

## Surya Nepal Private Limited

### Ratings

Facilities	Amount (Rs. Million)	Ratings <sup>1</sup>	Rating Action
Short Term Bank Facilities	5,750.00	<b>CARE-NP A1+ [A One Plus]</b>	<b>Reaffirmed</b>
<b>Total</b>	<b>5,750.00 [Five Thousand Seven Hundred Fifty Million Only]</b>		

*Annexure-1 Details of Facilities/Instruments to be rated*

CARE Ratings Nepal Limited (CRNL) has reaffirmed the rating of 'CARE-NP A1+' assigned to the short term bank facilities of Surya Nepal Private Limited (SNPL).

### Detailed Rationale & Key Rating Drivers

The reaffirmation in rating assigned to the bank facilities of SNPL continues to derive strength from its strong brand equity, leadership position in market with a strong portfolio of offerings mainly in its cigarette business and experienced management in the related field along with strong financial profile of the company. The rating also derives comfort from the availability of significant business and management expertise to SNPL from its strong holding Company- ITC Limited (ITC) across all businesses. These strengths are partially offset by exposure of the cigarette business, which is the main profit earning business segment of SNPL to high taxation regime and stringent regulatory framework in Nepal on cigarettes making the business susceptible to regulatory changes.

*Going forward, the ability of the company to actualize full revenue potential of cigarettes in midst of high taxation regime, difficult regulatory framework and the impact of future capital expenditure plans on the capital structure of the company remain the key rating sensitivities.*

### Detailed Description of the Key Rating Drivers

#### Key Rating Strengths

#### Strength and expertise derived from strong holding company - ITC Limited

ITC Limited, India holds 59% shares in SNPL. ITC is one of India's foremost private sector companies with gross sales value of around USD 8.45 billion during FY23 (refers to twelve-month period ended March 31, 2023) and market capitalization of USD 58.00 billion as on March 2023. Established in 1910, ITC operates in various business segments viz. FMCG (cigarettes, branded packaged foods, education & stationery products, personal care products, safety matches, agarbattis), hotels, paperboards & specialty paper, packaging, Agri businesses and information technology and is also the largest cigarette manufacturer and seller in India. ITC's capability in terms of extensive research and development to create product and packaging solutions and its expertise and experience in cigarette business provides significant competitive advantage to SNPL. Furthermore, ITC's Agri Business Division (ITC-ABD) procures tobacco leaf requirement of SNPL over and above the quantity procured by the Company from domestic sources.

#### Strong brand equity and leadership position in market

SNPL has been in the business of cigarette manufacturing for more than 35 years and has built various successful brands like Surya Legend, Surya 24 Carat, Surya Luxury Kings, Shikhar Filter Kings, Shikhar Ice Rush, Naulo, Khukuri Filter, Pilot Filter, Bijuli and Chautari to cater wide spectrum of consumer taste and preference. SNPL has significant market share and a strong presence

<sup>1</sup>Complete definition of the ratings assigned are available at [www.careratingsnepal.com](http://www.careratingsnepal.com) and other CARE publications

across segments. As one of the leading FMCG Companies in Nepal, SNPL has a deep and wide distribution network in the country with warehouses spread across Nepal for its products which reach over more than 100 distributors directly dealing with the company. Furthermore, strong brand equity, state of the art manufacturing facilities and processes, deep and wide distribution network and economies of scale provides a distinct source of competitive advantage over its competitors.

### **Experienced Management in the Related Field**

SNPL is a professionally managed company under the overall guidance of its Board of Directors. Mr. Sanjiv Puri, Chairman of SNPL, is also the Chairman & Managing Director of ITC. Mr. Puri, an alumnus of Indian Institute of Technology, Kanpur and Wharton School of Business, has held business leadership positions and also handled a wide range of responsibilities in manufacturing, operations and information & digital technology. Mr. Puri has also led SNPL as its Managing Director. The top and senior management team is highly experienced in their respective field of operations. Mr. Ravi K Rayavaram, Managing director of SNPL is a mechanical engineer and an alumnus of Indian School of Business who joined ITC in 2003 and has a total experience of 28 years. The board is supported by an experienced team across various functions.

### **Strong financial profile characterized by high profitability, minimal debt and strong liquidity backed by large liquid investments**

During FY22, SNPL reported net sales from sale of product of Rs. 26,986 Mn, aided by introduction of new brands despite increased taxes on tobacco products. With increase in net sales of the company, PBILDT also increased in FY22, with margins remaining rangebound. On account of low debt levels coupled with sustained strong cashflows from operations, SNPL's debt protection metrics remains highly favorable. The company has not availed any long-term debt from any Banks and Financial Institutions and debt is only in the form of working capital borrowings. Overall gearing ratio of the company stood low at 0.09x as on mid-July 2022. Furthermore, as on mid-July 2022, SNPL had substantial liquid assets in the form of bank deposits of Rs. 10,000 Mn in addition to a cash balance of around Rs. 153 Mn. During FY22, the company declared dividend aggregating to Rs. 10,403 Mn.

### **Key Rating Weakness**

#### **High concentration of business on cigarette segment**

Business of SNPL is highly concentrated on cigarette business. Although the company is also in other FMCG products like agarbatti, safety matches and branded packaged food products, the contribution is low in the Total Operating Income of the company. In a scenario which adversely impacts the cigarette business of the company, the scope of SNPL to take recourse to other business segment is negligible.

#### **Future capital expenditure plans; however, proposed to be met through strong cash flows from the business**

In order to diversify the business of the company, the management is planning to enter into the hotel business. While the company has capital expenditure plans, the effect of the same on the capital structure of the company is likely to be low, given the strong cash accruals from its current businesses, which is likely to fund most of the cash outgo. SNPL's internal accruals are expected to remain sufficient to fund its capital expenditure requirements. Any large debt funded capital expenditure in future would impact the financial profile of the company.

#### **Exposure of the cigarette business which is the main profit earning division to high taxation regime**

The increase in excise duty and Health Risk Tax (HRT) has resulted in an unprecedented increase in tax incidence on cigarettes. Over the past few years, the tax burden on cigarettes has more than doubled in all segments and more than trebled in the plains segment. This has significantly increased the operating pressure on the legal cigarette industry. Considering that the affordability of cigarettes in Nepal is less and cigarette as a product is highly price elastic in nature with a large number of smokers also

consuming relatively low-priced smokeless tobacco products like khaini, gutkha etc., the steep increase in tax incidence on cigarettes as aforementioned will encourage the shift to cheaper and largely tax evaded tobacco products which can impact the revenue and profitability of the company.

### Stringent regulatory framework in Nepal on cigarettes making the business susceptible to regulatory changes

The directives issued under the Tobacco Products Control and Regulation Act (TOPCA) which have been recently implemented require cigarette packages to carry Graphic Health Warnings (GHW) covering at least 90% of the total surface area of the packet – the largest in the world. Large GHW which practically provide no space for use of trademark, has potential to provide a fillip to growth of smuggled international brands that do not carry statutory GHW and as a result are perceived as a "safer" alternative by many consumers. Such growth in illicit cigarette trade could adversely impact the demand for domestic legal cigarettes.

### About the Company

SNPL started operations in 1986. ITC Limited, India holds 59% shares in SNPL and is its holding company. Furthermore, 39% shares are held by a group of Nepali individual and institutional shareholders and remaining 2% shares is held by British American Tobacco (Investments) Limited, UK. SNPL is the largest private sector manufacturing enterprise in Nepal and is currently engaged in the business of Cigarettes, Safety Matches, Agarbatti and Confectionery in Nepal.

### Financial Performance

(Rs. Million)

For the Period	FY20 (A)	FY21 (A)	FY22 (A)
Income from Operations	24,471	24,492	27,014
Overall Gearing (times)	0.13	0.10	0.09
Interest Coverage (times)	536.66	383.04	559.19
Current Ratio (times)	2.14	2.09	2.53
Total Debt/Gross Cash Accruals (times)	0.19	0.14	0.13

A: Audited

### Annexure-1 Details of Facilities Rated

Name of the Bank Facilities	Type of the Facility	Amount (Rs. Million)	Ratings
Short Term Bank Facilities	Working Capital Loans	5,750.00	CARE-NP A1+ [A One Plus]
<b>Total</b>		<b>5,750.00</b>	

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