Khilung Kalika Agro Farm Private Limited

Ratings

Facility/Instrument	Amount (Rs. in Million)	Ratings[1]	Rating Action
Long Term Bank Facilities	307.74 (Decreased from 352.88)	CARE-NP B+ [Single B Plus]	Reaffirmed
Short Term Bank Facilities	243.57 (Decreased from 292.40)	CARE-NP A4 [A Four]	Reaffirmed
Total Facilities	551.31 (Five Hundred Fifty One Million and Three Hundred and Ten Thousand Only))		

** Details of Facilities in Annexure 1*

CARE Ratings Nepal Limited (CRNL) has reaffirmed the ratings of 'CARE-NP B+' assigned to the long term bank facilities and 'CARE-NP A4' assigned to the short term bank facilities of Khilung Kalika Agro Farm Private Limited (KKPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of KKPL continue to be constrained by its below average financial risk profile marked by deteriorating operational performance and weak debt service coverage indicators. The ratings also factor in working capital intensive nature of operations, the company's presence in competitive nature of industry, exposure to inherent risk in poultry sector and exposure to volatile interest rates. The ratings, however, continue to derive strengths from experienced promoters and directors in the related field, diversified distribution network, stable demand outlook of poultry industry over the medium term and government support for agriculture based industry.

Going forward, the ability of the company to manage growth of the operations while improving the profit margins and rationalization of its debt through efficient working capital management would be the key rating sensitivities. Also, the ability of the company to manage and control various poultry related diseases with minimum impact on the business would also be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Below average financial risk profile marked by deteriorating operational performance and weak debt service coverage indicators

KKPL derives its revenue from sale of eggs, retired layers and fertilizers. The sales of eggs constitute major source of revenue for KKPL which contributed around ~98% of total income during FY23 (Unaudited; FY refers to the twelve-month period ending mid-July). The total operating income (TOI) declined by ~17% year-on-year to 377 Mn during FY23 on account of lower production during mid-quarter due to high number of retired layers resulting in less egg production. Consequently, the company incurred operational losses during FY23 on account of increased input prices. Additionally, profitability was also partly impacted by high raw materials consumption to feed the new batch of layers, leading to high cost to the company.

The capital structure of the company stood moderately leveraged with overall gearing at 2.50x at the end of FY23, improved from 3.06x at the end of FY22. The improvement in overall gearing was on account of additional infusion of equity of Rs. 200 Mn which was partially offset by accumulated losses during the year. Furthermore, coverage indicators were negative amid operational losses. However, comfort is taken from sustained financial support from the promoters in

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

FY23 to support operational and financial expenses, as needed. The ability of the company to achieve sufficient cash accruals to cover debt servicing from operations will remain crucial from analytical perspective.

Working capital intensive nature of business

The operations of the company are working capital intensive in nature. Poultry business requires to maintain adequate inventory level of parent birds and raw materials stock to feed the birds in different growing stages. This leads to a high inventory period, which stood at 156 days during FY23 (FY22: 211 days). KKPL's collection period was moderate at 18 days during FY23 with KKPL allowing around 15-20 days' credit periods to its customers. Based on the long business relationship, the company receives a payable period of around two to three months from its suppliers; Despite a reasonable collection and creditor days, KKPL's net operating cycle of the company was high at 118 days in FY23 owing to the substantially high inventory holding (FY22: 141 days). The high working capital requirements were met largely through bank borrowings which normally results in average utilization of over 90% of its sanctioned working capital limits.

Fragmented and competitive nature of industry

The poultry industry is highly competitive and fragmented with many regional unorganized players. Low capital intensity and low entry barrier facilitates easy entry of new players leading to increase in competition. Due to the stiff competitive, the pricing of poultry products remains volatile and also varies from place to place. Furthermore, inherent risk such as perishable nature of product, constraints in transportation, cost of feeds, diseases affect poultry business. Besides this, ability to continuously maintain and improve product quality is key factor to sustain and capture market share in poultry sector.

Vulnerability of the industry's performance to outbreaks of flu and other diseases

KKPL is involved in the sales of eggs, retired layers and fertilizers. Poultry business remains susceptible to inherent risk, such as diseases like Bird Flu which could impact sales of poultry feeds. Intermittent outbreaks of bird flu have affected exports since 2006. Such disease outbreaks affect poultry industry and movement of poultry products across the country. These avian flu outbreaks could lead to a drastic fall in demand followed by crash in poultry prices. Such scenario could pressurize the company's revenue flows as well as profitability.

Exposure to volatile interest rate risk

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. 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. Higher interest rates than envisaged could result in squeezed margins of the company. Hence, funding taken by the company is exposed to volatile interest rate.

Key Rating Strengths

Experienced promoters and directors in the related field

KKPL has five board of directors, chaired by Mr. Ganga Prasad Aryal. Before incorporating the company, he was engaged in similar business in individual capacity. Mr. Shovakanta Dhakal, managing director, has a long-standing experience in diversified sectors like banking, hotels, tourism, agriculture, poultry, renewable energy etc. He is also managing director of Janakpur Agro Farm Private Limited (CARE-NP B+/A4) chief executive officer of Om Agro Private Limited. Mr. Khuma Prasad Aryal, director, has experience in diversified sector. He is presently involved as Chairman in Gandaki Medical College and Teaching Hospital, Managing Director in Universal College of Medical Science and director in Nepalgunj Medical College. BOD is further supported by an experienced team across various functions/ departments.

Stable demand outlook of poultry industry over the medium term

The Nepalese poultry industry has seen increasing demand for production and productivity backed by increasing trend of consumer favoring white meat, increasing inflow of tourists and rapid urbanization, changing food habits of urban inhabitants and availability of poultry meats and eggs in all urban centers and even in small market areas. Poultry industry is relatively insulated from the economic cycle and given the current consumption trend, the demand for poultry products are likely to remain stable over the medium-term.

Favourable government policies towards poultry industry

Government of Nepal (GoN) has put restrictions on import of poultry items in Nepal from other countries as an initiative to protect domestic poultry sector and to attain self-sufficiency in the poultry sector. Since the industry remains susceptible to inherent risk, federal government has issued Bird Flu Control regulation, 2022 to carry out control mechanism to mitigate bird flu spread remaining in line with the Animal Health Livestock Services Act, 1998. The act will focus on standard mechanism accessing prior diagnosis of contamination and enforce strict restriction on transport of poultry products.

About the Company

Khilung Kalika Agro Farm Private Limited (KKPL) is a private company incorporated on March 14, 2014 having registered office located in Syangja, Nepal. KKPL is engaged in layer poultry farming and wholesale trading of eggs. The company has five breeding sheds, each with 51,000 layers' capacity as on mid-July 2022. It sells its products like eggs, retired layers and fertilizers to the customers located in Bagmati, Lumbini and Gandaki provinces.

Financial Performance

(Rs. Million)

For the Period	FY21 (A)	FY22 (A)	FY23 (UA)
Income from Operations	465	451	377
PBILDT Margin (%)	16.94	(0.39)	(40.90)
Overall Gearing (times)	3.45	3.06	2.50
Interest Coverage (times)	1.96	(0.03)	(2.93)
Current Ratio (times)	0.99	0.83	0.81
Total Debt/Gross Cash Accruals (times)	26.16	(9.25)	(2.51)

A: Audited, UA: Unaudited

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	307.74	CARE-NP B+ [Single B Plus]
Short Term Bank Facilities	Fund Based Limits	243.57	CARE-NP A4 [A Four]
Total		**551.31**	

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