Shikhar Organization Limited

Ratings

Facilities/Instrument	Amount (Rs. in Million)	Ratings[1]	Rating Action
Long Term Bank Facilities	420.00	CARE-NP BB- [Double B Minus]	Assigned
Short Term Bank Facilities	580.00	CARE-NP A4 [A Four]	Assigned
Total Facilities	1,000.00 (One Thousand Million Only)		
Issuer Rating	NA	CARE-NP BB-(Is) [Double B Minus (Issuer Rating)]	Assigned

** The issuer rating is subject to overall gearing ratio not exceeding 3.50x at the end of FY23*

*******Details of Facilities in Annexure 1*

CARE Ratings Nepal Limited (CRNL) has assigned Issuer rating of 'CARE-NP BB- (Is)' to Shikhar Organization Limited (SOL). Issuers with this rating are considered to offer moderate risk of default regarding timely servicing of financial obligations in Nepal. Also, CRNL has assigned rating of 'CARE-NP BB-' to the long term bank facilities and 'CARE-NP A4' to the short term bank facilities of SOL.

Detailed Rationale & Key Rating Drivers

The ratings assigned to SOL and its bank facilities are constrained by its leveraged capital structure with modest debt service coverage indicators majorly owing to working capital intensive nature of business leading to reliance on bank borrowings to meet working capital requirements. The ratings also factor in susceptibility to price fluctuation of seasonal agro products, fragmented and competitive nature of industry, and exposure to volatile interest rates.

The ratings, however, derive strengths from SOL's experienced promoters and management team in manufacturing and trading business, growing scale of operations and moderate profitability margins. The ratings also factor in stable demand outlook of agro industry over the medium term and established marketing and distribution setup with own brand and locational advantage.

Going forward, the ability of the company to profitably scale up its operations while managing its working capital requirements to support the growth in operations leading to an improved capital structure and coverage indicators would be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Leveraged capital structure with modest debt service coverage indicators

The capital structure of the company stood leveraged at the end of FY22 (Unaudited; FY refers to the twelve-month period ending mid-July) with debt to equity ratio of 2.26x (FY21:1.57x) and overall gearing ratio of 3.13x (FY21:2.10x). The deterioration in the gearing ratio at the end of FY22 was on account of increased term loan and working capital borrowings amid growing scale of operations. The interest coverage ratio of the company was modest at 1.18x during FY22, declined from 1.40x during FY21 on account of increased interest outgo during the year amid increased debt levels despite increased PBILDT generation. Similarly, total debt/GCA of the company stood very high at 66.56x at the end of FY22 which increased from 46.21x amid increased debt levels. As majority of the capex has already been completed and further funding for

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

company's need shall be obtained from additional equity through initial public offering (IPO), requirement for additional term debt is likely to remain low over the medium term. However, improvement in credit profile of the company would hinge on its ability to ramp of its scale as envisaged.

Working capital intensive nature of business leading to reliance on bank borrowings

The operations of the company are working capital intensive in nature. SOL is involved in processing of lentils and processing of paddy into rice by procuring raw materials both locally and via import. Due to seasonal nature of raw materials, SOL regularly needs to maintain inventory for at least three to four months for smooth operations. During FY22, average inventory holding was around 131 days. In addition, the company also needs to extend credit to its customers, which leads to reliance on working capital limits. Collection period remains high at 138 days on account of collection challenge from the customer amid ongoing liquidity crisis. The total operating cycle remains high around 196 days during FY22; however, shortened from 222 days during FY21 (Audited). The overall high working capital requirements are met largely through bank borrowings which normally results in average utilization of over 90% of its sanctioned working capital limits. The ability of SOL to efficiently manage working capital requirements leading to lesser dependence on borrowings would be critical from credit perspective.

Susceptibility to price fluctuation of seasonal products

SOL is engaged in processing of different agro products as wheat, rice, lentils and other agro. All these products are agro products, production is generally dependent on timing and intensity of the monsoon. Prices are highly volatile in nature, as their production and prices depend upon various factors like area under production, yield for the year, demand-supply scenario and inventory carry forward of last year. Furthermore, the supply is also dependent upon availability of seed, impacts of pests, as well as overall climatic condition during the year, exposing the fate of the company's operations to vagaries of nature.

