

United Traders Syndicate Private Limited

Rating

Facility/Instrument	Amount (Rs. in Million)	Ratings ¹	Rating Action
Short Term Bank Facilities	4,000.00	CARE-NP A3 [A Three]	Reaffirmed and removed from credit watch with developing implications
Total Facilities	4,000.00		

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 United Traders Syndicate Private Limited (UTSPL) and has removed the rating from credit watch with developing implications.

Detailed Rationale & Key Rating Drivers

The removal of rating assigned to the bank facilities of UTSPL from credit watch with developing implications factors in the Government of Nepal's (GoN's) announcement to lift the restriction of import of various non-essential items including certain passenger vehicles. The import restriction, effective from April 26, 2022 to December 16, 2022, is likely to result in deterioration in the financial performance of automobile traders like UTSPL in FY23 (FY refers to the twelve-month period ending mid-July). However, UTSPL's overall financial risk profile, despite some year-on-year moderation in FY23, is expected to remain fairly resolute, with likely sequential rebound in coming periods supported mainly by established brand presence of Toyota vehicles in Nepal. The rating continues to derive strength from UTSPL's long track record of operations and association with strong brand as sole distributor in Nepal, presence of an established dealer network experienced and resourceful promoters.

The rating also takes into account the company's growth in sales and profitability in FY22 (Audited, FY refers to the twelve-month period ended mid-July), although moderated in H1FY23 (Unaudited, H1 refers to the six-month period ended mid-January) due to sluggish demand. The rating, however, remains constrained by working capital intensive nature of operations, exposure to volatile interest rate, foreign exchange rate fluctuation risk, cyclical nature of auto industry and high competition from other automobile players. The rating also factors in the company's exposure to regulatory risk related to the automobile industry. Additionally, the rating also takes cognizance of the near-term muted demand scenario for automobiles. Amid a slow pace of economic growth, overall consumption in the country remains impacted by rising inflation and high funding cost. As cost of ownership escalates, funding options remain checked by limited credit appetite of banks and financial institutions (BFIs) after a disproportionately high credit expansion over the last couple of years and higher risk weights for personal hire-purchase loans of 150%, which have cumulatively led to increased reluctance of BFIs for financing of new automobiles.

Going forward, the ability of the company to profitably scale up its operations and rationalize its debt through efficient working capital management leading to improved overall solvency and debt service coverage indicators position will be the key rating sensitivities. Furthermore, any new policies by the Government of Nepal regarding further tightening the imports, which could impact the business profile of the company will also be a key rating sensitivity.

Detailed Description of the Key Rating Drivers

Key Rating Strengths

Experienced and resourceful promoters with long track record of operations

Incorporated in June 1971, UTSPL has a long track record of over 5 decades as the sole distributor of Toyota vehicles in Nepal. UTSPL derives strength from its strong shareholders being a part of the Vaidya's Organization of Industries and Trading

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

Houses, which has a long-established presence in Nepal through their group entities engaged in automobile trading and agro based industry. Mr. Suraj Vaidya, is the president of UT SPL since last 30 years. He is a past President of Federation of the Nepal Chamber of Commerce and Industries. Mrs. Ritu Singh Vaidya, managing director, looks after day-to-day operations of the company along with an experienced management team.

Established brand presence of Toyota vehicles in Nepal

UT SPL is the authorized distributor of Toyota Motor Corporation (TMC), which is among the market leaders in global passenger vehicle segment. Known for its durability, innovation and product quality, Toyota has built a strong brand equity over the years and has a strong brand presence in Nepal, particularly in the SUV segment. As a sole authorized distributor of Toyota vehicles and established dealer network, UT SPL has a large demand catering opportunity in Nepal, which links the fortune of the company to demand for Toyota vehicles in the country. UT SPL had introduced new models such as RAV4 Hybrid, Raize and new variants of leading Fortuner and Prado models during FY21, improved sales which aided in company's better financial performance in FY22. Updated portfolio coupled with strong brand recall of Toyota augurs well for the business prospects of the company over the long run in the highly competitive automotive industry.

Growth in sales and profitability in FY22, although moderation in H1FY23

The total operating income of UT SPL grew 56.55% year-on-year in FY22 to Rs. 7,615 Mn on account of higher sale of more premium vehicles during the year leading to increased price realizations. Although the company sold 520 units in FY22, compared to 526 units in FY21, better price realizations led to higher total income. PBILDT margin also improved to 11.07% in FY22 from 8.09% in FY21 aided by favorable change in product mix. Higher demand for newly launched models (in Nepal) and new facelifted variants of established models in passenger vehicle segment, in particular, added to UT SPL's sales growth and profitability in FY22. In H1FY23, however, the company reported total income of Rs. 1,863 Mn, declining 58.08% year-on-year with sale of 94 units (H1FY22: 305 units). The company was largely unaffected by the supply constraint amid the import restriction during the first half of FY23 as it had enough inventory built up prior the restriction kicked in. However, sales have been impacted so far this fiscal with sluggish demand amid overall economic slowdown. This is exacerbated further by the credit crunch in BFIs and elevated interest rates which have led to higher cost of ownership for new vehicles, which negatively impacted its demand outlook.

