

Daunne Flour Mills Private Limited

Rating

Facility/Instrument	Amount (Rs. in Million)	Ratings ¹	Rating Action
Long Term Bank Facilities	212.35 (Decreased from 221.95)	CARE-NP B+ [B Plus]	Reaffirmed
Short Term Bank Facilities	340.30	CARE-NP A4 [A Four]	Reaffirmed
Total Facilities	552.65 (Five Hundred Fifty-Two Million and Six Hundred Fifty Thousand Only)		

Details of Facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has assigned rating of 'CARE-NP B+' to the long term bank facilities and 'CARE-NP A4' to the short term bank facilities of Daunne Flour Mills Private Limited (DFMPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of DFMPL remain constrained by its below average financial risk profile marked by highly leveraged capital structure along with and relatively low profitability leading to modest debt service coverage indicators and elongated operating cycle resulting in increased reliance on bank borrowings. The ratings also factor in the susceptibility to price fluctuation of seasonal agro products, fragmented and competitive nature of industry, exposure to volatile interest rates, and exposure to regulatory risk.

The ratings, however, continue to derive strengths from experienced promoters and management team, stable demand outlook over the medium term, despite near-term supply constraints, for its products with wheat being one of the major Nepalese diets and established marketing setup with decent product diversification along with own brand. The ratings also take cognizance of the increasing trend in scale of the operations of the company over FY20-FY22 (FY refers to the twelve-month period ending mid-July).

Going forward, the ability of the company to sustain growth in operations while improving the profit margins and rationalization of its debt through efficient working capital management leading to improvement in its solvency and liquidity indicators 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

DFMPL has a highly leveraged capital structure with overall gearing ratio of 6.42x at the end of FY22, deteriorating from 5.42x at the end of FY21 on account of higher working capital requirements amid increasing scale of operations which has been met through bank borrowings.

Interest coverage ratio of the company remained modest at 1.27x in FY22 (FY21:1.36x). With increasing debt and moderation in profit, other debt service coverage indicators such as total debt to gross cash accruals also remained weak and stood above 35x for FY22. A limited gearing headroom could constraint the company from raising additional debt, when required. Furthermore, increased reliance on bank borrowings results in higher interest outgo, squeezing the company's returns.

Elongated operating cycle leading to high reliance on borrowings

The operations of the DFMPL are working capital intensive in nature marked by total operating cycle of 134 days in FY22. Majority of wheat requirement in FY22 was met through domestic purchases from wheat traders where company receives

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

credit period for around one month. Due to seasonal nature of raw materials, DFMPML needs to maintain inventory for around 3-4 months for smooth operations. Average inventory days was 104 days in FY22 which remained stable as compared to 106 days in FY21. Amid stiff competition, the company also needs to allow up to three months credit period to its customers, which led the average collection period of 72 days in FY22. This led to reliance of the company on bank borrowings for working capital needs. The average utilization of fund-based working capital limits against sanctioned limits was around 70% for nine months ending mid-April 2023.

Susceptibility to price fluctuation of seasonal agro products

DFMPML deals in various wheat products, whose prices are highly volatile in nature. Agro products are seasonal in nature with production and prices dependent on various factors like area under production, yield for the year, demand supply scenario and inventory carry forward of last year. Furthermore, the supply is dependent upon availability of seed, impacts of pests, monsoon during the particular year as well as overall climatic condition, exposing the fate of the company's operation to vagaries of nature.

Fragmented and competitive nature of industry

The flour-milling industry is highly fragmented due to presence of several organized/ unorganized players owing to low entry barrier due to low technology and capital requirement. The presence of local small scale millers capable to process wheat into comparable products, large millers have low pricing power. Furthermore, Nepal being a traditionally agriculture-based nation, wheat flour and allied products for household consumption are produced in domestic level as well.

Exposure to volatile interest rates and regulatory risk

Sustained requirement for short-term working capital borrowings has led to relatively high interest outgo for DFML (Rs. 50 Mn during FY22), impacting its net profitability. The company's interest rates 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. Amid tight liquidity interest rates have been on the higher side over FY22 and so far in FY23. Consequently, interest burden of the company is likely to have remained higher in FY23 as well, squeezing its profitability and impacting its liquidity position. Furthermore, earnings of the company are also susceptible to regulatory policies relating to tariff barriers and export policies of India, which is the major supplier of wheat to Nepal. India has restricted exports of wheat with effect from May 14, 2022 which has affected the availability of raw materials to flour manufacturers like DFMPML. A sustained supply constraint could impact the business prospects of the wheat processing/trading companies in Nepal. This will remain a key monitorable aspect.

