

Arihant Auto Corrugation Private Limited

Ratings

Facilities/ Instrument	Amount (Rs. in Million)	Ratings ¹	Rating Action
Long Term Bank Facilities	401.75	CARE-NP BB+ [Double B Plus]	Assigned
Short Term Bank Facilities	1,030.00	CARE-NP A4+ [A Four Plus]	Assigned
Total Facilities	1,431.75 (One Thousand Four Hundred Thirty One Million and Seven Hundred Fifty Thousand Only)		

Details of instruments/facilities in Annexure-1

CARE Ratings Nepal Limited (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 Arihant Auto Corrugation Private Limited (AAC).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of AAC are constrained by its leveraged capital structure, working capital intensive nature of operations and project implementation risk associated with its majorly debt funded ongoing capex. The ratings also factor in AAC's exposure to raw material price volatility risk, foreign exchange fluctuation risk and exposure to volatile interest rate. The ratings, however, derive strength from AAC's established track record of operations along with experienced promoter and management team in the related field and growing scale of operations over the past three fiscals with reasonably stable profitability margins. The ratings also factor in AAC's moderate capital structure and debt service coverage indicators and favorable growth prospect of the industry over the medium term.

Going forward, the ability of the company to profitably scale up its operations on a sustainable basis and effective management of working capital will be the key rating sensitivities. Furthermore, timely completion of the planned capex within envisaged cost estimations and realization of envisaged benefits therefrom will also be key rating considerations.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Working capital intensive nature of operation

AAC's operations are working capital intensive in nature. The company is involved in manufacturing its products by procuring raw materials both locally and via import. Furthermore, AAC is required to maintain adequate inventory of materials to cater the immediate demands from some major clients and to ensure regular supply of raw material for uninterrupted manufacturing operations. Similarly, being in a competitive business, the company has to extend credit to its customers of around 3 months. Consequently, operating cycle of AAC was high at around 96 days in FY22 which marginally improved from 102 days in FY21. Due to high operating cycle, the average fund-based working capital utilization remained high at around 90% of sanctioned limits during last twelve-months ended mid-January 2023.

Leveraged capital structure and implementation risk associated with ongoing capex

AAC is setting up a manufacturing facility for manufacturing laminated woods. The capex is planned to be funded via debt and equity at the ratio of 70:30. The commercial operation is expected to start from the beginning of FY24. The company remains exposed to the risks associated with the ongoing project implementation and swift stabilization as envisaged thereafter.

AAC's overall gearing ratio stood at 2.34x at the end of FY22, which slightly improved from 2.81x at the end of FY21 mainly on account of increase in tangible networth due to accretion of net profit to the reserves. However, this was partially offset by

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

additional long-term debt availed to fund ongoing capex coupled with higher working capital loan utilization to cater the increasing scale of operations.

Raw material price volatility risk and foreign exchange fluctuation risk

The prices of the AAC's raw materials are dependent upon the bargaining power of the suppliers, 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 ~78% of the total cost of production during FY22, thus, any volatility in prices of the same impacts the profitability of the company. Furthermore, partial value of raw material requirement (majorly wooden pulps) required for the manufacturing process is met through imports via India, China, etc. and the prices of the same are linked to USD, thereby exposing the company to foreign exchange fluctuation risk. 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 volatile interest rate

AAC had a substantial interest outgo in FY22 owing to high working capital utilization to fund its high inventory holding. The company's interest rates are based on a floating interest rate regime, where a certain premium is added to quarterly base rate and interest rate is changed accordingly on quarterly basis. Base rate 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. Sustained high interest rates, as seen over the last year or so, add to the interest burden of the company, squeezing its profitability and impacting its liquidity position.

Key Rating Strengths

Established track record of operations along with experienced promoter and management team in the related field

AAC was established in 2010 and is owned by institutional promoters i.e., Arihant Import and Export Pvt. Ltd., Arihant Pack Industries Pvt. Ltd., Arihant Industrial & Commercial Investment Ltd. and Real Estate Developers Pvt. Ltd. jointly owing 17.26% of the total capital of AAC. 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. Paras 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 AAC.

Growing scale of operations with stable profitability margins with moderate debt service coverage indicators

AAC generates its revenue from sale of variety of papers used for packaging of products like Kraft paper, tissue paper, duplex paper, etc. Total operating income (TOI) of the company has been growing on year-on-year basis with CAGR (compounded annual growth rate) of 39% over the last 4 years (FY19-FY22). During FY22, AAC achieved TOI of Rs. 2,356 Mn, which increased from Rs. 1,729 Mn in FY21, on account of increased sales quantity majorly contributed by Kraft paper and Corrugated boxes supported by increasing customer base as well as improvement in average price realization. PBILDT margin remained largely steady at around 14% in FY22 compared to 12.96% during FY21 with PAT margin of 6.78% (FY21: 4.01%). Accordingly, AAC generated Gross Cash accruals (GCA) of Rs. 238 Mn in FY22 which improved from Rs. 138 Mn in FY21. Furthermore, the sales trend has sustained so far in FY23 with the company booking revenue of Rs. 1,182 Mn during H1FY23 (Unaudited; H1 refers to the six-month period ended mid-January).

