CareEdge RATINGS

Arihant Infrastructure Limited

Rating

Facilities	Amount (Rs. in Million)	Ratings[1]	Rating Action
Short Term Bank Facilities	**890.00**	**CARE-NP A4 [A Four]**	**Assigned**
Total Facilities	**890.00 (Eight Hundred and Ninety Million Only)**		

Details of instruments/facilities in Annexure-1

CARE Ratings Nepal Limited (CRNL) has assigned rating of 'CARE-NP A4' to the short term bank facilities of Arihant Infrastructure Limited (AIL).

Detailed Rationale & Key Rating Drivers

The rating assigned to the bank facilities of AIL is constrained by its small scale of operations with low net profitability amid increasing finance cost in FY22 (Audited; FY refers to the twelve-months period ending mid-July), leveraged capital structure and weak debt service coverage indicators of the company. The rating also factors in limited track record of operations, working capital intensive nature of operations, exposure to volatile interest rate and foreign exchange fluctuation risk. The rating, however, derives strength from AIL's experienced promoter in trading and manufacturing business and its growing scale of operations. The rating also factors in diversified distribution network coupled with support from group associates with broadened yet interrelated scope of operations.

Going forward, the ability of the company to profitably scale up its operations on a sustainable basis and effective management of working capital leading to improved solvency indicators would be the key rating sensitivities. Furthermore, ability of the company to manage the foreign exchange fluctuation risks would also be a key rating sensitivity.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Limited track record of operations, although part of an established group

AIL was incorporated in November 17, 2009, however it started its commercial operations in FY21 and therefore, has a limited track record of less than two years of commercial operations. However, AIL is a part of Arihant group which deals with a large number of wholesalers and traders, with whom it has been associated for over two decades. The group is involved in diversified business like automobiles, trading, and remittance service among others, which bodes well for the business prospect of the company going forward.

Minimal net profitability amid increasing finance cost although decent scale of operations

AIL commenced its operations during FY21. The company derives its income from import and distribution of copper, coals, battery, chemicals, resin, gypsum and various related products. AIL's financial performance was marked by steady scale of operations for the past two years (FY21-FY22) which accounts to Rs. 844 Mn in FY22 (FY21: 895 Mn).

PBILDT margin of the company improved to 9.19% in FY22 compared to 3.87% in FY21 on account of improvement in average price realization of various products traded during the year. However, PAT margin of the company decreased 0.37% in FY22 from 1.16% in PY. This decrease in net margin was on account of increasing finance cost of the company to Rs. 66 Mn compared to Rs. 23 Mn in FY21. The scale of operations of AIL remains small marked by gross cash accruals (GCA) and tangible net worth (TNW) of Rs. 5 Mn and Rs. 182 Mn respectively during FY22.

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

Highly leveraged capital structure with weak debt service coverage indicators of the company

Gearing ratio of AIL stood high at 3.62x at the end of FY22 which improved from 9.03x at the end of FY21 aided by increased net worth base supported by equity infusion coupled with accrual of profits. The increasing trend in networth, however, is likely to remain offset by increasing debt requirement of the company going forward to cater the ongoing capex as well as to support the growing scale of the company, which could lead to increased utilizations of the working capital facilities. This is likely to result in a sustained high gearing level of the company over the near-term with limited gearing headroom. Similarly, debt coverage indicators stood weak with interest coverage ratio of 1.18x in FY22 compared to 1.51x in FY21. TOL/TNW of the company improved to 3.71x as on mid-July 2022 from 9.52x at the end of FY21 majorly on account of increase in net worth of the company to Rs. 183 Mn as on mid-July 2022 from Rs. 94 Mn at the end of FY21. Total Debt/Gross Cash Accruals stood high at 106.38x at the end of FY22 which increased from 79.01x at the end of FY21 majorly on account of lower scale of operation coupled with increase in interest expenses.

Working capital intensive nature of operations

AIL's operations are working capital intensive in nature. The company is required to maintain adequate level of inventory to avoid stock out as the supply is totally dependent upon imports. AIL imports its products from foreign countries and stocks them in its warehouse and the marketing and distribution happens through its three branches. AIL's average inventory holding period stood at 222 days in FY22. Furthermore, average collection period was also high at 133 days in FY22, which had increased from 71 days in FY21 due to ongoing liquidity crisis resulting in challenges in collection from its customers. Consequently, total operating cycle of the company was substantially high at 327 days in FY22. This resulted in increased reliance on bank borrowings to meet working capital needs leading to a relatively high debt levels. The average working capital utilization of the company against the drawing power remained high at more than 90% during the last 12 months ended mid-December 2022.

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, with substantial upward pressure on interest rates in the last few quarters. A contractionary monetary policy for FY23 coupled with increasing inflation has only added to the upward pressure on interest rates, resulting in increased base rates of BFIs in the first half of FY23. 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.

Foreign exchange fluctuation risk and input price volatility risk

AIL imports diversified products such as copper, coal, battery, resins, gypsum and other chemicals compounds, etc. from various countries and distributes them in Nepal. AIL has to make payment to its foreign suppliers in USD and hedging for the same is not exercised which exposes AIL to the risk associated with the fluctuation in foreign currency exchange rate. The raw material cost stood at around 87% of the total operating income of the company during FY22. 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 the key rating sensitivities.

Key Rating Strengths

Experienced promoter in trading and manufacturing business

AIL is owned by institutional promoters i.e. Arihant Industrial & Commercial Investment Limited and Arihant Chemicals & Adhesive Private Limited jointly owning 45.99% of the total capital of AIL. Furthermore, the company is managed under the overall guidance of the Company's Board of Directors (BoD) who possesses wide experience in the related field. Mr. Girish Kumar Lunia, Managing Director, has been involved in different businesses from the last two decades and is supported by team of qualified and experienced professionals to run the day-to-day operations of AIL.

Diversified distribution network coupled with support from group associates with broadened yet interrelated scope of operations

AIL has its corporate office in Biratnagar and is operating via two branches located in Itahari and Birgunj. Furthermore, having association with group companies that are diversified yet interrelated has supported AIL to generate organic and trajectory growth in the overall trading sectors, deriving the benefits of cross selling of products. Being a part of Arihant Group has aided the company in reducing the company's risk by product diversification followed by lowering the cost of marketing and sales. AIL also derives the benefit of retained customers due to selling to its associated entities. With the involvement of promoters in similar line of business, AIL stands to leverage on the group's experience, networking and existing distribution channel.

About the Company

Arihant Infrastructure Limited (AIL) was incorporated on November 17, 2009 and started commercial operations during FY21. The company is involved in import and trading of coals, copper, battery, conductor, battery, Gypsum, resins, etc. The company has its corporate office in Biratnagar and is operating via two branches located in Itahari and Birgunj.

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

(Rs. in Million)

Particulars	FY21 (A)	FY22 (A)
Income from operations	895	844
PBILDT Margin (%)	3.87	9.19
Overall Gearing (times)	9.03	3.62
Interest coverage (times)	1.51	1.18
Current Ratio (times)	1.03	1.06
Total Debt to Gross Cash Accruals (times)	79.01	106.38

A: Audited

Annexure-1: Details of Facilities Rated

Name of the Instrument	Type of the Facility	Amount (Rs. Million)	Rating
Short Term Bank Facilities	Fund Based Limit	20.00	CARE-NP A4 [A Four]
Short Term Bank Facilities	Non-Fund Based Limit	870.00	CARE-NP A4 [A Four]
Total Facilities		**890.00**	

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