Baba Enterprises Private Limited

Rating

Facilities/Instrument	Amount (Rs. in Million)	Rating[1]	Rating Action
Short Term Bank Facilities	**565.00**	**CARE-NP A4 [A Four]**	**Assigned**
Total Facilities	**565.00 (Five Hundred Sixty-Five Million Only)**		

** Details of Facilities in Annexure 1*

CARE Ratings Nepal Limited (CRNL) has assigned rating of 'CARE-NP A4 [A Four]' to the short term bank facilities of Baba Enterprises Private Limited (BEPL).

Detailed Rationale & Key Rating Drivers

The rating assigned to the bank facilities of BEPL is constrained by its highly leveraged capital structure with modest debt service coverage indicators, working capital intensive nature of business leading to elongated operating cycle resulting in increased reliance on bank borrowings to meet working capital requirements and exposure to interest rate risk. The rating also factors in exposure to price volatility risk and foreign exchange fluctuation risk, fragmented and competitive nature of industry, and inherent risk associated with trading business.

The rating, however, derives strength from experienced promoter in trading business, improving financial performance of the company in FY22 (Audited; FY refers to the twelve-month period ending mid-July) marked by growth in sales and profitability, and stable demand outlook of textile industry over the medium term.

Going forward, the ability of the company to profitably scale up its operations, manage its working capital requirements to support the growth in operations while improving its capital structure would be the key rating sensitivities

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Highly leveraged capital structure with modest debt service coverage indicators

The company reported substantially high gearing ratio of 4.90x at the end of FY22, although improved from 6.65x at the end of FY21 on account of increase in tangible networth supported by infusion of equity (Rs. 30 Mn in FY22) coupled with accretion of profits. The debt levels of the company, however, continues to stay relatively high owing to high working capital requirements and the working capital borrowings increased to Rs. 474 Mn at the end of FY22 from Rs. 382 Mn over previous balance sheet date to support the growing operations. Consequently, interest coverage ratio of the company stood modest at 1.45x during FY22, slightly declining from 1.57x during FY21, with higher PBILDT during FY22 offset by increased interest expenses. Furthermore, Total Debt/ Gross Cash Accruals (GCA) stood high at around 40 times in FY22 although improved from 49.03x in FY21 on account of improved GCA. Nevertheless, the company's capital structure remained highly leveraged with minimal gearing headroom at the end of FY22.

Working capital intensive nature of business leading to elongated operating cycle

The operations of BEPL are working capital intensive in nature as the company is involved in trading of different types of textile rolls, which are majorly imported from various countries. The company needs to procure raw materials through letter of credit and also needs to fund inventory and debtors which lead to high reliance on working capital limits. The procurement

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

of material normally requires lead time of around two months leading to inventory days of around 69 days during FY22. Furthermore, on account of competitive nature of industry, the company generally allows around 90 days of credit period to its customers. Average collection period, however, stood high at 116 days in FY22 on account of liquidity crisis resulting in collection issues from some customers. Creditors period stood at around 7 days in FY22 (FY21: 7 days). Consequently, operating cycle stood high at 178 days in FY22. The resultant high working capital requirements are met largely through bank borrowings which normally results in average utilization of around 80% of its sanctioned working capital limits. Furthermore, sustained requirement for short-term working capital borrowings leads to a relatively high interest expense for BEPL, adversely impacting its net profitability. Hence, any significant rate hikes could put increased interest burden on the company, squeezing its profitability and impacting its liquidity position. The ability of BEPL to efficiently manage working capital requirements leading to lesser dependence on borrowings would be critical from credit perspective.

Exposure to price volatility risk and foreign exchange fluctuation risk

BEPL imported around 98% of the items it traded from China, Korea, Taiwan, Bangladesh and India during FY22. Any sharp adverse movement in price without any corresponding movement in the traded goods' price is expected to affect the profitability of the company, especially in light of its high inventory holding period. The ability of the company to pass through changes in prices of the traded products and managing the foreign exchange fluctuation risks related to imports of traded items will have a direct bearing on its profitability.

Presence in highly fragmented and competitive nature of industry

The company is in import/ trading of garment products from various countries and sells in domestic market. BEPH operates in intensely competitive and fragmented marked by the presence of numerous big and small players in the unorganized segment. As a result, the company has to compete in terms of price to capture the limited market of importing similar products from foreign countries and selling domestically. Furthermore, in order to push sales to sustain the competition credit sales in the market has substantially increased leading to increased debtor days and high working capital requirement for companies.

Inherent risk associated with the trading business

The company is exposed to the risks associated with the trading nature of business like inherently low profitability margins, availability of the traded commodity in desired quantity and quality etc. Though the company has been getting regular orders and also has an established business relationship with its customers, the company does not have any long-term sourcing and supply contracts with its suppliers and clients, respectively. The company is also exposed to the competition in textile trading business due to low entry barriers.

Key Rating Strengths

Experienced promoter in trading business

BEPL derives strength from its strong promoter having an experience of around three decades in textile business. BEPL is managed under the overall guidance of Mr. Navin Khetan, Chairman, who has been involved in textile business since its inception in 1994. Furthermore, the board is supported by the experienced management team.

Improving financial performance in FY22 marked by growth in sales and profitability

BEPL generates its revenue from sale of different types of textile products. During FY22, the total operating income (TOI) of the company increased by ~37% over FY21 to Rs. 1,053 Mn. The increase in revenue is attributable to increased demand from the domestic manufacturers of garment products post pandemic. Being a trading business, margins generally remain thin. PBILDT margin improved to 5.28% during FY22 from 4.33% during FY21, supported by growing scale. The company achieved net profit of Rs. 11 Mn during FY22 compared to Rs. 8 Mn during FY21. The relatively lower accretion of net profits in FY22 was on account of higher interest. Furthermore, the growth in income has sustained so far in FY23 with the company booking total sales of Rs. 760 Mn during 8MFY23 (Unaudited; refers to the eight-month period ended mid-March 2023). Growing scale bodes well for company's business profile.

Stable demand outlook of textile industry over medium term

The ready-made garment manufacturing business in Nepal is increasing in high numbers over the past years after pandemic. There is a growing demand for locally-made, high-quality clothing that is fashionable and affordable in the market. Nepal's proximity to large garment markets like India and China also make it easy for the procurement of raw materials. Trades like BEPL could benefit from the increasing demand for locally manufactured garments in the country over the medium-term.

About the Company

BEPL is a private limited company incorporated on June 30, 1994 under the Companies Act, 2063 of Nepal. The company is involved in trading of different types of garments and textile products all over Nepal. The registered office of the company is located at Kathmandu, Nepal.

Financial Performance

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

(Rs. In Million)

For the Period	FY20 (A)	FY21 (A)	FY22 (A)
Income from Operations	337	766	1,053
PBILDT Margin (%)	5.96	4.33	5.28
Overall Gearing (times)	2.80	6.65	4.90
Interest Coverage (times)	1.43	1.57	1.45
Current Ratio (times)	1.55	1.33	1.32
Total Debt/Gross Cash Accruals(times)	37.11	49.03	39.34

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 Limits	420.00	CARE-NP A4 [A Four]
Short Term Bank Facilities	Non-Fund Based Limits	145.00	CARE-NP A4 [A Four]
Total		**565.00**	

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About CARE Ratings:
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Our parent company, CARE Ratings Limited commenced operations in April 1993 and over two decades, it has established itself as one of the leading credit rating agencies in India. CARE is registered with the Securities and Exchange Board of India (SEBI) and also recognized as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI).