### ***Working capital intensive nature of operation***

Automobile dealership business has inherent high working capital intensity due to high inventory holding requirements and credit to the dealers of the company. The company has to maintain fixed level of inventory for display at its twenty two showrooms across Nepal coupled with high level of inventory to guard against supply shortages as the supply is totally dependent upon imports. Further, the vehicles dealt by the company are of high value which lead to high quantum of inventory built up. Apart from this, the vehicle manufacturers/ suppliers deliver vehicle only against the letter of credit. Thus, the business depends heavily on working capital borrowings and inventory funding channels. During FY20, average operating cycle of the company was high and deteriorated from 326 days in FY19 to 498 days in FY20 mainly on account of increase in inventory holding period coupled with increase in debtor collection period. Accordingly, the

average utilization of working capital limit was on the higher side at ~93% during the last 12 months ended on mid-August 2020.

***Cyclical nature of construction equipment & auto industry and high competition from other players***

The construction equipment industry is cyclical in nature and is dependent on factors like pace of construction activities in the country and government spending. With slowdown in government spending and construction activities due to Covid-19, the market for heavy equipment's has been impacted last year. Further, there is stiff competition from automobile dealerships in Nepal. Due to high competition dealers are forced to pass on discount and exchange scheme to attract customer as this is volume driven business. Further, the impact of COVID-19 is also expected to be seen in Nepalese economy with the slowdown of various industries including the automobiles sector in the current financial year. However, considering the social distancing norms and resistance to travel in public vehicles, the demand for two-wheeler vehicles is expected to increase in future.

***Exposure to regulatory risk related to construction equipment and automobile industry***

The automobile industry in Nepal belongs to the highly taxed industry. Construction equipment's are mostly bank financed and tight liquidity in banking sector could impact the sales of these equipment's. However, since there is no regulatory cap on financing of construction equipment it provides some comfort. Additionally, circular dated November 6, 2018 issued by Nepal Rastra Bank has decreased cap on bank financing to 50% of value of vehicle used for personal purpose from 65% which slow down the demand growth in the passenger vehicle segment.

**Key Rating Strengths**

***Experienced and resourceful promoter group***

DBS derives strength from its strong promoter group belonging to MV Dugar Group. MV Dugar Group is involved in diversified business like construction, automobiles trading, hydropower, insurance and banking. The group is one of the prominent business houses in Nepal in automobile sector and has its footprint across Nepal representing vast range of automobile companies in various segment which includes 2 wheeler vehicles, commercial vehicles, agri solution and construction equipment. DBS has only one promoter, Mr. Motilal Dugar, who is also the Chairman of the company as well as of MV Dugar Group. Mr. Motilal Dugar, who has an experience of over 55 years and is one of the prominent businessman of Nepal. He is also the Chairman of Sunrise Bank Limited and Vice President of Nepal-USA Chamber of Commerce & Industry Nepal. Mr. Dugar is supported by a team of experienced professional in handling day to day operations of the company.

***Long track record of operations with strong group presence and exposure in automobile dealership***

The group has been into dealership of various brand of vehicles through a partnership firm for more than two decades. DBS was incorporated in July 2015 and thereafter started its operations as a sole distributor in Nepal for various automobile brands. The company currently is the sole authorized distributor in Nepal

for Mahindra Earth Master & accessories, Mahindra & Mahindra (M&M) heavy vehicles as well as commercial vehicles and construction equipments & Piaggio two-wheelers: Vespa & Aprilia.

***Established brand and sole authorized distributor of Mahindra & Mahindra (M&M) construction equipment's and commercial vehicles and Piaggio Two wheelers with significant market share in the Nepalese market***

DBS is presently the sole authorized dealer in Nepal for M&M construction equipment's and commercial vehicles and Piaggio two wheelers – Aprilia & Vespa. M&M is an Indian multinational automobile manufacturing company and is one of the major tractor sellers in the world by volume and is also one of India's largest vehicle manufacturers. M&M is the leading company of the Mahindra Group. Piaggio Vehicles Private Limited (PVPL) is a 100% subsidiary of Piaggio & C S.P.A of Italy, one of the global leaders in manufacturing two-wheelers. The two wheeler vehicles are manufactured from its plant in India which is operated by PVPL. Dealership for Piaggio under DBS started in the year 2018 thus entering into 2 wheeler segment and diversifying the product profile of the company. Being an authorized dealer for various products from reputed companies gives DBS a high client base and also large demand catering opportunity. The brands dealt by the company are among top brands in the Nepalese automotive market and have country wide presence coupled with significant market share in each category of vehicles.

***Established marketing and dealer network across the country***

DBS has an established dealer network across Nepal with total of 21 dealers for two wheelers and 15 dealers for M&M vehicles. Additionally, the company also has 22 own operated showrooms located in different parts of Nepal. During FY20 contribution of dealer sales and showroom sales were 50:50 in terms of units of vehicle sold.

### **About the Company**

Dugar Brothers & Sons Private Limited (DBS) is a private limited company incorporated on July 08, 2015 and is part of the MV Dugar Group of Nepal promoted by Mr. Motilal Dugar.

**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	3,599	3,914	2,967
PBILDIT Margin (%)	8.29	7.30	11.26
Overall Gearing (times)	8.39	10.25	5.83
Interest coverage (times)	1.54	1.20	1.33
Current Ratio (times)	1.10	1.29	1.16
Total Debt/Gross Cash Accruals (times)	24.51	55.73	27.34

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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	Fund Based Limits	2,520.00	CARE-NP A4+
Short Term Bank Facilities	Non Fund Based Limits	1,630.00	CARE-NP A4+
<b>Total</b>		<b>4,150.00</b>	