Kwality Oil Refinery Private Limited

Rating

Facilities/Instrument	Amount (Rs. in Million)	Ratings[1]	Rating Action
Short Term Bank Facilities	**2,750.00**	**CARE-NP A4+ [A Four Plus]**	**Assigned**
Total Facilities	**2,750.00 (Two Thousand Seven Hundred and Fifty Million Only)**		

** Details of Facilities in Annexure 1*

CARE Ratings Nepal Limited (CRNL) has assigned rating of 'CARE-NP A4+ [A Four Plus]' to the short-term bank facilities of Kwality Oil Refinery Private Limited (KOPL).

Detailed Rationale & Key Rating Drivers

The rating assigned to the bank facilities of KOPL are constrained by its working capital intensive nature of business leading to reliance on bank borrowings to meet working capital requirements, moderately leveraged capital structure, reliance of majority of revenues from exports to India which is dependent on tariff arbitrage between direct imports vis-à-vis imports from Nepal exposing KOPL to changes in tariff regimes of India for direct imports of various edible oils/crude, raw material price volatility risk, foreign exchange fluctuation risk, and regulatory risk. The rating also factors in susceptibility of KOPL's business to price fluctuation of seasonal agro products, competitive nature of industry, and exposure to volatile interest rates.

The rating, however, derive strength from KOPL's established track record of operations with experienced promoters, increasing scale of operations with improving profitability and cash accruals leading to improved debt service coverage indicators. The rating also factors in stable demand of edible oil and locational advantage for both imports and exports. The rating also takes cognizance of the continued upswing in sales during FY22 (Unaudited, refers to the twelve-month period ended mid-July 2022) and the likely benefits the company's financials are expected to have accrued in FY22 from economies of scale.

Going forward, the ability of company to manage growth in operations while maintaining the profit margins, rationalization of its debt through efficient working capital management would be the key rating sensitivities. Furthermore, the ability of the company to pass through changes in raw material prices to the customers and managing the foreign exchange fluctuation risks related to raw materials will also be the key rating sensitivities.

Detailed description of the key rating drivers

Key Rating Weaknesses

Working capital intensive nature of business leading to reliance on bank borrowings

The operations of the company are working capital intensive in nature as the company imports its raw materials from various countries such as Argentina, Brazil, Malaysia, Indonesia etc through Letter of Credit. KOPL has to keep enough inventory for smooth operations which lead to reliance on working capital limits. Company generally receives advance payment from the customer (for export), which led collection period around one month during FY21 (Audited, refers to the twelve-month period ended mid-July 2021) including domestic sales. Majority of the company's debt at the end of FY21 was short-term working capital borrowings, which remains on the higher side given the working capital intensive nature of business. This led to a

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

moderately leveraged gearing level of 2.11x at the end of FY21, although improved from 5.51x at the end of FY20 aided by aided by infusion of Rs. 25 Mn capital by the promoters coupled with increased accretion of profits to the networth.

Raw material price volatility risk and foreign exchange fluctuation risk

KOPL's major raw materials agro based commodities which include crude soyabean oil, crude sunflower oil and crude palm oil which are imported from various countries. The raw material cost contributed around 80% of the total operating income of the company during FY21. The prices of these raw materials are market linked and determined on a periodic basis, thus exposing the company to the volatility in input prices, which has a bearing on its profitability margins. Similarly, foreign exchange fluctuation risk also remains a major risk factor for a company like KOPL, with procurement predominantly in foreign currency (USD) whiles sales realization in domestic currency or Indian rupee. KOPL has taken forward hedging mechanism to minimize the risk associated with fluctuation in foreign currency. The ability of the company to pass through changes in raw material prices to the customers and managing the foreign exchange fluctuation risks related to raw materials will be crucial from its profitability perspective.

Competitive nature of industry

Import and processing/refining of edible oils is highly fragmented due to presence of several organized/ unorganized players owing to low entry barrier and low technology and moderate capital requirement. Low product differentiation of KOPL's product results in high competition from other players including traders. Considering the competitive nature of industry, the millers have low pricing power.

Exposure to volatile interest rate

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. Furthermore, increased bank rates announced in the Monetary Policy for FY23 is likely to add to the upward pressure on interest rates going forward. Any 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

The operation of KOPL is vulnerable to regulatory risk arising from various laws and policies of the importing and exporting countries coupled with the domestic policies of Nepal. KOPL's exports revenue (~82% of total sales in FY21), relies on the tariff arbitrage in India between direct imports of crude by Indian millers vis-à-vis imports of refined edible oil from Nepal. KOPL, like many millers in Nepal, try to exploit any substantial tariff differential in India, which keep changing for different edible oils every year. Over the past few years, there have been in changes in government policies, either domestic or international regarding import/export of edible crude. KOPL's revenue is susceptible to regulatory policies relating to tariff barriers (differential trade tariffs among South Asian Free Trade Area), non-tariffs barriers (restriction on the quality of imports), international freight rates etc. Any unfavorable change in policy could impact the financial profiles of entities operating in the importing of crude edible oil and exporting to India.

