

Dugar Spices & Food Products Private Limited

Ratings

Facilities/ Instrument	Amount (Rs. in Million)	Ratings ¹	Rating Action
Long Term Bank Facilities	505.88	CARE-NP BB [Double B]	Assigned
Short Term Bank Facilities	494.12	CARE-NP A4 [A Four]	Assigned
Total Facilities	1,000.00 (One Thousand Million 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 Dugar Spices & Food Products Private Limited (DSFP).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of DSFP are constrained by its highly leveraged capital structure with modest debt service coverage indicators, sustained dividend payouts, and elongated operating cycle. The ratings also factor in raw material price volatility risk and foreign exchange fluctuation risk, presence in fragmented and highly competitive nature of industry and exposure to volatile interest rate.

The ratings, however, derive strength from DSFP's established track record of operations along with experienced promoter and management team in the related field and its growing scale of operations, although net profitability remains minimal amid increasing finance cost. The ratings also factor in stable demand outlook of packaged snacks and spices over the medium term and diversified product portfolio and distribution network of the company with established brand presence.

Going forward, the ability of the company to manage growth in operations while maintaining the profit margins and rationalization of its debt through efficient working capital management would be the key rating sensitivities. Furthermore, deterioration in capitalization structure of the company through substantial outflow of dividend shall also remain a rating sensitivity.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Below average financial risk profile marked by highly leveraged capital structure with sustained dividend payouts and declining profitability in FY22

DSFP has made sustained dividend payouts over the years, leading to moderation in the net worth base. During FY20, FY21 and FY22, DSFP distributed dividend of Rs. 50 Mn, Rs. 16 Mn and Rs. 60 Mn, respectively. Consequently, DSFP's capital structure stood highly leveraged with overall gearing ratio of 7.46x at the end of FY22 (Audited; FY refers to the twelve-month period ending mid-July), which deteriorated from 5.90x at the end of FY21. Similarly, the company's total outside liabilities/ tangible net worth also stood high at 11.22x at the end of FY22. DSFP's PBILDT margin declined to 8.56% in FY22 from 10.95% in FY21 owing to increase in input prices, which the company was not able to fully pass through. Declined operating margin coupled with increased interest expense led to a lower PAT margin of 1.52% during FY22 compared to 3.25% in FY21. During H1FY23 (Unaudited, H1 refers to the six-month period ending mid-January), the revenue momentum has sustained with TOI of Rs. 1,183 Mn. Consequently, debt service indicators of the company were modest with interest coverage ratio of 1.96x and total debt/ gross cash accruals (GCA) of 12.81x in FY22 (PY: 2.72x, 8.98x).

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

Working capital intensive nature of operations leading to high reliance on bank borrowings

DSFP is involved in manufacturing fried snacks, namkeen, spices and pickles by procuring raw materials both locally and via import from India, Malaysia and Indonesia. The company needs to maintain adequate inventory for smooth operations and also extend reasonable credit to their customers, leading to reliance on bank borrowings to meet working capital requirements. DSFP generally allows around 15 to 45 days of credit period to its dealers for snacks products and around 30 to 60 days for spices. However, the same have been stretched amid ongoing liquidity crisis in the market, as a result of which average receivable days stood at around 61 days during FY22. Average inventory holding period was 104 days in FY22. The company generally needs to keep inventory for around 3-4 months for smooth operations. The procurement is normally backed by letter of credit majorly via usance with 45 to 90 days credit facility. Consequently, average payable period remained at around 61 days for FY22, leading to the net operating cycle high at around 103 days.

Raw material price volatility risk and foreign exchange fluctuation risk

Wheat flour, palm oil, palmolein, spices, packaging materials are the major raw materials for DSFP which are domestically purchased as well as imported from various countries. The prices of the DSFP's raw materials are market linked 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. Raw material cost contributed around 78% of the total operating income of the company during FY22 which increased from 75% during FY21. As apparent during FY21 and FY22, DSFP's overall profitability hugely depends on raw material prices and the company's ability to pass through the changes to the customers. While increase in raw material prices could be sudden and substantial, the company's ability to immediately pass through the changes could be limited, particularly in a competitive market. Hence, the company's overall profitability remains highly exposed to the volatility in input prices.

