Narayani Oil Refinery Udhyog Private Limited

Rating

Facilities/Instrument	Amount (Rs. in Million)	Rating[1]	Rating Action
Short Term Bank Facilities	**5,174.00 (decreased from 5,210.00)**	**CARE-NP A3 [A Three]**	**Reaffirmed**
Total Facilities	**5,174.00 (Five Thousand One Hundred Seventy Four Million Only)**		

** Details of Facilities in Annexure 1*

CARE Ratings Nepal Limited (CRNL) has reaffirmed the rating of 'CARE-NP A3' assigned to the short term bank facilities of Narayani Oil Refinery Udhyog Private Limited (NOPL).

Detailed Rationale & Key Rating Drivers

The reaffirmation of the rating assigned to the bank facilities of NOPL continues to take comfort in the satisfactory financial risk profile of the company characterized by its minimally leveraged capital structure with sufficient gearing headroom coupled with adequate coverage indicators at the end of FY22 (Audited; FY refers to the twelve-month period ending mid-July), albeit some moderation is expected in FY23 amid a challenging operating environment currently for Nepalese refiners due to unfavorable export outlook to India over the near-term. The rating continues to derive strength from NOPL's long track record of operations along with experienced promoters and management team, its established distribution network for exports as well as domestic sales, locational advantage of NOPL's manufacturing facilities, and a stable demand prospects for edible oils over the medium term, which however is offset to some extent by the volatility in export opportunities for Nepalese refiners.

The rating remains constrained by NOPL's working capital intensive nature of business and reliance on exports to India for significant portion of its income which in turn is dependent on tariff arbitrage between direct import of crude edible oil in India vis-à-vis import of refined oils from Nepal exposing NOPL to changes in tariff regimes by Government of India (GoI) for imports of various edible oils/crude. The rating continues to factor in susceptibility of NOPL's business to price fluctuation of seasonal agro products, foreign exchange fluctuation risk, and regulatory risk. The rating also takes cognizance of the declining trend in NOPL's Total Operating Income (TOI) in H1FY23 (Unaudited; H1 refers to six-months period ending mid-January) owing to substantially lower export sales which is expected to adversely impact the financial performance of the company over the near-term and the company's business and financial risk profile will continue to expose to unfavourable change in government policies of the importing country.

Going forward, the ability of the company to manage growth in the operations by increased penetration in the domestic market leading to lesser dependency in the volatile exports business while maintaining profit margins will be the key rating sensitivities. Also, prolonged unfavorable change in the regulatory framework pertaining to trade regulations and tariff differentials with India adversely impacting exports prospects for substantially longer periods leading to a material decline in operating profile of the company on a sustained basis will also be a key rating sensitivity. Additionally, any substantial dividend outflow leading to material deterioration in capital structure and/or liquidity profile of the company will also remain rating sensitivity.

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

Detailed Description of the Key Rating Drivers

Key Rating Strengths

Established track record of operations along with experienced promoters and management team

NOPL has been into processing and marketing of edible oil for more than three decades and has developed an established market for itself in domestic as well as export markets through its long-standing presence in this sector. NOPL is part of Chachan family group which is one of the established business groups in Nepal. The group is involved in various businesses including cement manufacturing, edible oil refinery and trading of fertilizers. The company is managed under the overall guidance of its six-member Board of Directors (BoD) which includes experienced businessmen/industrialists with wide experience in the food processing business. Day to day operations of the company is handled by Mr. Nikhil Chachan, who has been a director in the company since last seven years. The BOD is supported by a team of experience professionals across various functions.

Locational advantage for both imports and exports

The plant site is located in Bara District, Nepal around 4 kms from Birgunj dry port. Since most of the raw materials requirements of NOPL are imported from various countries are unloaded on Indian ports, the factory's proximity to the border remains a competitive advantage leading to savings in freight cost. Furthermore, NOPL also exports its products to India which accounted for 49% of total revenue in FY22. The factory's proximity to Indian border remains a positive point with regards to freight cost saving in export of goods.

Established distribution network

NOPL sells its products through whole sellers throughout Nepal. The company has sales depot in Itahari and Pokhara whereas main selling activities are done through the Birgunj office. Export to India is majorly in the north-Eastern part of the country in West Bengal, Bihar, Uttar Pradesh, Rajastan and Delhi etc.

Satisfactory financial risk profile, albeit decline expected in FY23 amid challenging operating environment

NOPL generates its revenue from sale of refined sunflower, palmolein, soyabean and fatty acid oil domestically as well as through exports to India. During FY22, the company booked total operating income (TOI) of Rs. 10,948 Mn (FY21: Rs. 10,659 Mn). TOI during FY22 stood at similar range compared to FY21 majorly on account of reduction in import duty on crude edible oil for Indian refiners by GoI during H2FY22 limiting scope for incremental export sales to India for Nepalese refiners like NOPL since the second half of FY22. PBILDT margin of the company declined to 7.33% during FY22 from 14.81% during FY21 on account of increased input prices in international markets relative inability to pass through the increased input prices amid declined sales prospects mainly in H2FY22 coupled with intensified competition. Consequently, PAT margin also declined to 5.28% during FY22 from 13.19% during FY21.

