

## Dugar Brothers & Sons Private Limited

### Ratings

Facilities	Amount (Rs. in Million)	Rating <sup>1</sup>	Rating Action
Short-Term Bank Facilities	4,150	CARE-NP A4+ [A Four plus] (Credit watch with developing implications)	Rating reaffirmed and placed on credit watch with developing implications

Details of instruments/facilities in Annexure-1

CARE Ratings Nepal Limited (CRNL) has placed the rating of 'CARE-NP A4+' for the short-term bank facilities of Dugar Brothers & Sons Private Limited (DBS) on credit watch with developing implications.

### Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of DBS have been placed on credit watch with developing implications factoring in an uncertain operating environment for automobile traders in Nepal, over the near-term, following the various steps taken by the Government of Nepal (GoN) to restrict imports, particularly of high-ticket non-essential items. The woes of the automobile trading industry are exacerbated further by the challenges currently faced by the country's banking system amid declining liquidity. Buildup of liquidity stress leading to increased upward pressure on interest rates, limited credit appetite of banks and financial institutions (BFIs) after a disproportionately high credit expansion over the last couple of years and increase in risk weights for personal hire-purchase loans to 150% from 100% have cumulatively led to increased reluctance of BFIs for financing of new automobile purchase and opening of new letter of credit for import of automobiles. CRNL will resolve the rating watch once clarity emerges on the extent and scope of impact on DBS's business of the above measures.

The rating continues to be constrained by DBS's working capital intensive nature of operations, cyclical nature of the construction equipment and auto industry, exposure to volatile interest rate and foreign exchange rate fluctuation risk, and increasing competition from other automobile players, and exposure to regulatory risk related to the automobile industry. The rating factors in DBS's moderate capital structure and improved debt service coverage indicators at the end of FY21 (Audited, refers to the twelve-month period ended mid-July 2021). However, amid the current business environment, the sustainability of the improvement in DBS' financial risk profile going forward could seem challenging. The rating continues to derive strength from DBS's experienced and resourceful promoter group, long track record of operation, association with established brand as sole distributor in Nepal, and presence of an established dealer network across the country. The rating also factors in improving financial risk profile of the company marked by improving profitability in FY21.

*Going forward, the ability of the company to continue to profitably scale up its operations and effective management of working capital will be the key rating sensitivities. Furthermore, any new policies by the Government of Nepal regarding further tightening the imports, which could impact the business profile of the company will also be a key rating sensitivity.*

### Detailed Description of the Key Rating Drivers

#### Key Rating Weaknesses

#### Working capital intensive nature of operations

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 is required to maintain minimum level of inventory for display and high level of inventory to guard against supply shortages as the supply is totally dependent upon imports. 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 FY21, the operating cycle of the company improved to 208 days in FY21

<sup>1</sup>Complete definition of the ratings assigned are available at [www.careratingsnepal.com](http://www.careratingsnepal.com) and other CARE publications

from 391 days in FY20 mainly on account of low inventory at the end of FY21. However, overall working capital cycle remains elongated given the working capital-intensive nature of operations, leading to dependence on borrowings.

### **Leveraged capital structure and debt service coverage indicators, albeit improving trend in FY21**

The capital structure of the company is leveraged with gearing ratio of 2.37x at the end of FY21, which had improved from 6.13x at the end of FY20 backed by lower working capital borrowings boosted by shortened operating cycle during FY21 coupled with increased profit accretion to the reserve amid improved operational performance during FY21. Similarly, interest coverage ratio of the company also improved to 3.22x in FY21 (FY20: 1.20x) due to higher PBILDT generation as well as reduction in interest expense. Total Debt/GCA was maintained at 5.47x in FY21 which was reduced from 35.24x in FY20 on account of decline in total loans at the end of FY21 coupled with higher gross cash accruals.

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

The demand for 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 the market for heavy equipment's had been impacted in FY20, however in FY21, construction activities increased its pace. Also, the demand for two-wheelers is inherently vulnerable to the economic cycles and is highly sensitive to interest rates. Demand for two wheelers increases during period of high economy growth rate period and low interest rate regime and vice-versa. Also there is stiff competition from other automobile dealerships in Nepal. There are large numbers of players operating in market for two wheelers like Bajaj, Hero, Honda, TVS, Yamaha etc. Due to high competition dealers are forced to pass on discount and exchange scheme to attract customer as this is volume driven business, which will to put pressure on its profitability.