Established dealer network

UT SPL has an established dealer network with total 10 dealers in major cities of Nepal (i.e. Kathmandu, Lalitpur, Pokhara, Chitwan, Butwal, Biratnagar, Janakpur, Dhangadi, Nepalgunj, Jhapa). Additionally, the company has three owned showrooms (one showroom for vehicles and two showrooms for spares parts) along with two owned service centers. The company has an integrated mode of operations, functioning in various verticals of automobile dealership business to provide one stop solution to its customers. It operates service stations, sells spare parts, and has tie-ups for vehicle finance and insurance. This allows it to provide a comprehensive range of services to the customer at a single point.

Key Rating Weaknesses

Leveraged capital structure and working capital intensive nature of operation

UT SPL's overall gearing ratio increased slightly to 2.55x at the end of FY22 from 2.39x at the end of FY21 on account of higher working capital borrowings. Although the overall gearing improved slightly to 2.38x at the end of H1FY23, the company's working capital borrowing was substantially high relative to its scale of operations reflected by deterioration in its total debt to gross cash accruals (GCA) to 44.10x at the end of H1FY23 from 7.02x at the end of FY22. Interest coverage ratio also declined to 1.24x during H1FY23 from 3.71x in FY22, majorly due to high interest outgo during the period.

Automobile dealership business in Nepal has inherent high working capital intensity due to high inventory holding requirements and credit extended to the dealers. The company needs to maintain fixed level of inventory for display and high level of inventory to guard against supply shortages as the supply is totally dependent upon imports. Apart from this, the vehicle manufacturer/ supplier delivers vehicle only against the letter of credit. Thus, the business operations depend heavily on working capital borrowings. Average utilization of working capital limit was around 65% of drawing power during twelve-month period ended January 2023. During FY22, UT SPL had average inventory holding period of 44 days (FY21: 62 days) and average collection period of 84 days (FY21: 99 days). As a result, the overall operating cycle during FY22 decreased to 122 days from 156 days in FY21.

Exposure to volatile interest rate and foreign exchange rate fluctuation risk

UT SPL had a substantial interest outgo in FY22 and H1FY23 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. However, Nepal Bankers Association's decision to lower premium on loans by 1% from March 2023 could provide some relief. Nevertheless, funding taken by the company remains exposed to volatile interest rate.

Cyclical nature of the auto industry and high competition from other automobile players

The demand for passenger vehicles is inherently vulnerable to the economic cycles and is highly sensitive to interest rates. Demand for passenger vehicles increases during period of high economy growth rate period and low interest rate regime and vice-versa. Also, there is stiff competition from other automobile dealerships in Nepal with large number of players operating in market. Competition is also intensified due to introduction of electric vehicles, which have a lower duty/tax regime. Due to high competition, dealers are forced to provide discounts and schemes to attract customer, which put pressure on its profitability.

Exposure to regulatory risk related to automobile industry

The demand in automobile sector is impacted by heavy import duty (which include custom duty, excise duty and value added tax) imposed on the import of automobiles which are still considered as luxury items in Nepal. Amid a slew of restrictions to limit outflow of foreign reserve, the Government of Nepal (GoN) had decided to ban import of non-essential items listed under 10 categories on April 26, 2022 which included certain automobiles. Although the government lifted the ban on December 16, 2023, restrictions of similar or different nature might happen in future, which can have an adverse impact on the automobile trading industry. Dealership business of UT SPL remains exposed to similar policies of the GoN/Central Bank and this will remain a key monitorable.

About the Company

United Traders Syndicate Private Limited (UT SPL) was incorporated in June 18, 1971 by Dr. Vijay G. Vaidya as a sole distributor of Toyota vehicles for Nepal. The group is involved in trading Toyota vehicles, spare parts and services since 1967. The company shares are owned by mainly three shareholders, Mr. Suraj Vaidya (60%), Mrs. Ritu Singh Vaidya (30%) and Mrs. Susan Vaidya Shrestha (10%).

Brief financials of UT SPL for FY21, FY22 and H1FY23 are given below:

(Rs. Million)

For the year ended Mid-July	FY21 (Audited)	FY22 (Audited)	H1FY23 (Unaudited)
Income from Operations	4,864	7,615	1,863
PBILDT Margin (%)	8.09	11.07	11.68
Overall Gearing (times)	2.39	2.55	2.38
Interest Coverage (times)	2.26	3.71	1.24
Current Ratio (times)	1.19	1.19	1.24
Total Debt/Gross Cash Accruals (times)	12.22	7.02	44.10

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 Limit	3,400.00	CARE-NP A3
Short Term Bank Facilities	Non-Fund Based Limit	490.00	CARE-NP A3
Short Term Bank Facilities	Proposed	110.00	CARE-NP A3
Total		4,000.00	

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About CARE Ratings:

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