June 2021

Rating Rationale

Khilung Kalika Agro Farm Private Limited

Rating

Facility	Amount (Rs. In Million)	Rating[1]	Rating Action
Long Term Bank Facilities	319.28	CARE-NP B+ [B Plus]	Assigned
Short Term Bank Facilities	200.72	CARE-NP A4 [A Four]	Assigned
Total Facilities	**520.00**		

Details of Facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has assigned rating of 'CARE-NP B+' to the long term bank facilities and 'CARE-NP A4' to the short term bank facilities of Khilung Kalika Agro Farm Private Limited (KKPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of KKPL are constrained by the relatively small scale of operations, weak financial risk profile marked by net losses, highly leveraged capital structure and stressed debt service indicators of the company and working capital intensive nature of operations. The ratings also factor in fragmented and competitive nature of industry, exposure to inherent risk in poultry in term of disease outbreaks.

The ratings, however, derive strength from experienced promoters, growing dealer network, positive industry outlook, and favourable government policies.

Going forward, the ability of the company to profitably scale up of its operations while efficiently managing the working capital requirements will be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Relatively small scale of operation with loss incurred in FY20

The sales of eggs and retired layers constitute major source of revenue for KKPL. The scale of operations of the entity remained small as marked by its total operating income (TOI) of Rs. 181 Mn in FY20. The small scale limits the company's financial flexibility in times of stress and deprives it from scale benefits.

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

FY20 was the exceptional year for the company and company had reported losses at net level. The same was mainly attributed to a disease outbreak in the poultry farm. Significant losses also led to stressed debt service coverage indicators. However, the promoters have supported the business with unsecured loans.

Highly Leveraged capital structure

During FY20, KKPL reported significant losses which eroded the net worth of the company. With the low base of own funds, its operations are highly susceptible to any business shock, thereby limiting its ability to absorb losses or financial exigencies. Furthermore, it also results into increased vulnerability of its financial risk profile to any incremental debt.

Working capital intensive nature of business

The Operating cycle of the company remained high during the review period. The company, due to its nature of business, requires to keep high inventory level of parent birds and raw materials stock to feed the birds in different growing stages, therefore has a high inventory period of 440 days as on July 15, 2020. The company has been allowing around 15-20 days' credit periods to its customers whereas the credit period allowed to is up to 90 days on bulk purchases from its suppliers. The high working capital requirements were met largely through bank borrowings which resulted in a high average utilization of around 95% of its sanctioned working capital limits for 12 months period ended mid-February, 2020.

Fragmented and competitive nature of industry

The poultry industry is highly competitive and fragmented with many regional unorganized players. Low capital intensity and low entry barrier facilitates easy entry of new players leading to increase in competition. Due to the stiff competitive, the pricing of poultry products remains volatile and also varies from place to place. Further, inherent risk such as perishable nature of product, constraints in transportation, cost of feeds, diseases affect poultry business. Besides this, ability to continuously maintain and improve product quality is key factor to sustain and capture market share in poultry sector.

Exposure to inherent risk in poultry in term of disease outbreaks

Intermittent outbreaks of bird flu have affected sales of eggs in the last few years. These avian flu outbreaks lead to a drastic fall in demand followed by crash in poultry prices. The news of bird flu outbreaks in India and Nepal during FY20 had led to slowdown in sales of poultry and related products in Nepal. Such a slowdown could lead to poultry products being piled up leading to an excess supply situation thereby causing a sharp fall in poultry prices. Most of the insurance policy provide indemnity against the death of poultry due to accident (including fire, lightening, flood, cyclone, storms, tempest, earthquakes, strike, riot, act of terrorism) or diseases etc., but do not provide indemnity against losses due to Bird flu as it is considered as inherent risk related to poultry business.

Key Rating Strengths

Experienced promoters in the related field

KKPL has five board of directors, chaired by Mr. Ganga Prasad Aryal. Before incorporating the company, he was engaged in similar business in individual capacity Mr. Shovakanta Dhakal, managing director, has a long standing experience in diversified sectors like banking, hotels, agricultures and poultry. He is also involved in Janakpur Agro Farm Private Limited as managing director and in Om Agro Private Limited as chief executive officer.

Growing dealer network

KKPL sells its products (eggs, retired layers and organic manures) in the market via whole-sellers and is mainly concentrated in Bagmati, Lumbini and Gandaki provinces out of seven provinces in Nepal. It has year on year growing customer network of 197 dealers in FY20 and the same increased from 165 customers in last 12 months. Growing and established network improves the bargaining capacity of the company and lends supports to market of its products.

Positive Industry outlook and favourable Government policies

The poultry industry has seen mounting effect due to increase in demand driven by the rapidly changing food habits of the average Nepalese consumer favouring for white meat, dictated by the lifestyle changes in the urban and semi-urban regions of the country. The demands for poultry products are sustainable and accordingly, the kind of industry is relatively insulated from the economic cycle.

The government has put restrictions on import of poultry items in Nepal from other countries as an initiative to protect domestic poultry sector and to attain self-sufficiency in the poultry sector.

About the Company

Khilung Kalika Agro Farm Private Limited (KKPL) is a private company and was established in 2014 having registered office in Syangja, Nepal. KKPL is engaged in layer poultry farming and wholesale trading of eggs. The company has four breeding sheds, each with 50,000 layers' capacity as on mid-April 2021. It sells its products like eggs, cull birds and manure to the customers located in Bagmati, Lumbini and Gandaki.

Brief Financial Performance of KKPL during last 3 years ending FY20 is given below:

(Rs. In Million)

For the year ended Mid July	FY18	FY19	FY20
	(Audited)		
Period of operation	**12 months**	**12 months**	**12 months**
Income from Operations	350	303	181
PBILDT Margin (%)	22.59	27.99	4.54
Overall Gearing (times)	7.18	5.80	-13.63

Interest coverage (times)	2.04	2.41	0.17
Current Ratio (times)	0.68	1.29	0.99
Total Debt/ Gross Cash Accruals (times)	10.74	11.22	-5.26

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Annexure 1: Details of the Facilities rated

Nature of the Facility	Type of the Facility	Amount (Rs. Million)	Rating
Long Term Bank Facilities	Term loan	319.28	CARE-NP B+
Short Term Bank Facilities	Working Capital loans	164.40	CARE-NP A4
Short Term Bank Facilities	Letter of Credit	36.32	CARE-NP A4
Total		**520.00**	