Presence in fragmented and highly competitive nature of industry

The snacks and spices industry is highly fragmented due to presence of several organized/ unorganized players owing to low entry barrier. Increasing demand for packaged snacks and spices has led to increased numbers of new players entering the market, while large established players are increasing their offerings to capture more market share resulting in an intensely competitive market. As observed over the years, threat from new players with more appealing products remains high in the market. Considering the fragmented and competitive nature of industry, DSFP has low pricing power.

Exposure to volatile interest rate

DSFP had Rs. 101 Mn as finance cost in FY22, which increased from Rs. 76 Mn in FY21, thus squeezing its net profitability. DSFP's interest expenses are based on 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. Thus, funding taken by the company is exposed to volatile interest rate.

Key Rating Strengths**Established track record of operations along with experienced promoters and management team in the related field**

DSFP was established in 1999 and has an established track record of more than two decades. The company is managed under the overall guidance of the company's board of directors (BOD) who possess wide industry experience. Mr. Motilal Dugar, Chairman, has over three decades of multi-sectoral experience and is supported by team of qualified and experienced professionals to run the day-to-day operations. Furthermore, DSFP is a part of Century Group which is involved in diversified businesses across manufacturing foods, condiments, confectioneries, fruit & vegetable sector, chemicals & polymers, rotogravure printing & packaging, merchandising, hospitality & service industries. Existing reputation and goodwill of the group also helps to create market for its product.

Diversified product portfolio with wide distribution network and established brand presence

The product portfolio of DSFP includes fried snacks, namkeen, spices and pickles catering to the demand of a diverse customer base. DSFP has also been manufacturing various varieties of snacks like moong dal, bhujija, furandana, cheese balls, etc. The company sells its products under different brand names among which the brand "Century" has become well-established among snacks manufactured in the Nepal. This provides competitive advantage to the company against new players entering the industry. Furthermore, DSFP has an established market presence via more than 300 dealers spread across the country and direct sales to hotels and restaurants. DSFP also exports its products to foreign countries which accounted for 1.22% of total income in FY22.

Growing scale of operations

DSFP's scale of operations has been increasing steadily over the last four years (FY19- FY22) with its Total operating income (TOI) growing at a Compounded Annual Growth Rate (CAGR) of 24.31% to Rs. 2,303 Mn in FY22. This sustained increase in TOI is mainly attributable to sustained growth in market share of its existing products coupled with expansion of product portfolio. Total revenue is mainly contributed by mix masala contributing around 35% of total revenue. The company has large product portfolio of more than 50 varieties of products having varied margins.

Stable demand outlook of packaged snacks and spices over the medium term

Snack foods, generally consumed between main meals, are an integral part of Nepalese lifestyle and culture. The demand for the packaged snacks industry has been growing for decades. Furthermore, with the increasing working culture leading to "cash-rich less-time" situations, people's food preference is gradually shifting towards eating outside of home rather than preparing in the kitchen. In addition, the hassle-free preparation setup of packaged food items has led to surge in demand for these products in the market, which caters well for the market prospects of DSFP.

About the Company

Dugar Spices & Foods Products Private Limited (DSFP) was incorporated on September 06, 1999 and is involved in manufacturing of varieties of traditional spices, snacks, savoury namkeen, pickles, fruits jams, jellies, confectioneries, dry fruits and nuts, breakfast cereals, CTC teas, etc. The manufacturing facility for all the products is located in Biratnagar-7, Morang, Nepal. The company has a combined total installed capacity of 15,030 Metric Ton Per Annum (MTPA). DSFP sells these products under the brand "Century" across a wide price range in the domestic as well as foreign market.

Brief financial performance of DSFP during last three financial years is given below:

(Rs. in Million)

Particulars	FY20 (A)	FY21 (A)	FY22 (A)
Income from operations	1,293	1,888	2,303
PBILDT Margin (%)	14.69	10.95	8.56
Overall Gearing (times)	8.16	5.90	7.46
Interest coverage (times)	2.06	2.72	1.96
Current Ratio (times)	0.91	0.92	0.91
Total Debt to Gross Cash Accruals (times)	9.16	8.98	12.81

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	505.88	CARE-NP BB [Double B]
Short Term Bank Facilities	Fund Based Limit	339.12	CARE-NP A4 [A Four]
Short Term Bank Facilities	Non-Fund Based Limit	155.00	CARE-NP A4 [A Four]
Total Facilities		1,000.00	

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