### **Exposure to volatile interest rates**

Nepalese banking sector has a floating interest rate regime, where a certain premium is added to the quarterly base rate and interest rate is changed accordingly on quarterly basis. The base rates of the banks and financial institutions (BFIs) in Nepal remain quite volatile as they are impacted by available liquidity in the system which leads to change in interest rates. The volatility in interest rate is more evident currently on account of the ongoing liquidity stress in the economy, with substantial upward pressure on interest rates in the last 2-3 quarters. Any further significant rate hikes could put increased interest burden on the company, squeezing its profitability and impacting its liquidity position. Therefore, funding taken by the company from BFIs is subject to volatile interest rate.

### **Exposure to regulatory risk related to automobile industry**

The demand in automobile sector is impacted by heavy import duty (which includes custom duty, excise duty and value added tax) imposed on the import of automobiles, which are still considered as luxury items in Nepal. Amid declining foreign reserve, the GoN has been discouraging imports, particularly of high value non-essential items such as automobiles. In April 2022, the GoN announced import restriction of imports of automobiles under various categories. Furthermore, Nepal Rastra Bank has also introduced several counter measures such as decreasing cap on bank financing to 50% of value of vehicle used for personal purpose from 65%, imposing 50% margin for opening letter of credit for import of automobiles and 100% for spare parts, and increasing risk weights on personal hire purchase loans to 150% from 100% to discourage import of automobiles. Hence, dealership business of the company remains exposed to risk related to similar policies of the GoN/Central Bank. This will remain a key monitorable aspect.

## Key Rating Strengths

### Experienced and resourceful promoter group

DBS derives strength from its strong promoter group belonging to MV Dugar Group of companies which has strong presence in diversified business like construction, automobiles trading, hydropower, insurance and banking. Along with DBS, the group has presence in vast range of automobile companies in various segments including two-wheeler vehicles, commercial vehicles, agri solution and construction equipment. The day to day operation of the company is managed by Mr. Motilal Dugar, Chairman, who has experience of over 55 years in various industries including automobile trading.

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

The group has been into dealership of various brands 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 equipment & 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 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. Furthermore, 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 one of India's largest vehicle manufacturers. 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.

### Financial profile marked by improvement in profitability in FY21

The company's revenue grew 56.94% year on year (yoy) to Rs. 4,655 Mn backed by a surge in demand following the pandemic hit FY20. Earlier in FY20, the company's revenue declined by 24.22% yoy mainly due to the impact of lockdown imposed by the GoN amid the Covid-19 pandemic. As overall economy started to normalize, despite the lingering impact of the pandemic, demand for vehicles picked-up in the country in FY21. DBS sold 10,058 units in FY21 compared to 5,688 in FY20. Boosted by higher revenues, PBILDT of the company also improved in FY21 to Rs.464 Mn (Rs. 298 Mn in FY20). PBILDT margin remained almost stable at around 10% in last 2 financial years (FY20 & FY21). PAT of the company increased to Rs.263 Mn in FY21 with PAT margin of 5.65% compared to Rs.48 Mn in FY20 with PAT margin of 1.63%. The demand trend had continued into FY22 with DBS reporting revenues of Rs. 2,508 Mn during H1FY22 (Unaudited, refers to the six-month period ended mid-Jan 2022) with sales of 6,107 units. However, the current supply constraint and decreased financing from BFIs is likely to impact the near-term prospects of the company leading to some moderation in the financial performance of the company in FY22 on a yoy basis. Favorable resolution of the aforementioned supply constraint coupled with improved liquidity in the banking system leading to increased financing by BFIs for new automobile purchase in a timely manner will remain critical monitorable aspect for the automobile trading industry.

## 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. 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 equipment's, HAMM compactor & accessories & Piaggio two-wheelers: Vespa & Aprilia.

Brief Financial Performance during last 3 years is given below:

For the Year ended Mid- July,	FY19 (A)	FY20 (A)	FY21 (A)
Income from Operations	3,914	2,966	4,655
PBILDT Margin (%)	7.30	10.06	9.98
Overall Gearing (times)	10.25	6.13	2.37
Interest Coverage (times)	1.20	1.20	3.22
Current Ratio (times)	1.29	1.13	1.21
Total Debt/ Gross Cash Accruals (times)	66.38	35.24	5.47

A: Audited

#### Annexure-1: Details of Instruments/Facilities

Name of the Instrument	Type of the Facility	Amount (Rs. Million)	Rating
Short Term Bank Facilities	Fund Based Limit	2,520.00	CARE-NP A4+ [A Four plus] (Credit watch with developing implications)
Short Term Bank Facilities	Non-Fund Based Limit	1,630.00	CARE-NP A4+ [A Four plus] (Credit watch with developing implications)
<b>Total Facilities</b>		<b>4,150.00</b>	

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##### About CARE Ratings Nepal Limited:

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