

Jayshree PU Tech

Ratings

| Facilities | Amount (Rs. in Million) | Ratings ¹ | Rating Action |
|----------------------------|---|---------------------------------|----------------------------|
| Long Term Bank Facilities | 205.00 | CARE-NP BB- [Double B Minus] | Revised from CARE-NP BB |
| Short Term Bank Facilities | 295.00 | CARE-NP A4 [A Four] | Reaffirmed |
| Total Facilities | 500.00 (Five Hundred Million Only) | | |

Details of instruments/facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has revised the rating assigned to the long term bank facilities of Jayshree PU Tech (JSPU) to 'CARE-NP BB-' from 'CARE-NP BB'. CRNL has reaffirmed the rating of 'CARE-NP A4' assigned to the short term bank facilities of JSPU.

Detailed Rationale & Key Rating Drivers

The revision in the ratings assigned to the bank facilities of JSPU takes into account the deterioration in its overall financial risk profile during FY22 (Audited; FY refers to the twelve-month period ending mid-July) owing to elongated operating cycle resulting in increased reliance on bank borrowings to meet working capital requirements along with year-on-year decline in Total Operating Income (TOI) and profitability of the firm amid sluggish demand scenario for its products. The ratings also continue to factor in JSPU's exposure to volatile interest rate, raw material price volatility risk, vulnerability to changes in fashion trends and obsolescence risk associated with inventory. The ratings also factor in JSPU's presence in competitive nature of industry and foreign exchange fluctuation risk associated with procurement of raw materials.

The ratings, however, continue to derive strength from experienced promoters & established track record of operations, established distribution network & brand presence and stable demand outlook of footwear industry over the medium term.

Going forward, the ability of the firm 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 elongated operating cycle of the firm resulting in increased reliance on working capital borrowings

The operations of the firm are working capital intensive in nature marked by high inventory holding at the end of FY22. It is critical for the company to maintain adequate levels of inventory, which tends to be on the higher side given the wide range of designs, shape, sizes and colour of shoes to meet the immediate demand of its customers in a highly competitive industry. This results in high inventory holding for the firm with average inventory holding of 408 days at the end of FY22, increasing from 310 days at the end of FY21. Also, being in a highly competitive industry, the firm has to extend generous credit period to its dealers leading to average collection period at around 83 days during FY22 (PY: 84 days). Also, the firm imports its raw materials mainly through usance Letter of Credit, generally with credit period of 90-120 days. Consequently, net operating cycle of the firm was substantially high at 397 days in FY22, which increased from 303 days in FY21. A highly elongated operating cycle leads to increased reliance of the firm on the bank finance for meeting its working capital needs.

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

Decline in income and profitability, moderation in capital structure during FY22

JSPU's TOI declined 4.82% year-on-year to Rs. 525 Mn during FY22 mainly on account of deteriorated demand scenario during FY22. Furthermore, profitability also declined in FY22 amid increase in input prices resulting in decline in PBILDT margin by 534 bps to 21.02%. Declining PBILDT coupled with increase in interest expense led to squeezed PAT margin, which declined by 774 bps to 9.25% during FY22. Gross Cash Accruals (GCA) of the firm declined by ~37% to Rs. 69 Mn during FY22. Overall gearing of the firm stood moderate at around 2.44x at the end of FY22 which deteriorated from 2.16x at the end of FY21, mainly on account of increase in bank borrowings of the firm. Amid high interest expenses and decline in PBILDT, JSPU's interest coverage ratio deteriorated to 3.03x during FY22 from 6.32x during FY21. Furthermore, JSPU's total debt/GCA deteriorated to 9.36x during FY22 from 4.27x during FY21. During H1FY23 (Unaudited; H1 refers to six-month period ending mid-January), company reported TOI of Rs. 387 Mn. The ability of the firm to profitably scale up the operations will be critical from credit perspective.

Raw material volatility risk and foreign exchange fluctuation risk

Polyurethane, Laminated Fab and Rexin are the major raw materials for JSPU which are majorly imported from different countries and procured domestically. The prices of the JSPU's raw materials are market linked and determined on a periodic basis, thus exposing the firm to the volatility in the prices of raw materials which has a bearing on its profitability margins. Raw material cost contributed around 90% of the total production cost of the firm during last 3 years (FY20-FY22). JSPU's overall profitability hugely depends on raw material prices and the firm's ability to pass through the changes to the customers. While increase in raw material prices could be sudden and substantial, the firm's ability to immediately pass through the changes could be limited, particularly in a competitive market. Hence, the firm's overall profitability remains highly exposed to the volatility in input prices. JSPU mainly imports raw materials from India and China and the firm's import from Chinese suppliers is invoiced in USD. The product of the firm is completely sold in the domestic market. With initial cash outlay for procurement in foreign currency and sales realization in domestic currency, the firm is exposed to the fluctuation in foreign currency exchange rates. Since, the firm does not hedge its foreign exchange exposure, JSPU is exposed to any sharp depreciation in the value of Nepalese rupee against USD which may impact its cash accruals.