Although year-on-year decline in profitability margins led to slightly moderated debt service coverage indicators of the company in FY22 compared to FY21, the coverage indicators still remained at comfortable levels. Overall gearing ratio of the company stood at 0.78x at the end of FY22 which improved from 2.38x at the end of FY21 on account of decrease in working capital loans to Rs. 1,552 Mn at the end of FY22 from Rs. 4,323 Mn at the end of FY21 coupled with increased net worth of the company. Interest coverage ratio of the company stood comfortable at 5.53x in FY22, although moderated from 23.42x in FY21 due to decline in PBILDT coupled with higher interest outgo. However, as a result of decline in working capital loans at the end of FY22, total debt/GCA stood low at 2.49x during FY22 (FY21: 2.96x).

Furthermore, during H1FY23, NOPL has achieved sales of Rs. 3,900 Mn out of which the export sales accounted for only 18% of the total sales compared to 55% during H1FY22. NOPL's exports to India continues to be impacted by reduced scope for arbitrage following the introduction of duty free import scheme for soybean and sunflower crude by GoI in May 24, 2022 followed by lowering of import duty on import of palmolein to 5% from 7.5% in February 13, 2022 to help curb exorbitantly high oil prices in India. Until a positive revision in the import duty by GoI, exports prospects for NOPL remain slim and its TOI for FY23 could be limited to around Rs. 8,000 Mn. Profitability is also likely to remain sluggish over the near term owing lower scale of operations, although likely to be offset to some extent by comparatively softer input prices in FY23. Furthermore, the overall financial risk profile of the company is expected to remain relatively stable with gearing levels and interest coverage remaining range bound, albeit likely with further moderation by FY23 end. However, any further negative deviation in the financial risk profile resulting from a prolonged decline in operating performance beyond FY23 will be critical from credit perspective and will remain a key monitorable aspect.

Essential part of cooking leading to stable demand in domestic market

The demand prospect of edible oil industry in Nepal is growing as oil is one of essential commodity for cooking. Further, with demand being higher than domestic production and slowdown in domestic agriculture production, large volume of edible as well as crude oil is being imported in Nepal giving importers like NOPL a favorable business environment. Despite decline in export sales, comfort is taken from the decent scale of NOPL's domestic business although a near-term decline in profitability exacerbated by intense competition, the company's credit risk profile is expected to remain resilient enough to ride out the near term dip in scale of operations and profitability.

Key Rating Weaknesses

Working capital intensive nature of business

The operations of the company are working capital intensive in nature. NOPL is involved in processing of various crude edible oils into refined oils fit for human consumption. These crude oils are imported from Australia, Canada, India, Argentina, Brazil, Ukraine, Malaysia and Indonesia which are procured through Letter of Credit. NOPL has to keep enough inventory for smooth operations owing to long lead times and extend reasonable credit to its customers amid increased competition, which results in an elongated operating cycle and leads to reliance on borrowings to fund working capital requirements. The company generally allows up to two months credit period to its customers; average collection period days was 50 days during FY22 (FY21:50 days). Furthermore, the company keeps inventory for around one month and the inventory turnover was 35 days for FY22 (FY21:29 days). With relatively low creditor days of around 5 days in FY22, the total operating cycle of the company was elongated at 81 days in FY22 which slightly elongated from 72 days in FY21. The working capital requirements were met through bank borrowings which normally results in moderate average utilization of around 70% of its sanctioned working capital limits. The ability of NOPL to efficiently manage working capital requirements leading to lesser dependence on borrowings particularly amid a declining scale of operations will be a key monitorable from analytical perspective, as a further stretched operating cycle could add to the financial burden of the company. Hence, timely realization of debtors leading to a stable operating cycle will be critical from credit perspective.

Raw material price volatility risk and foreign exchange fluctuation risk

The company is exposed to inherent risk related to volatility in the exchange rate on timing difference and different currencies between receipt of export remittance and crystallization of import liabilities. Crude soyabean, palmolein, sunflower oil and crude palm oil are the major raw materials for NOPL which are imported from various countries. The prices of the NOPL's raw materials are linked to market forces and determined on a periodic basis, thus exposing the company to the volatility in the prices of raw materials which has a bearing on its profitability margins. The raw material cost contributed around 91% of the total operating income of the company during FY22. Furthermore, the total raw material requirement is met through imports and the prices of the same are linked to USD, for which the company is exposed to the foreign exchange fluctuation risk which company doesn't hedge. NOPL incurred foreign exchange loss of Rs. 94 Mn during FY22 as compared to gain of Rs. 30 Mn during FY21. 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 crucial from its profitability perspective.