Key Rating Strengths

Experienced promoters and management team

DFMPML is managed under the overall guidance of its seven-member board of directors which includes experienced businessmen with wide experience in the manufacturing and trading sectors. The board is led by Mr. Ganesh Prasad Pokharel, Chairman, who has over a decade of experience in the manufacturing and trading industry. The board of directors is aptly supported by a management team led by Mr. Sunil Sharma Bohora, General Manager, who has been involved in DFMPML for the last six years and has an experience of more than two decades in the top-level management of various manufacturing companies.

Established marketing setup and product diversification

DFMPML has an established distribution network centered at major cities in western and central region of Nepal. As on mid-April 2023, the company had a customer base of more than 300 customers, including corporate buyers who are manufacturers of food items derived from refined flour. The product portfolio of DFMPML includes maida, aata, chakki aata,

choker, suji and daliya, catering to the demand of diverse customer base. Majority of sales is derived through sale of maida to industrial buyers who are manufacturers of food items like pasta, noodles, biscuits, etc. Company has targeted aata, suji and daliya to household consumers which it sells via traders/distributors. The company sells its products under the brand name of "Daunne Gold" which is an established name in the Nepalese market and provides competitive advantage to the company against new players entering the industry.

Growing scale of operations over FY22-9MFY23, albeit with moderation in profitability

Over FY19-FY22, DFML's total operating income (TOI) grew at a Compounded Annual Growth Rate (CAGR) of 22.81% backed by increased sales volume amid sustained demand. The TOI grew by 15.80% year-on-year in FY22 to Rs. 836 Mn. Revenue growth momentum continued into 9MFY23 with TOI of Rs. 882 Mn. Despite growing trend in income levels, however, PBILDT margin of the company has remained steady around 7%-8% over FY20-FY22. Furthermore, the company's net profits have been on the lower side, impacted by higher interest expense. The ability of DFML to rationalize its debt through efficient working capital management would be critical for its net profitability.

Stable demand outlook over medium term with wheat being one of the major Nepalese diet

The demand prospect of wheat industry is likely to remain stable, notwithstanding the near-term supply constraint, as wheat products are considered one of major diets of Nepalese consumers. In addition, wheat products carry special traditional values in Nepal, and are used in preparing culturally valued foods especially during festive seasons. Due to availability of its products with varied packaging options ranging from 1 kg to 50 kg, DFML has been able to attract household consumers, in addition to industrial buyers.

About the Company

Daunne Flour Mills Private Limited (DFMPL) is a private limited company incorporated on August 30, 2013 for processing of wheat for production of refined flour (maida) and allied products. The company has its manufacturing facility in Ramgram-11, Nawalparasi, Nepal. The company has a refined flour (maida) mill having installed capacity of 180 Metric Ton Per Day (MTPD) and flour (atta) mill having installed capacity of 60 MTPD as on mid-April 2023. DFMPL sells these products under the brand name of "Daunne Gold" to various household and industrial customers mainly in western and central region of Nepal.

Financial Performance

For the year ended Mid-July	FY20 (Audited)	FY21 (Audited)	FY22 (Audited)
Income from Operations	672	722	836
PBILDT Margin (%)	7.38	7.71	7.63
Overall Gearing (times)	8.57	4.09	6.42
Interest Coverage (times)	1.28	1.36	1.27
Current Ratio (times)	0.83	0.98	0.99
Total Debt/Gross Cash Accruals (times)	46.65	30.67	37.75

Annexure 1: Details of the Facilities rated

Nature of the Facility	Type of the Facility	Amount (Rs. in Million)	Rating
Long Term Bank Facilities	Fixed Term Loan	212.35	CARE-NP B+
Short Term Bank Facilities	Fund Based Limit	340.00	CARE-NP A4
Short Term Bank Facilities	Non-Fund Based Limit	0.30	CARE-NP A4
Total		552.65	

Contact us**Analyst Contact**

Ms. Insha Shrestha

Contact No.: +977-14012629

Email: prashiddhas@careratingsnepal.com

Mr. Santosh Pudasaini

Contact No.: +977-14012629

Email: pudasaini.santosh@careratingsnepal.com

Relationship Contact

Mr. Achin Nirwani

Contact No.: +977 9818832909

Email: achin.nirwani@careratingsnepal.com

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