Key Rating Strengths

Established track record of operations and experienced promoters

KOPL has been involved in processing of edible oil for more than 18 years and derives strength from experienced promoters. The company is managed under the overall guidance of its board of directors, which includes experienced businessmen/industrialists in the related field of manufacturing and trading. Mr. Ghanashyam Kabra, Managing Director has experience of more than 18 years in the food processing and trading sector. Similarly, other directors of the company also have reasonable experience in the related business. The directors of the company are supported by a team of experienced professionals.

Improving financial risk profile marked by growth in sales and improved profitability and cash accruals

KOR generates its revenue from sale of refined sunflower, palmolein, soyabean and fatty acid oil. Total Operating Income (TOI) of the company increased by 52% during FY21 to Rs. 2,802 Mn (PY: Rs. 1,845 Mn) majorly due to increased sales of soyabean oil to Rs. 2,351 Mn in FY21 (PY: Rs. 663 Mn).

PBILDT margin of the company grew to 8.36% in FY21 from 7.32% in FY20 supported by growing scale. Foreign exchange fluctuation loss of the company was Rs. 6 Mn during FY21 which was less compared to foreign exchange loss of Rs. 20 Mn during FY20 since KOPL considerably mitigated foreign currency risk by hedging through forward contracts. Consequently, PAT margin of the company increased to 5.38% in FY21 from 3.10% in FY20. Similarly, Gross Cash accruals (GCA) increased to Rs. 163 Mn from Rs. 65 Mn. Total sales grew further to Rs. 6,488 Mn in FY22 boosted by increase in sales of palm oil.

Aided by increased scale and improved profitability, KOPL's debt service coverage indicators also improved on a year on year basis in FY21. Total Debt/GCA was 3.99x during FY21, which improved from 11.39x of FY20. Likewise, interest coverage ratio improved to 7.64x in FY21 from 3.64x in FY20. This improvement in interest coverage ratio was due to growth in PBILDT of the company coupled with decline in interest cost.

Essential part of cooking leading to stable demand and steady growth in the revenue

The demand prospect of edible oil industry is stable as oil is one of essential commodity for cooking. Further, with demand higher than domestic production and slowdown in domestic agriculture production, large volume of edible as well as crude oil is being imported in Nepal giving importers like KOPL a favourable environment. Nepal has seen a steady growth in import of edible oil over the years. KOPL focused on maintaining its quality with installation of automatization and most state of art plant.

Locational advantage for both imports and exports

KOPL's plant site is located in Morang, Nepal near to Nepal-India boarder. Since all of the raw materials requirements of KOPL imported from various countries are unloaded on Indian ports, the factory's proximity to the border leads to savings in freight cost. Close proximity to Indian boarder is also beneficial from the company's exports perspective as it exports majority of its products to India which accounted for 82% of total revenue in FY21.

About the Company

Kwality Oil Refinery Private Limited (KOPL) is a private limited company incorporated on March 1, 2004 under the flagship of Kabra G Group for processing/refining of edible oils, having plant in Katahari, Morang, Nepal. It is involved in the production of Vanaspati Ghee, Refined Vanaspati Oil like Soyabean, Sunflower, Palmolein, Palm, Rapeseed, Ground Nut, Corn and many more satisfying the needs of customers and trends. Currently, the total installed capacity for refined oil is 250 Metric Ton Per Day.

Brief financial performance of KOPL during last 2 years is given below:

(Rs. In Million)

Particulars	FY20 (A)	FY21 (A)
Income from Operations	1,847	2,809
PBILDT Margin (%)	7.32	8.36
Overall Gearing (times)	5.51	2.11
Interest coverage (times)	3.64	7.64
Current Ratio(times)	1.43	1.17
Total Debt/Gross Cash Accruals(times)	11.39	3.99

A: Audited

Annexure 1: Details of the Facilities Rated

Nature of the Facility	Type of the Facility	Amount (Rs. in Million)	Rating
Short Term Bank Facilities	Fund Based Limit	2,750.00	CARE-NP A4+ [A Four Plus]
Total		**2,750.00**	

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