Paramount Motors Private Limited (Revised)

Ratings

Facilities	Amount (Rs. in Million)	Rating[1]	Rating Action
Long Term Bank Facilities	150.00 (Increased from 30.00)	CARE-NP BBB- [Triple B Minus] (Credit watch with developing implications)	Rating reaffirmed and placed on credit watch with developing implications
Short-Term Bank Facilities	1,400.00 (Increased from 990.00)	CARE-NP A3 [A Three] (Credit watch with developing implications)	Rating reaffirmed and placed on credit watch with developing implications
Total Facilities	**1,550.00**		

Details of instruments/facilities in Annexure-1

CARE Ratings Nepal Limited (CRNL) has placed the rating of 'CARE-NP BBB-' for the long-term bank facilities and 'CARE-NP A3 for the short-term bank facilities of Paramount Motors Private Limited (PMPL) on credit watch with developing implications.

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of PMPL 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/discourage imports of various non-essential trading items. In April 2022, the 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. Although electric vehicles sold by PMPL, which accounted for around 74% of PMPL's revenues in FY21 (Audited, refers to the twelve-month period ended mid-July 2021), are exempt from this restriction, the near term demand and supply scenario for passenger vehicles, including electric, remains unpredictable, exacerbated further by the challenges 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. Furthermore, GoN has, through the budget for FY23, announced increased excise duty and customs for electric vehicles over 100kW, which could hike prices by at least 30%, adversely impacting the demand for electric passenger vehicles going forward. CRNL will resolve the rating watch once clarity emerges on the extent and scope of impact on PMPL's business of the above measures.

The ratings continue to derive strength from PMPL's experienced and resourceful promoter group, association with strong 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, comfortable capital structure, and improving debt service coverage indicators. The ratings, however, continue to remain constrained by PMPL's moderate track record of operation, working capital intensive nature of operations, exposure to volatile interest rate and foreign exchange rate fluctuation risk, cyclical nature of auto industry and increasing 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 remain the key rating sensitivities. Furthermore, any further policies of the Government of Nepal regarding tightening the imports, which could impact the business profile of the company will also be a key rating sensitivity.

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

Detailed Description of the Key Rating Drivers

Key Rating Strengths

Experienced and resourceful promoter group

PMPL derives strength from its strong promoters, being part of the Vishal Group of Companies which has a strong presence in Nepal through various group entities engaged in trade, manufacturing, hospitality, insurance and banking. Along with PMPL, the group has presence in the automobile industry as distributor/dealer of other automobile brands for more than a decade.

Improving brand value of MG Motor and authorized distributorship in Nepal

PMPL is presently, the authorized distributor in Nepal for MG Motor owned by the Shanghai-based Chinese state-owned automotive SAIC Motor Corporation Limited (SMCL). MG Motor is one of the fast growing automotive brands, with increasing market share particularly in the electric passenger vehicle segment in Nepal. Being authorized distributor of MG vehicles, PMPL has access to an increasing customer base and large demand catering opportunity. Furthermore, the company has also started dealing passenger vehicles of Mazda during FY21, which will add to the business prospects of the company going forward.

Established dealer network

PMPL started operations in August 2018 and within a short period has established a dealer network with total of ten dealers covering major cities of Nepal including Kathmandu, Biratnagar, Bharatpur, Pokhara, Butwal, Nepalgunj etc. Currently, the company has one rented showroom in Naxal, Kathmandu, service center at Dhumbarahi, Kathmandu and one godown in Birgunj. During FY21, 98 cars were sold through owned showrooms and 39 cars through dealers.

Subdued performance in FY21, however, substantial growth in revenue and profitability in 8MFY22

In FY21, the revenue of the company slightly decreased to Rs. 711 Mn compared to Rs. 793 Mn in FY20 due to high tax rate imposed by the government for EVs coupled with impact of lockdown imposed by the GoN due to Covid-19 pandemic on the operational activities resulting in muted sales. PBILDT margin declined from 17.58% in FY20 to 9.20% in FY21 on account of stock clearance with lower mark-up amid sluggish demand. Consequently, PAT declined to Rs. 38 Mn in FY21 from Rs. 84 Mn in FY20. However, during 8MFY22, boosted by a new lower tax regime for EVs, the company's revenue increased significantly to Rs. 3,281 Mn aided by increased sales volume, particularly of the MG electric passenger vehicles. The company sold 705 units during 8MFY22 (Unaudited, refers to the eight-month period ended mid-March 2022) compared to 137 units during FY21. PMPL has reported PBILDT of Rs. 460 Mn during 8MFY22 with PBILDT margin of 14.02%.

