Surya Nepal Private Limited

Ratings

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

Annexure-1 Details of Facilities/Instruments to be rated

CARE Ratings Nepal Limited (CRNL) has reaffirmed the rating of `CARE-NP A1+' assigned to the short term bank facilities of Surya Nepal Private Limited (SNPL).

Detailed Rationale & Key Rating Drivers

The reaffirmation in rating assigned to the bank facilities of Surya Nepal Private Limited (SNPL) continues to derive its strength from 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 market capitalization of around 40.75 billion USD and Gross Sales Value of 11.89 billion USDs as on March 2022. 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 & specialty paper, packaging, Agri businesses and information technology. 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. Furthermore, 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.

Strong brand equity and leadership position in market

SNPL has been in the business of cigarette manufacturing for more than 35 years and has built various successful brands like Surya Legend, Surya 24 Carat, Surya Luxury Kings, Shikhar Filter Kings, Shikhar Ice Rush, Naulo, Khukuri Filter, Pilot Filter, Bijuli and Chautari 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 deep and wide distribution network in the country

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

with warehouses spread across Nepal for its products which reach over more than 100 distributors 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. Ravi K Rayavaram, Managing Director of SNPL is a mechanical engineer and an alumnus of Indian School of Business who joined ITC in 2003 and has a total experience of 27 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

Net sales from sale of product of the company increased marginally by ~0.02%, y-o-y growth, to Rs. 24,446 Mn in FY21. The increase in taxes on tobacco products during the budget of FY20/21 led to increase in price of cigratte which had an adverse impact on the net sales growth. PBILDT decreased in absolute terms by 3.78% in FY21 on account of increased cost of raw materials. Further, overall PAT of the company also decreased by 4.39% in FY21. Though declined, it continued to remain high. Net profit stood at Rs. 9,416 Mn in FY21 as against Rs. 9,848 Mn in the previous financial year (FY20).

The company has comfortable profitability margins which led to generation of sufficient cash flows to manage the working capital requirements and any capex programs. Hence, the Company has not availed any long-term debt from any Bank/Financial Institutions and debt is in the form of working capital borrowing only as a result overall gearing ratio of the Company is low at 0.10x at FY21 end. Furthermore, as on FY21 end, SNPL had substantial liquid assets in the form of bank balance of Rs. 6,264 Mn in addition to a cash balance of around Rs. 121 Mn. During FY21, the company declared dividend aggregating to Rs. 9,415 Mn.

Key Rating Weakness

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 more than doubled in all segments and more than 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 as a product is highly price elastic in nature with a large number of smokers 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 albeit 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.

Brief Financials of last three years is as under:

(in Rs. Million)

Particulars	FY19	FY20	FY21
	Audited	Audited	Audited
Income from Operations	25,137	24,471	24,493
Overall Gearing (times)	0.03	0.13	0.10
Interest coverage (times)	273.61	536.66	383.05
Current ratio (times)	2.71	2.14	2.09
Total Debt/GCA	0.04	0.19	0.14

Annexure-1 Details of Facilities/Instruments to be rated

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

Contact us

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About CARE Ratings:

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