Surya Nepal Private Limited

Ratings

Facilities	Amount (Rs. in Million)	Rating[1]	Rating Action
Short Term Bank Facilities	5,750.00	**CARE-NP A1+ [A One Plus]**	**Reaffirmed**
Total Bank Facilities	**5,750.00 (Five Billion Seven Hundred and Fifty Million)**		

Details of instruments/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) continues to derive 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 along with strong financial profile of the company. 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.

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 Gross Sales Value of INR 74,979 Crores. 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.

[1]*Complete definitions of the ratings assigned are available at www.careratingsnepal.com and in other CRNL publications*

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 various successful brands to cater wide spectrum of consumer taste and preference. 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 and processes, deep and wide distribution network and economies of scale provides a distinct source of competitive advantage over its competitors.

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 Kumar 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 net revenue of Rs. 24,442 Mn for the year ended FY20 as compared to Rs 25,123 Mn during the previous year, reporting a marginal decline of 2.71% in FY20.
The decline is majorly on account of disruptions in business operations due to Covid-19 and subsequent containment measures including a nationwide lockdown for around 3 months which impacted revenue and profitability of the company in FY20. Profitability margin of the company remained steady.
The company has comfortable profitability margins which led to generate sufficient cash flows to manage the working capital requirements and any capex programmes. Hence, reliance on external bank borrowings is negligible and total debt is mainly in the form of working capital borrowings (having very low average utilization); as a result of which, the company has comfortable capital structure. The capital structure stood comfortable marked by overall gearing ratio of 0.13x, as on July 15, 2020.
Furthermore, as on July 15, 2020, SNPL had liquid investments of Rs. 7,823 Mn in addition to a cash balance of around Rs. 63 Mn. For the financial year ended mid- July 2020, 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 and Health Risk Tax (HRT) has resulted in an unprecedented increase in tax incidence on cigarettes. Over the past few years, the tax burden on cigarettes has doubled in all segments and trebled in the plains segment. This has significantly increased the operating pressure on the legal cigarette industry. Considering that the affordability of cigarettes in Nepal is less and cigarette industry as a product is highly price elastic in nature with a large number of smokers (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 cash 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.

Financial Performance

(Rs. Million)

For the year ended Mid July	2018 (12m, A)	2019 (12m, A)	2020 (12m, A)
Income from Operations	24,228	25,137	24,471
Overall Gearing (times)	0.08	0.03	0.13
Interest Coverage (times)	671.98	273.61	632.39
Current Ratio (times)	2.59	2.71	2.14
Total Debt/ Gross Cash Accruals (times)	0.11	0.04	0.19

A: Audited

Annexure 1: Details of the Facilities Rated

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

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About CARE Ratings Nepal Limited:
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Our parent company, CARE Ratings Limited commenced operations in April 1993 and over two decades, it has established itself as one of the leading credit rating agencies in India. CARE is registered with the Securities and Exchange Board of India (SEBI) and also recognized as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI).