# Indushankar Chini Udhyog Limited: [ICRANP] LB/ A4 (Assigned)

**June 10, 2019**

## Summary of rated instruments:

| Instrument* | Rated Amount (NPR Million) | Rating Action |
|---|---|---|
| Long-term; Fund-based Limits | 410.00 | [ICRANP]LB; assigned |
| Short-term; Fund-based Limits | 1,337.50 | [ICRANP]A4; assigned |
| Short-term; Non-fund Based Limits | 10.00 | [ICRANP]A4; Assigned |
| **Total** | **1,757.50** | |

* Instrument details are provided in Annexure-1.

## Rating action

ICRA Nepal has assigned the long-term rating of [ICRANP]LB (pronounced ICRA NP L B) to the NPR 410-million long-term loans of Indushankar Chini Udhyog Limited (ICUL or the company). ICRA Nepal has also assigned the short-term rating of [ICRANP]A4 (pronounced ICRA NP A four) to the NPR 1,337.50 million fund-based limits and the NPR 10 million non-fund based limits of ICUL.

## Rationale

The ratings are constrained by a significant threat to the domestic sugar mills from cheaper imports. During the last two years ending FY2018, the sugar price has slumped globally making imports cheaper. In FY2018, imported sugar was available at lower price points vis-à-vis the local produce, affecting the offtake of local producers. In a move to protect the domestic producers from the cheaper imports, the Government of Nepal (GoN) has gradually increased the custom tariff from 15% till FY2018 to 30% in FY2019 and 40% for FY2020. It has also restricted the sugar imports to 100,000-metric tonne per annum from early FY2019. However, overproduction and softening of sugar prices on the international market is likely to continue over the near term and the effectiveness of the enhanced import tariff/ restrictions to protect the domestic players remains to be seen.

The ratings of ICUL also remain constrained by its weak financial profile characterised by high gearing, stretched coverage indicators and tight liquidity position. ICUL's working capital intensity spiked in FY2018 amid weak offtake of sugar caused by cheaper imports; resulting in a significant increase in inventory days. Coupled with the dividend outflow in FY2017 and weak cash accruals, ICUL's reliance on external working capital financing increased, thereby increasing its gearing (5.8 times in mid-July 2018 against 2.4 times in mid-July 2017) in the current high interest rate regime. ICUL reported operating and net losses in FY2018 because of the sharp decline in sales and inventory write down; causing deterioration in the debt coverage indicators of ICUL. Similarly, the liquidity position of the company also remains weak because of increased working capital intensity, declining margins, low net cash accruals and dividend outflow in FY2017. This has led to a sustained need for external financing through promoter loans and occasional overutilisation of its drawing power. The ratings also remain constrained by IUCL's dependence on milling operations for its entire revenue, which has led to volatility in profitability. Even with the limited co-generation and distillery operations (proposed from FY2020 onwards), the contribution from the same is likely to remain small.

Nonetheless, the assigned rating factors in the long track record of ICUL (operating since 1984) and its experienced promoter group. The rating also factors in the positive demand outlook for ICUL, given the growing domestic sugar consumption and inadequate domestic production in Nepal. The rating also derives comfort from the established sales channel (with over 50 distributors) and moderately diversified customer profile of ICUL. The ratings also factor in the duty protection accorded to the domestic industries by the GoN through import barriers on finished sugar, including the recently introduced quantitative import ceiling.

## Key rating drivers

### Credit strengths

**Long track record and experienced promoters –** Incorporated in 1984, ICUL is among the established players in the domestic sugar industry. The company is involved in the production of white plantation sugar. The promoters have been involved in this sector for over 30 years and are highly experienced. The promoter's experience in other manufacturing ventures and trading segment also remains a comfort.

**Established sales channel -** The company has an established supply chain comprising nearly 50 distributors across the country. The sales remain fairly diversified across its customers with the top 10 customers accounting for ~37% of its sales in FY2018.

**Duty protection –** Following the significant impact on domestic sugar manufacturers in FY2018 from cheaper imports, the GoN has resorted to enhanced duty protection for the domestic sugar producers. The GoN increased the custom duty on imported sugar from 15% till FY2018 to 30% in FY2019. The recent budgetary announcements for FY2020 has further increased the custom duty to 40%. In addition, the GoN has also implemented the quantitative ceiling on sugar imports at 100,000 MT from early FY2019 (September 2018) which is in effect till mid-July 2019. Enhanced duty protection and quantitative import restriction (assuming continuation of the same) is likely to support the earnings and cash flows of the domestic manufacturers.

### Credit challenges

**Competition from imports and concentrated revenue profile** - The sales realisation for local players is determined by the landed cost of imported sugar. International sugar price are expected to face downward pressure over the near term due to surplus production by large players like Indian sugar mills, among others. Large scale advantage available with these players and consequent low cost of production partly offsets the impact of high custom duty in the importing nation like Nepal. Therefore, over the near term, import will remain a major threat for domestic sugar producers. Continuation of high import tariff and quantitative import ceiling will have a significant impact on the domestic players.