Exposure to regulatory risk

The operations of NOPL is vulnerable to regulatory risk arising from various laws and policies of the importing and exporting countries coupled with the domestic policies of Nepal. NOPL's exports revenue (~49% of total sales in FY22), relies on the tariff arbitrage in India between direct imports of crude by Indian millers vis-à-vis imports of refined edible oil from Nepal. NOPL, like many millers in Nepal, tries to exploit the tariff differential, which keep changing for different edible oils every year as per the policies of the GoI. Furthermore, over the past few years, there have been several changes in government policies, either domestic or international regarding import/export of edible crude sometimes limiting and at other times enhancing refiners like NOPL's ability to export to India. NOPL's revenue profile is thus susceptible to regulatory policies relating to tariff barriers (differential trade tariffs among South Asian Free Trade Area), non-tariffs barriers (restriction on the quality of imports), international freight rates etc. Any sustained unfavorable change in policies by local governments impacting exports of refined oils or procurement of crude could have a bearing on the financial profiles of the refiners like NOPL.

Competitive nature of industry

Import and processing/refining of edible oils is highly fragmented due to presence of several organized/ unorganized players owing to low entry barrier and low technology and capital requirement. Low product differentiation of NOPL's product results in high competition from other players including traders. Considering the competitive nature of industry, the millers have low pricing power. Agro products are also seasonal in nature with production dependent on various factors such as monsoon and climatic condition, exposing the fate of the company's operation to vagaries of nature.

Exposure to volatile interest rate risk

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.

Industry Outlook

Amid change in duty structure (lower/zero import duty) by Government of India (GoI) on imports of various crude edible oils, Nepalese refiners' income levels in FY23 are expected to drop substantially compared to the high growths reported over FY21-FY22 which was supported by surging exports to India of palmolein and soybean oil. Nepal's exports of edible oil to India has declined substantially compared to previous years. According to Department of Customs and the Trade and Export Promotion Center (TEPC), exports of edible oils to India from Nepal have declined by 69% year-on-year (y-o-y) in H1FY23. Hence, refiners like NOPL are likely to remain impacted over the near term as export opportunities to India remain slim. However, refiners with a decent domestic presence are expected to fare better than the majorly export oriented player. NOPL's domestic sales of over Rs. 5,000 Mn sales annually is likely to support the earning profile of the company to some extent in the interim. Moreover, export opportunities to India are likely to resume sometime in the near future given the

GoI, as in the past, looks to support local farmers who have relatively higher cost of production, with higher duty on import of crude edible oil.

Furthermore, upward revision in import duty of crude edible oils in India is more likely now that the edible oil prices have fallen back to a more manageable level compared to the substantial upswing in prices observed in the second half of FY22 amid supply-side constraints coupled with rising inflation, which was among the major reasons for the change in import duty regime in India by GoI. Although, upward revision in import duty of various crude edible oils in India, when that happens, is likely to again open opportunities for Nepalese refiners, this remains contingent upon the intermittent changes in related policies of GoI, resulting in a volatile income levels for refiners like NOPL going forward as well.

About the Company

Narayani Oil Refinery Udhyog Private Limited (NOPL) is a private limited company incorporated on September 20, 1989 for processing/refining of edible oils, having plant in Lipanimal, Bara District, Nepal. The company has been in operations for over three decades. Currently, the total installed capacity for refined soyabean, palmolein, vegetable oil, mustard oil, sunflower oil and palm oil is 117,000 MTPA. NOPL sells these edible oils under the brand names of "Trishakti", "Smile", "Aarogya", "Shree" "Neelmani", "Kundan" and "Nilkamal" in the domestic market.

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

(Rs. In Million)

Particulars	FY20 (A)	FY21 (A)	FY22 (A)
Income from Operations	8,169	10,659	10,948
PBILDT Margin (%)	13.30	14.81	7.33
Overall Gearing (times)	3.04	2.38	0.78
Interest coverage (times)	13.60	23.42	5.53
Current Ratio(times)	1.17	1.30	1.83
Total Debt/Gross Cash Accruals(times)	3.20	2.96	2.49

A: Audited

Annexure 1: Details of the Facilities Rated

Nature of the Facility	Type of the Facility	Amount (Rs. in Million)	Rating
Short Term Bank Facilities	Fund Based/Non-Fund Based	5,174.00	CARE-NP A3 [A Three]
Total		**5,174.00**	

Contact us

Analyst Contact
Ms. Anusha Thapa
+977-01-4012630
anusha.thapa@careratingsnepal.com

Mr. Santosh Pudasaini
+977-01-4012628
pudasaini.santosh@careratingsnepal.com

Relationship Contact
Name: Achin Nirwani
+977 9818832909
achin.nirwani@careratingsnepal.com

About CARE Ratings:

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