

Gorkha Department Store

Rating

Facility/Instrument	Amount (Rs. in Million)	Ratings ¹	Rating Action
Long Term Bank Facilities	99.67	CARE-NP B+ [B Plus]	Assigned
Short Term Bank Facilities	1,080.33	CARE-NP A4 [A Four]	Assigned
Total Facilities	1,180.00 (One Billion One Hundred and Eighty Million Only)		

Details of Facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has assigned rating of 'CARE-NP B+' to the long term bank facilities and 'CARE-NP A4' to the short term bank facilities of Gorkha Department Store (GDS).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of GDS are constrained by its weak financial risk profile indicated by its fluctuating scale of operations in the recent years with subdued gross profitability in FY22 (Unaudited, FY refers to the twelve-month period ended mid-July), leveraged capital structure and modest debt service coverage indicators. The ratings also factor in highly elongated operating cycle and working capital intensive nature of operations, proprietorship nature of constitution, fragmented nature of retail chain industry with competition of small and large players, and exposure to volatile interest rates. The ratings, however, derive strength from GDS's established track record of operations and experienced promoters in the related field, locational advantage along with established brand and stable demand outlook of retail trade segment over the medium term.

Going forward, the ability of GDS to profitably scale up its operations, and rationalize its working capital requirements leading to improved coverage and solvency indicators would be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Weak financial risk profile marked by fluctuating scale of operations and declining profitability

Over FY18 (Audited) - FY22, GDS's scale of operations was fluctuating, reflected by growth in FY19 (Audited) and decline in two consecutive years thereafter (FY20 and FY21; Audited). The decline was on account of the store's sales impacted by multiple waves of covid-19 coupled with government-imposed lockdowns which led to decline in demand, especially relating to non-essential items. Although total income from operations grew by 90.73% in FY22 to Rs. 1,133 Mn amidst gradual revival of economic activities, the improvement was at the expense of significantly lower gross profit margin as compared to historical levels. PBILDT margin of the store in FY22 was only 9.48% (FY21: 24.56%), lowest since FY18. The ability of GDS to manage growth in the operations while improving its profit margins remains critical in terms of credit perspective.

GDS's capital structure was leveraged, with debt-equity ratio and overall gearing ratio at 0.25x and 2.54x respectively as on mid-July 2022, improved from 16.34x and 54.84x respectively as on mid-July 2021. In FY22, there was a significant amount of fund injection by the proprietor, thereby lowering its gearing levels. GDS's interest coverage ratio, which was already on a declining trend for the past four financial years, stood modest at 1.20x in FY22. Total debt/GCA of the store had been historically on the higher side and stood at 49.09x at the end of FY21. Although the same improved to 11.85x at the end of FY22, it was aided by substantial amount of non-operational income which contributed to the firm's gross cash accruals. The

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

firm's ability to manage its debt requirements to support growth in operations while improving its capital structure is also critical from credit perspective and will be a key monitorable.

Highly elongated operating cycle and working capital intensive nature of operations

The operations of GDS are working capital intensive in nature due to its elongated operating cycle, owing to its substantially high inventory holding period. Average inventory days of GDS was remarkably high at 679 days in FY22, albeit improved from 1,366 days in FY21. Disruption in the store's operations due to multiple lockdowns in FY20 and FY21 had led to accumulation of inventory. The firm also receives credit from its suppliers, which however, was not enough to offset the substantially long inventory holding period, thus leading to high reliance on bank finance for its working capital needs. The firm has almost full utilization of its sanctioned fund based working capital borrowings for the last twelve months ended mid-January 2023. The ability of GDS to efficiently manage working capital requirements leading to lesser dependence on external borrowings would be critical from credit perspective.

Proprietorship nature of constitution

GDS, being a sole proprietorship, is exposed to inherent risk of the proprietor's funds/capital being withdrawn at time of personal contingency and firm being dissolved upon the death/retirement/insolvency of the proprietor which may affect financial flexibility of the firm. Moreover, being a proprietorship business, GDS has restricted avenues to raise capital which could prove a hindrance to its growth.

Fragmented industry with competition from small and large players

The retail segment of Nepal is characterized by its high degree of fragmentation, dominated by the unorganized retail (mom-and-pop stores and local 'kirana' stores). GDS needs to compete with large number of small and medium-size players as well as other emerging large players as number of departmental stores and supermarkets dealing with similar range of product portfolio is on the up. Increasing presence of various small and large players results in intense competition within the industry. High fragmentation and intense competition could lead to price wars and discounts resulting in pressure on margins, which was also evident in the financial performance of GDS in FY22.

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 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 firm, squeezing its profitability and impacting its liquidity position. Therefore, funding taken by the firm from BFIs is subject to volatile interest rate.

Key Rating Strengths

Established track record of operations and experienced promoters in the related field

GDS started its business operations in 1999 from an outlet in Itahari, Sunsari as one of the first department stores in the region. The firm is solely owned by Mrs. Anju Acharya Khatri, Sole Proprietor, and is managed under the guidance of Mr.

Balram Acharya Khatri, Managing Director. Mr. Khatri has an experience of over twenty years in trading sector and is also involved as a promoter in various businesses from different sectors such as hospitality, agro processing, trading, etc.

Locational advantage along with established brand

Over the years, GDS has expanded to four stores in four different cities – Itahari, Damak, Pathari and Biratchowk, spread at the distances of 12-15 km. The cities are among the most populous and fast-growing cities in Eastern Nepal and are also located in close proximities to major custom points across the Indian border. Being one of the first supermarket stores in Eastern Nepal, Gorkha Department Store has established itself as a well-recognized brand in the region, which gives it a competitive advantage against newer players of comparable sizes.

About the firm

Gorkha Department Store (GDS) is a sole proprietorship firm incorporated on October 5, 1999 for retail trading of a variety of household consumption goods under one roof. With the firm's registered office located in Itahari, Sunsari, GDS has been in operation for more than 22 years. It has four outlets in four of the major towns of Eastern Nepal.

Brief financials of the firm for the past three financial years ended mid-July, 2022 is shown as follows:

For the year ended Mid-July	FY20 (Audited)	FY21 (Audited)	FY22 (Unaudited)
Income from Operations	922	594	1,133
PBILDT Margin (%)	13.55	24.56	9.48
Overall Gearing (times)	49.02	54.84	2.54
Interest Coverage (times)	1.35	1.23	1.20
Current Ratio (times)	1.08	1.02	1.14
Total Debt/Gross Cash Accruals (times)	34.17	49.09	11.85

Annexure 1: Details of the Facilities rated

Nature of the Facility	Type of the Facility	Amount (Rs. in Million)	Rating
Long Term Bank Facilities	Fixed Term Loan	99.67	CARE-NP B+
Short Term Bank Facilities	Fund Based Limit	1000.33	CARE-NP A4
Short Term Bank Facilities	Non-Fund Based Limit	80.00	CARE-NP A4
Total		1,180.00	

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