

## V.G. Automobiles Private Limited (Revised)

### Ratings

Facilities	Amount (Rs. in Million)	Rating <sup>1</sup>	Rating Action
Long Term Bank Facilities	2.30 (Decreased from 3.15)	CARE-NP BBB- [Triple B Minus]	Reaffirmed
Short-Term Bank Facilities	1,685.00 (Increased from 1,638.50)	CARE-NP A3 [A Three]	Reaffirmed
<b>Total Facilities</b>	<b>1,687.30</b>		

Details of instruments/facilities in Annexure-1

CARE Ratings Nepal Limited (CRNL) has reaffirmed the rating of 'CARE-NP BBB-' for the long-term bank facilities and 'CARE-NP A3' for the short-term bank facilities of V.G. Automobiles Private Limited (VGAPL).

### Detailed Rationale & Key Rating Drivers

The reaffirmation of ratings assigned to the bank facilities of VGAPL derives strength from its improved financial risk profile at the end of FY21 (Audited, refers to the twelve-months period ended mid-July 2021) marked by increased revenues and improved profitability leading to better debt service coverage indicators and moderate capital structure. The ratings also factor in experienced and resourceful promoters with company being part of Vishal Group of Companies, moderate track record of operations and authorized distributor of reputed two-wheeler and three-wheeler brands and established dealer network.

The ratings, however, are constrained by working capital intensive nature of operations, cyclical nature of the auto industry and high competition from other automobile players, exposure to volatile interest rates and regulatory risk related to automobile industry. Although the ratings consider the near term challenges faced by the automobile trading industry in Nepal, particularly due to the import restriction for various automobiles announced by the Government of Nepal (GoN) till mid-July 2022, majority of VGAPL's business (around 90% during FY21) remains exempt from this restriction.

*Going forward, the ability of the company to profitably scale up its operations and improvement in its overall solvency position will be the key rating sensitivities. Any further regulatory development related to tightening the imports, which could impact the business profile of the company beyond FY22 will remain a key monitorable aspect.*

### Detailed Description of the Key Rating Drivers

#### Key Rating Strengths

##### Experienced and resourceful promoter group

VGAPL 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 VGAPL, the group has presence in the automobile industry as 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)).

##### Financial profile marked by growth in revenue and substantial improvement in net profits in FY21

The company's total operating income grew 3% year on year to Rs. 1,250 Mn in FY21 backed by increment in sales, owing to ease in government restriction in FY21. VGAPL had sold 4,456 units in FY21 compared to 4,240 units in FY20. PBILDT margin of the company remained stable at around 10% during FY21. However, the company's short-term facility utilization declined

<sup>1</sup>Complete definition of the ratings assigned are available at [www.careratingsnepal.com](http://www.careratingsnepal.com) and other CARE publications

substantially in FY21 boosted by rationalization of working capital cycle. This led to significantly lower interest expense of Rs. 23 Mn in FY21, compared to Rs. 84 Mn in FY20. Consequently, PAT of the company improved to Rs. 73 Mn in FY21 compared to Rs 25 Mn in FY20. Although the growth trend had continued during the first half of FY22, sales have been sluggish during the second half of the current fiscal year. Bank's relative reluctance to open new letter of credit for import of automobiles coupled with muted demand scenario amid the tight liquidity situation in the country is expected to impact overall financial performance of the company over the near-term. The uncertainty over the near-term business prospects of the automobile trading industry, in general, in the current situation calls for a closer monitoring of regulatory norms and liquidity challenges in the country.

#### **Moderate capital structure with improved debt service coverage indicators**

Overall gearing ratio of VGAPL improved from 2.48x at the end of FY20 to 2.01x at the end of FY21 on account of decline in short term loans at the year-end coupled with improvement in net worth of the company due to accretion of profits to reserves. Furthermore, amid sustained PBILTD coupled with substantial decrease in interest expense, interest coverage improved to 5.54x during FY21 from 1.49x in FY20. The total debt/ GCA of the company improved from 20.59x in FY20 to 8.72x in FY21 aided by better cash accruals and lower debt levels.

#### **Moderate track record of operations and authorized distributor of established brands**

VGAPL was incorporated in March 2013, and started its commercial operation as a distributor of Suzuki Motorcycle India Private Limited's (SMIPL) motorbikes and spare parts in Nepal. The company is also an exclusive distributor of Atul Auto Limited's three-wheeler vehicles and its spare parts and also sells Motul lubricants in Nepal. VGAPL is the authorized dealer in Nepal for SMIPL, Atul Auto Limited and Atlantic Lubricants & Specialities Private Limited. Thus, the company has diversified product profile. SMIPL is a subsidiary of one of the world's leading two-wheeler manufacturer, Suzuki Motor Corporation, Japan.

#### **Established dealer network**

VGAPL has established dealer network with 58 dealers for two wheelers, 14 dealers for three wheelers and 66 dealers for Motul lubricants. Additionally, the company owns three showrooms along with one service centre for two wheelers segment. The company sold 3,948 vehicles through dealers (including 48 three wheelers) and 508 vehicles through owned showrooms during FY21.

#### **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 reasonably high credit provided to the dealers. During FY21, operating cycle of the company stayed elongated at 281 days, although improved from 327 days in FY20 mainly on account of decrease in average collection period from 151 days in FY20 to 102 days in FY21. The improvement in collection period over the previous year was mainly on account of a more normal business environment during FY21 compared to the adverse impact of the first wave of the covid-19 pandemic during the last quarter of FY20 (quarter ended mid-July 2020). However, given the long lead time and reasonable credit period generally given to the dealers coupled with procurement from supplier majorly on Letter of Credit at sight, the company's operations will remain working capital intensive with reliance in working capital borrowings as the operations increase in scale over the medium term. The company's ability to efficiently manage its working capital requirements leading to lower reliance on borrowings would be critical in sustaining the improved net profitability reported during FY21.

##### **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 the 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 tight liquidity situation in the market coupled with declining forex reserve, the Government of Nepal has introduced several policies in the recent past such as increasing cash margin for imports of automobiles to 50% from earlier 1% in December 2021. 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. Amid the current market dynamics where banks are reluctant to open new LCs and also to finance vehicles. Developments in the industry after the current restriction in imports is over on mid-July 2022 and any other similar policies by the GoN/NRB, which could impact the automobile trading industry, will remain a key monitorable.

### About the Company

VGAPL was incorporated on March 13, 2013 to deal in automobiles as well as spare parts. The company started its operations as an authorized distributor for SMIPL for their two-wheeler vehicles and spare parts in Nepal. During FY18, the company also entered into dealership agreement with Atul Auto Limited and Motul Lubricants as authorized distributor.

Brief financial performance for the last three year ending FY21 are given below:

For the Year ended Mid- July,	FY19 (A)	FY20 (A)	FY21(A)
Income from Operations	1,880	1,211	1,250
PBILDT Margin (%)	10.64	10.39	10.14
Overall Gearing (times)	3.44	2.48	2.01
Interest Coverage (times)	2.43	1.49	5.54
Current Ratio (times)	1.18	1.26	1.37
Total Debt/ Gross Cash Accruals (times)	9.87	20.59	8.72

A: Audited

### 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	2.30	CARE-NP BBB-
Short Term Bank Facilities	Fund Based Limit	1655.00	CARE-NP A3
Short Term Bank Facilities	Non-Fund Based Limit	30.00	CARE-NP A3
<b>Total Facilities</b>		<b>1,687.30</b>	

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### About CARE Ratings Nepal Limited:

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