AAC's interest coverage remained moderate at 3.53x during FY22 which improved from 2.88x during FY21 supported by increased PBILDT generation amid increasing scale of operation. Furthermore, total debt/GCA of the company improved to 5.27x during FY22 from 7.49x during FY21 with improvement in GCA to Rs. 238 Mn during FY22 from Rs. 138 Mn during FY21. The company's financial leverage could increase over the near-term owing to fresh draws of term loans for the ongoing capex.

Favorable growth prospect of the industry and diverse product range catering to wide spectrum of industries

The growing retail and e-commerce industries, along with the growing demand for environment-friendly packaging products, currently represent as the key factors driving the growth of the paper packaging industry including AAC. With the rapid increase in the number of online shopping platforms, the requirement for paper packaging products has escalated significantly. Furthermore, increasing consciousness among consumers regarding sustainable packaging and the increasing innovations among brands to enhance the efficiency of the product and to produce visually appealing variants are projected to drive the paper packaging market growth in the upcoming years. Furthermore, AAC sells variety of papers like duplex paper, Kraft paper, tissue paper and corrugated boxes to various reputed FMCG brands established in Nepalese market which provides leverage to the company catering well for the growth of the company.

About the Company

Arihant Auto Corrugation Private Limited (AAC) was incorporated on November 01, 2010 and is involved in manufacturing of various printed cardboard boxes, Kraft papers and Duplex Papers. Similarly, the company is also involved in manufacturing of Tissue paper Rolls under the brand name of "Pure". The manufacturing plant for all the product is located in Biratnagar -09, Morang, Nepal.

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

(Rs. in Million)

Particulars	FY20 (A)	FY21 (A)	FY22 (A)
Income from operations	1,021	1,729	2,356
PBILDT Margin (%)	15.41	12.96	14.76
Overall Gearing (times)	3.43	2.81	2.34
Interest coverage (times)	2.51	2.88	3.53
Current Ratio (times)	1.05	1.05	1.01
Total Debt to Gross Cash Accruals (times)	9.72	7.49	5.27

A: Audited

Annexure-1: Details of Facilities Rated

Name of the Instrument	Type of the Facility	Amount (Rs. Million)	Rating
Long Term Bank Facilities	Term Loan	401.75	CARE-NP BB+ [Double B Plus]
Short Term Bank Facilities	Fund Based Limit	665.00	CARE-NP A4+ [A Four Plus]
Short Term Bank Facilities	Non-Fund Based Limit	365.00	CARE-NP A4+ [A Four Plus]
Total Facilities		1,431.75	

Contact us

Analyst Contact

Ms. Sarina Khakurel

Contact No.: +977-01-4012628

Email: sarina.khakurel@careratingsnepal.com

Mr. Santosh Pudasaini

Contact No.: +977-01-4012630

Email: pudasaini.santosh@careratingsnepal.com

Relationship Contact

Mr. Achin Nirwani

Contact No.: +977 9818832909

Email: achin.nirwani@careratingsnepal.com

About CARE Ratings Nepal Limited:

CARE Ratings Nepal Limited (CRNL) is licensed by the Securities Board of Nepal w.e.f. November 16, 2017. CRNL is supported by CARE Ratings Limited through a technical services agreement to provide technical support in the areas such as rating systems and procedures, methodologies, etc. from CARE Ratings on an ongoing basis. The technical support shall ensure that CRNL has adequate resources to provide high quality credit opinions in Nepal.

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).

Disclaimer

CRNL's ratings are opinions on credit quality and are not recommendations to sanction, renew, disburse or recall the concerned bank facilities or to buy, sell or hold any security. CRNL has based its ratings on information obtained from sources believed by it to be accurate and reliable. CRNL does not, however, guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. Most entities whose bank facilities/instruments are rated by CRNL have paid a credit rating fee, based on the amount and type of bank facilities/instruments. In case of partnership/proprietary concerns, the rating assigned by CARE is, inter-alia, based on the capital deployed by the partners/proprietor and the financial strength of the firm at present. The rating may undergo change in case of withdrawal of capital or the unsecured loans brought in by the partners/proprietor in addition to the financial performance and other relevant factors. CARE is not responsible for any errors and states that it has no financial liability whatsoever to the users of CARE's rating.