Fragmented and competitive nature of industry

Import and processing of agro products is highly fragmented due to presence of several organized/ unorganized players owing to low entry barrier and low technology and capital requirement. Considering the fragmented and competitive nature of industry, small and medium sized traders have low pricing power over its products in the market. The pricing is mainly market driven and any such market price lower than the cost of procurement of product to SOL will hit the profitability of the company.

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.

Key Rating Strengths

Established track record of operations with experienced promoters

SOL derives strength from its promoter group belonging to Shikhar Organization which has established presence in manufacturing and trading of Fast-Moving Consumer Goods (FMCG) products in Nepal. The group has presence in diversified businesses and is involved in trading/manufacturing products such as food, agro machinery, water pumps, sweets & and other FMCG products. The company is managed under the overall guidance of the company's board of directors (BOD) who possess wide industry experience. The company has seven members in its board, chaired by Mr. Kedarnath Sharma, who has experience of over 27 years in manufacturing and trading business. He is also chairman at Natraj Agro Private Limited (CARE-NP BB) and Garden Mart Private Limited (CARE-NP BB-). Similarly, other directors of the company also have work experience in various business sectors. The company management team is led by Mr. Puskar Malla, who has more than 15 years of experience in related sectors. The BOD are further supported by a team of experienced management team members.

Growing scale of operations with moderate profitability

SOL generates its revenue from sale of variety of agro food products namely wheat, rice, lentils and byproducts of rice with its brand name Upakar. The total income of the SOL increased at a CAGR of 68.24% during the four-year period from FY19 to FY22. During FY22, Total Operating Income (TOI) of the company increased by 50% to Rs. 711 Mn from Rs. 475 Mn during FY21. This increase is mainly attributable to increase in quantity sales coupled with diversified sales of agro products which previously was focused on sales of single product (lentils). PBILDT margin of the company improved to 11.47% in FY22 from 8.33% in FY21 due to improvement in product mix coupled with increase scale. However, due to high interest outgo and depreciation base, PAT margin stood modest at 0.84% in FY22 (FY21: 0.93 %).

Established marketing setup with own brand and locational advantage

SOL sells its products all over Nepal and has a customer base spread across all major cities in the country. The company sells its products under the brand name 'Upakar' which is an established brand name in Nepalese market, also a well-known name for other products of Shikhar Organization for over a decade. SOL has a customer base of whole-sellers and retailers spread across all major cities in the country which provides a ready market for its products. The company also makes direct selling to department stores. These sales are made through direct marketing to existing as well as new customers. SOL imports majorly from Canada and Myanmar for the purchase of lentils. For wheat and rice the purchase are majorly done from the local suppliers. The company also import from India if required. The offices and godowns are located in Bauniya.

Stable demand outlook of agro industry over medium term

Rice and lentils are a preferred staple food for majority of Nepalese. Rice ranks first among all the cereal crops in terms of acreage area, production and consumption. Furthermore, with demand higher than domestic production and slowdown in domestic agriculture production, large volume of rice and lentils is being imported in Nepal. With growing population, its consumption is also expected to increase, thereby leading to a stable demand outlook over the medium-long term.

About the Company

SOL is a public limited company incorporated on August 31, 2017 for the processing of lentils, rice, wheat and other agro products. Initially, the company was operating as private limited company under the name Shikhar Organization Private Limited. The agro foods product are sold in the market under the brand name Upakar.

Brief financial performance of SOL during last 3 years is given below:

(Rs. In Million)

Particulars	FY20 (A)	FY21 (A)	FY22(UA)
Income from Operations	429	475	711
PBILDT Margin (%)	5.47	8.33	11.71
Overall Gearing (times)	0.81	2.10	3.13
Interest coverage (times)	1.98	1.40	1.22
Current Ratio (times)	2.02	1.90	1.38
Total Debt/Gross Cash Accruals (times)	11.96	46.21	56.62

A: Audited, UA: Unaudited

Annexure 1: Details of the Facilities Rated

Nature of the Facility	Type of the Facility	Amount (Rs. in Million)	Rating
Long Term Bank Facilities	Term Loan	420.00	CARE-NP BB- [Double B Minus]
Short Term Bank Facilities	Fund Based Limit	550.00	CARE-NP A4 [A Four]
Short Term Bank Facilities	Non-Fund Based Limit	30.00	CARE-NP A4 [A Four]
Total		**1,000.00**	

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About CARE Ratings:

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