Vulnerability to changes in fashion trends and obsolescence risk associated with inventory with its presence in highly competitive footwear industry

The footwear segment is driven by fashion trends and its target segment's aspirations. Therefore, their association with brands may change within a short span of time. Thus, manufacturers need to constantly innovate and adapt to the changing preferences of the target segment with its team of in-house designers who work on the upcoming season's collections and is expected to have the ability to adapt to the changing market trends. Furthermore, companies need to manage their inventories according to fashion and changing trends. At times, such fashion trends are short-lived, resulting in risk of inventory becoming obsolete if it does not meet the taste and preferences of the customers. This could adversely impact the financial profiles of entities operating in the business segment.

The footwear industry is intensely competitive and fragmented marked by the presence of both larger players with established brand presence and numerous smaller players in the unorganized segment. The players in the industry do not have pricing power and are exposed to competition-induced pressures on profitability. The demand of footwear industry is considered cyclical as it depends upon the seasonal demand from the market.

Exposure to volatile interest rate

JSPU had Rs. 36 Mn as finance cost in FY22, which increased from Rs. 23 Mn in FY21, thus squeezing its net profitability. JSPU'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 firm is exposed to volatile interest rate.

Key Rating Strengths

Experienced promoters and established track record of operations

JSPU is a partnership firm managed under overall guidance of partners, Mr. Anuj Poddar and Mr. Rajesh Kumar Agrawal. Mr. Anuj Poddar, is also the Director of the Jayshree Company Private Limited (CARE NP BB/A4, manufacturer of PVC slippers) and Jayshree Polymers Private Limited (manufacturing of PU, PVC and sports footwear), with more than two decades of experience in related business. Mr. Rajesh Kumar Agrawal, has business experience of over 15 years in footwear industry. The experience of the partners in footwear industry bodes well for the overall business prospects of the firm in an increasingly competitive industry. Furthermore, the partners are supported by an experienced team across various functions. The firm has an established track record of operations of more than a decade in the manufacturing of footwear products in Nepal.

Established distribution network and brand presence

JSPU has an increasing presence across nation reaching all provinces of Nepal and covering most major towns and cities. At the end of mid-January 2023, the firm had around 27 dealers across the country. The strong marketing network across all major cities in the country provides a ready market for its products. Furthermore, the firm, along with other group companies, sells its products under the brand name "Magic", which is an established name in the footwear segment in the domestic market.

Stable demand outlook of footwear industry over medium term

The footwear 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 footweares that is fashionable and affordable in the market. Nepal's proximity to large footwear markets like India and China also make it easy for the procurement of raw materials. Manufacturers like JSPU could benefit from the increasing demand for locally manufactured footweares in the country over the medium-term.

About the Company

Jayshree PU Tech (JSPU) was incorporated on November 08, 2009. The firm manufactures slippers, sandals and shoes under its brand name "Magic". As on mid-July 2022, JSPU had total licensed capacity of 0.90 Mn pairs per annum. The manufacturing facility is located in Biratnagar, Nepal.

Financial Performance

| For the Period | FY20 (A) | FY21 (A) | FY22 (A) |
|---|----------|----------|----------|
| Income from Operations | 397 | 552 | 525 |
| PBILDT Margin (%) | 20.87 | 26.36 | 21.02 |
| Overall Gearing (times) | 4.18 | 2.16 | 2.44 |
| Total Outstanding Liabilities/ Tangible Net Worth (times) | 5.17 | 2.97 | 3.03 |
| Interest Coverage (times) | 2.07 | 6.32 | 3.03 |
| Current Ratio (times) | 1.56 | 1.81 | 1.92 |
| Total Debt/Gross Cash Accruals (times) | 12.74 | 4.27 | 9.36 |

A: Audited

Annexure 1: Details of the Facilities Rated

| Name of the Bank Facilities | Type of the Facility | Amount (Rs. In Million) | Ratings |
|-----------------------------|----------------------|----------------------------|---------------------------------|
| Long Term Bank Facilities | Term Loan | 205.00 | CARE-NP BB- [Double B Minus] |
| Short Term Bank Facilities | Fund Based Limits | 295.00 | CARE-NP A4 [A Four] |
| Total | | 500.00 | |

Contact Us

Analyst Contact

Mr. Girish Bhatta

+977-01-4012630

girish.bhatta@careratingsnepal.com

Mr. Santosh Pudasaini

+977-01-4012628

pudasaini.santosh@careratingsnepal.com

Relationship Contact

Mr. Achin Nirwani

+977-9818832909

achin.nirwani@careratingsnepal.com

About CARE Ratings Nepal Limited:

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