

Vivek Automobiles Private Limited

Ratings

Facilities	Amount (Rs. in Million)	Rating ¹	Rating Action
Short-Term Bank Facilities	3,180.00	CARE-NP A3 [A Three] (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 A3' for the short-term bank facilities of Vivek Automobiles Private Limited (VAPL) on credit watch with developing implications.

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of VAPL 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 VAPL's business of the above measures.

The rating continues to derive strength from above average financial profile of the company coupled with moderate level of capital structure and debt service coverage indicators during FY21 (audited, refers to 12 months period ended mid-July 2021). The rating also factors in established track record of operations along with experienced and resourceful promoter group, association with strong brand as sole distributor in Nepal, and presence of an established dealer network across the country. The rating, however, continues to remain constrained by working capital intensive nature of operations, exposure to volatile interest rate, foreign exchange rate fluctuation risk, cyclical nature of auto industry and high competition from other automobile players. The rating also factors in exposure to regulatory risk related to the automobile industry.

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 Strengths

Experienced and resourceful promoter group

VAPL 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 VAPL, 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 operations of the company is managed by Mr. Motital Dugar, Chairman, who has experience of over 5 decades in various industries including automobile trading.

¹Complete definition of the ratings assigned are available at www.careratingsnepal.com and other CARE publications

Established 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. VAPL was incorporated in December 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 Royal Enfield Motorcycle, John Deere tractors and Piaggio three wheelers. The company is diversified in two wheeler, three wheeler and tractors segment.

Strong brand value of Royal Enfield Motorcycle, John Deere tractors and Piaggio Three wheelers and sole authorized distributor in Nepal with significant market share in the Nepalese market

VAPL is presently the sole authorized dealer in Nepal for Royal Enfield Motorcycle, John Deere tractors and Piaggio three wheelers. Being an authorized dealer for various products from reputed companies gives VAPL 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

VAPL has an established dealer network across Nepal with total of 18 dealers for three wheelers and 7 dealers for Royal Enfield two-wheelers. Additionally, the company also owns 32 operated showrooms located in different parts of Nepal. VAPL also has six sales and service center across Nepal. Contract with dealer is on year-to-year basis and dealers are provided with dealer's price to sell the vehicle.

Improved capital structure with comfortable debt service coverage indicators at the end of FY21

As on July 15, 2021, Debt-to-Equity ratio of the company improved to 0.16x from 0.46x as on July 15, 2020. Furthermore, the overall gearing ratio of the company remained comfortable at 1.55x at the end of FY21, which had improved from 3.26x 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 and partial repayment of term loans. Similarly, interest coverage ratio of the company improved to 6.47x in FY21 (FY20: 1.91x) due to higher PBILDT generation as well as reduction in interest expense. Total debt to GCA of the company has improved to 2.04x in FY21 (FY20:8.90x) on account of decline in total loans at the end of FY21 coupled with higher gross cash accruals.

Financial profile marked by sustained revenue growth and profit accretion

Financial risk profile of the company in FY21 is characterized by significant increase in revenue during FY21 by ~56.87% year on year to Rs. 6,571 Mn (vis-à-vis Rs. 4,189 Mn in FY20). Earlier in FY20, the company's revenue declined by 0.17% year on year (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. VAPL sold 8,763 units in FY21 compared to 6,133 in FY20. Boosted by higher revenues, PBILDT of the company also improved in FY21 to Rs.574 Mn (Rs. 399 Mn in FY20). However, PBILDT margin marginally deteriorated from 9.53% in FY20 to 8.73% in FY21 on account of higher sales of lower margin products coupled with competitive pricing and discounts as vehicle dealers resorted to lower pricings to lure customers amid the pandemic. PAT of the company increased to Rs. 343 Mn with PAT margin of 6.81% compared to Rs. 123 Mn in FY20 with PAT margin of 2.94%. The demand trend had sustained into FY22 with VAPL reporting revenues of Rs. 3,326 Mn during H1FY22 (Unaudited, refers to the six-month period ended mid-Jan 2022) with sales of 5,585 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.

Key Rating Weaknesses**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 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, operating cycle of the company improved to 189 days from 311 days in FY20. However, overall working capital cycle remains elongated given the working capital-intensive nature of operations, leading to dependence on borrowings.

Cyclical nature of the auto industry and high competition from other automobile players

The demand for automobiles is inherently vulnerable to the economic cycles and is highly sensitive to interest rates. Demand for motorbikes increases during period of high economy growth rate 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. Further, competition is also intensified due to introduction of electric vehicles in the market.

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.

About the Company

Vivek Automobiles Private Limited (VAPL) is a private limited company incorporated on December 31, 2015 and is part of the MV Dugar Group of Nepal. The company currently is the sole authorized distributor in Nepal for Royal Enfield Motorcycle, John Deere tractors & accessories and Piaggio three-wheelers.

Brief financials of VAPL for last three years ending FY21 are given below:

For the Year ended Mid- July,	FY19 (A)	FY20 (A)	FY21 (A)
Income from Operations	4,196	4,189	6,571
PBILDT Margin (%)	9.42	9.53	8.73
Overall Gearing (times)	4.23	3.11	1.00
Interest Coverage (times)	1.94	1.91	6.47
Current Ratio (times)	1.11	1.18	1.28
Total Debt/ Gross Cash Accruals (times)	10.69	8.50	2.04

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	1,820.00	CARE-NP A3 [A Three] (Credit watch with developing implications)
Short Term Bank Facilities	Non-Fund Based Limit	1,360.00	CARE-NP A3 [A Three] (Credit watch with developing implications)
Total Facilities		3,180.00	

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About CARE Ratings Nepal Limited:

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