Comfortable capital structure of the company with strong debt service coverage indicators

The overall gearing ratio of the company improved to 1.67x at the end of FY21 from 2.68x at the end of FY20 mainly on account of lower working capital borrowings at the end of FY21. Additionally, interest coverage ratio of the company also improved to 7.10x during FY21 from 5.71x in FY20 on account of lower interest expenses. Backed by higher sales leading to increased PBILDT in 8MFY2, PMPL's gearing ratio improved to 0.44x and interest coverage remained very comfortable at 31.15x. Similarly, PMPL's Total Debt to Gross Cash Accruals stood at 0.66x at the end of 8MFY22 backed by significantly higher gross cash accrual during the period.

Key Rating Weakness

Moderate track record of operations

PMPL started its commercial operation as an authorized distributor for MG vehicles in Nepal from August 2018 and therefore, has a limited operational track record. FY20 was the first full year of operation for the company and operational track over the last three years has been a bit volatile. However, having promoters with nearly a decade of experience in auto dealership business along with other group companies bodes well for the business prospect of the company going forward.

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 has to maintain fixed 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 elongated to 228 days from 145 days in FY20 mainly on account of higher inventory and receivables at the end of FY21, impacted mainly by sluggish sales amid an interim increase in duty and tax for EVs during FY21.

Cyclical nature of the auto industry and high competition from other automobile 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 number of players operating in market like Hyundai, Honda, Toyota, Nissan, Volkswagen, Ford, TATA Motors, and Jeep etc. Competition is also intensified due to introduction of electric vehicles by other brands 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. The GoN's long-term policy on electric vehicles remains indecisive, as indicated by the frequently changing duty and tax regime on EVs over the last two years. After providing relief in excise duty and customs for EVs through budget for FY22, the GoN has again increased these by at least 30% for EVs with power over 100kW. In context of the current liquidity stress, 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, increasing risk weights on personal hire purchase loans to 150% from 100% to discourage import of automobiles amid declining forex reserve. While the government's plan to reduce the import of petroleum products bodes well for EVs, increased import duty could adversely impact sales, as was apparent during FY21. Hence, dealership business of PMPL remains exposed to risk related to similar policies of the GoN/Central Bank. This will remain a key monitorable aspect.

About the Company

PMPL was incorporated on April 28, 2016 to deal in automobiles as well as spare parts. The company started its operations from August 2018 as an authorized distributor for MG Vehicles in Nepal. In March 2020, the company also entered into dealership agreement with Mazda Motor Corporation, Japan as authorized distributor of Mazda vehicles in Nepal.

Brief financial performance over FY20-8MFY22 is given below:

For the Year ended Mid- July,	FY20 (A)	FY21 (A)	8MFY22 (UA)
Income from Operations	793	711	3,281
PBILDT Margin (%)	17.58	9.20	14.02
Overall Gearing (times)	2.68	1.67	0.44
Interest Coverage (times)	5.71	7.10	31.15
Current Ratio (times)	1.19	1.36	2.09
Total Debt/ Gross Cash Accruals (times)	4.03	6.42	0.66

A: Audited; UA: Unaudited

Annexure-1: Details of Instruments/Facilities

Name of the Instrument	Type of the Facility	Amount (Rs. Million)	Rating
Long Term Bank Facilities (Proposed)	Term Loan	150.00	CARE-NP BBB- (Credit watch with developing implications)
Short Term Bank Facilities	Fund Based Limit	660.00	CARE-NP A3 (Credit watch with developing implications)
Short Term Bank Facilities	Non-Fund Based Limit	740.00	CARE-NP A3 (Credit watch with developing implications)
Total Facilities		**1,550.00**	

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About CARE Ratings Nepal Limited:

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