

Advanced Automobiles Private Limited (Revised)

Ratings

Facilities	Amount (Rs. in Million)	Rating ¹	Rating Action
Short Term Bank Facilities	1,110.00 (Increased from 960.00)	CARE-NP A4 [A Four] (Credit watch with developing implications)	Rating reaffirmed and placed on credit watch with developing implications
Long Term Bank Facilities	- (Reduced from 3.75)	-	Withdrawn
Total Facilities	1,110.00		

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bank facilities of Advanced Automobiles Private Limited (AAPL) on credit watch with developing implications and withdrawn the rating assigned to the long term bank facilities of AAPLs the company has paid the loan in full and there is no amount outstanding under the facilities.

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of AAPL 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 of various non-essential trading items. In April 2022, GoN imposed restriction in imports of certain items, which included jeeps, cars and vans (except ambulance and mortuary van) till mid-July 2022 to help curb outflow of foreign reserve. Subsequently, the near term business prospects of the company are expected to be impacted by this supply constraint. 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 high-ticket luxury items such as automobiles. CRNL will resolve the rating watch once clarity emerges on the extent and scope of impact on AAPL's business of the above measures.

The rating continues to be constrained by AAPL's working capital intensive nature of operations, cyclical nature of auto industry, moderate track record of operation, 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 also factors in AAPL's moderate debt service coverage indicators and capital structure, which have been on an improving trend in FY21 (Audited, refers to the twelve-month period ended mid-July 2022). The rating continues to derive strength from AAPL's experienced and resourceful promoter group, association with established brand as authorized 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 growing scale and 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.

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

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Leveraged capital structure

The capital structure of the company remained leveraged with gearing ratio of 3.50x at the end of FY21 which had improved from 10.35x 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 2.82x in FY21 (FY20: 0.20x) due to higher PBILDT generation as well as lower interest expense.

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 153 days in FY21 from 244 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.

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

The demand for passenger vehicles is inherently vulnerable to the economic cycles and is highly sensitive to interest rates. Demand for passenger vehicles 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 like Hyundai, Honda, Toyota, Nissan, Volkswagen, Ford, TATA Motors, Jeep, 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 announced restriction in imports of automobiles, among various other non-essential items. Although the imposition is announced till mid-July 2022, continuation of the same for a longer period can have a significant adverse impact on the automobile trading industry. 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 passenger vehicles and increasing risk weights on personal hire purchase loans to 150% from 100% to discourage import of automobiles. Hence, dealership business of AAPL 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

AAPL derives strength from its strong promoters, being a part of the Vishal Group of Companies which has a strong presence in Nepal through their group entities in trade, manufacturing, hospitality, insurance and banking. Along with AAPL, the group has presence in the automobile industry as authorized distributor/dealer of other automobile brands for more than a decade. The day to day operations of the company are managed by Mr. Nikunj Agrawal, Managing Director, who has experience of over a decade in various industries including automobile trading. He is also a director in NIC Asia Bank Limited (CARE-NP A- (Is)).

Established brand, authorized distributor of Renault SAS and established dealer network

AAPL is an authorized dealer in Nepal for Renault SAS. Renault is a French multinational automobile manufacturer which was founded in early 1900's and had sold 2,696 million vehicles globally in 2021. AAPL mostly imports Renault cars from Renault India Private Limited. AAPL has established dealer network of 21 dealers strategically located covering major cities of Nepal. Additionally, the company also has own operated showroom located in Kathmandu.

Financial risk profile marked by improvement in revenue and profitability in FY21

The company's revenue grew 82.26% year on year (yoy) to Rs. 1,664 Mn in FY21 backed by a surge in demand following the pandemic hit FY20. Earlier in FY20, the company's revenues had declined 51.37% 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 passenger vehicles picked-up in the country in FY21. AAPL sold 618 units in FY21 compared to 311 in FY20. Boosted by higher revenues, PBIDLT margin of the company improved to 8.73% in FY21 from 1.83% in FY20. Consequently, PAT of the company also increased to Rs. 84 Mn in FY21 compared to net loss of Rs 80 Mn in FY20. The demand trend had continued into FY22 with AAPL reporting revenues of Rs. 2,288 Mn during 9MFY22 (Unaudited, refers to the nine-month period ended mid-July 2022) with sales of 834 units. However, the current import restriction is likely to impact the near-term operations of the company leading to some moderation in the financial performance of the company in FY22 on a yoy basis. Continuation of the import restriction beyond mid-July 2022 will negatively impact the company's business prospects and will remain critical from credit perspective.

About the Company

Advanced Automobiles Private Limited was incorporated in September 13, 2013 and started its operation from October 2016 as an authorized distributor for Renault SAS, France in Nepal. The company is engaged in the sale of passenger vehicles of Renault, servicing of the vehicles and sale of spare parts. The company owns and operates two showrooms and two service centers that are situated in Kathmandu.

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

For the Year ended Mid- July,	FY19 (A)	FY20 (A)	FY21 (A)
Income from Operations	1,898	923	1,682
PBIDLT Margin (%)	3.02	1.83	8.77
Overall Gearing (times)	5.25	10.35	3.50
Interest Coverage (times)	0.53	0.20	2.82
Current Ratio (times)	1.10	1.01	1.18
Total Debt/ Gross Cash Accruals (times)	Negative	Negative	6.95

A: Audited; UA: Unaudited

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	900.00	CARE-NP A4 [A Four] (Credit watch with developing implications)
Short Term Bank Facilities	Non-Fund Based Limit	210.00	CARE-NP A4 [A Four] (Credit watch with developing implications)
Total Facilities		1,110.00	

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About CARE Ratings Nepal Limited:

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Disclosure: Shareholders of Advanced Automobiles Private Limited are also amongst the shareholders of CARE Ratings Nepal Limited (CRNL). None of the shareholders of CRNL (including shareholders of Advanced Automobiles Private Limited) are part of CRNL's rating committee and they do not participate in the rating process. And hence, they didn't have any role in assignment of credit rating of Advanced Automobiles Private Limited by CRNL.