ICUL's revenue profile remains concentrated as its revenue remains driven by sugar sales (in addition to nominal proceeds from the sales of by-products-viz. molasses and bagasse). ICUL plans to commission a 3MW co-generation unit and a 30 KLPD[1] distillery unit from FY2020, which will help diversify the revenue stream of the company. However, the company's ability to timely commission and stabilise the projects remain to be seen.

**Weak financial profile –** ICUL's financial profile has deteriorated in FY2018 amid a sharp decline in sales and inventory write-down resulting in operating losses. At the same time, a weak offtake in sugar and resulting high inventory level has led to increased working capital borrowings, increasing the debt levels of ICUL in current high interest rate regime. As a result, the debt coverage of the company also remains weak. The incremental financial profile of the company, over short term, will depend on the effectiveness of the Government measures to maintain the import of cheaper sugar at a reasonable level.

**Tight liquidity position -** The company's liquidity position has remained tight over the years due to high working capital intensity and weak cash accruals. The liquidity was further stretched in FY2018 amid weak profitability/cash flows, increase in cash conversion cycle and dividend outflow in FY2017. To support the liquidity requirement of the company, ICUL has been utilising external fund injection from the promoters on a sustained basis. The near-term liquidity profile is also expected to remain stretched as the finished inventory will take time to liquidate (assuming the continuation of the duty protection and import ceiling) while the creditors payment towards cane purchased is expected to be made sooner.

*1 Kilolitres per day*

**Availability of raw materials –** Sugar mills in Nepal (including ICUL) have been operating at sub-optimal capacity utilisation in the past because of the raw material (sugarcane) constraints. As such, availability of cane to support the mills operation also remains a concern. As the cane price is decided by the Government, which includes government subsidy towards the cane farmers, the Government's ability to continue to subsidise cane payments for supporting the industry will also be a key monitorable. Thus, the industry will continue to remain dependent upon the Government policies.

**Industry cyclicality -** As sugarcane is an agro-commodity, it is exposed to industry cyclicality (for example- years of weak monsoon resulting in sharp correction of production) and agro-climatic risks damage from pests, untimely precipitation, weather conditions etc which affects the cane recovery rate. This also remains a rating concern.

**Analytical approach:** For arriving at the ratings, ICRA Nepal has applied its rating methodology as indicated below.

**Links to applicable criteria:**
Corporate Credit Rating Methodology

## About the company

Indushankar Chini Udhyog Limited (ICUL) was incorporated in 1984 as a public limited company. It is one of the large and established players in domestic sugar manufacturing segment with installed sugarcane crushing capacity of 4,500 TCD (tonne crushed per day). IUCL accounts for ~15% of the industry capacity of ~30,000 TCD, in a fragmented sugar industry of Nepal. IUCL manufactures and sells the M-30 grade white plantation sugar under the brand name RajHans. The company's distribution channel comprises wholesale dealers who then pass on the sugar to retail traders and finally to the consumers.

IUCL is a family-owned business wherein Mr. Rajesh Kumar Kedia and his family members hold the entire equity stake. As on mid-April 2019, the company's only sugar manufacturing unit is located in the Hariwan city of Sarlahi District in South-Eastern Nepal. The sugarcane required for the manufacturing process is procured mostly from the local farmers of Sarlahi and adjoining districts of South eastern Nepal. The company plans to commission a 3-MW co-generation unit from crushing year 2019 (which falls in FY2020, starting December 2019) for which the power purchase agreement with the Nepal Electricity Authority has been signed. ICUL also plans to start a 30-KLPD distillery unit from crushing year 2019. As on mid-April 2019, the company's distribution channel comprised a network of around 50 distributors across the country.

## Key financial indicators

| | FY2015 (Audited) | FY2016 (Audited) | FY2017 (Audited) | FY2018 (Audited) |
|---|---|---|---|---|
| Operating Income-OI (NPR Million) | 1,699.4 | 2,136.0 | 1,983.7 | 1,092.1 |
| OPBDITA/OI (%) | 3.6% | 11.8% | 14.7% | -2.0% |
| Total Debt/Tangible Net Worth TNW (times) | 5.5 | 3.4 | 2.4 | 5.8 |
| Total Outside Liabilities/ TNW (times) | 10.9 | 3.6 | 2.8 | 9.4 |
| Total Debt/OPBDITA (times) | 14.0 | 4.3 | 3.2 | -62.7 |
| Interest Coverage (times) | 1.4 | 5.9 | 4.3 | -0.4 |

*Source: Company data*

## Annexure-1: Instrument Details

| Instrument | Limit (NPR in Million) | Ratings |
|---|---|---|
| **Long-term, fund based** | | |
| Term loan | 410.00 | [ICRANP] LB |
| **Total long term, fund based (A)** | **410.00** | |
| | | |

| | | |
|---|---|---|
| **Short-Term Loans** | | |
| Fund based (OD/TR/DL/STL) | 1,337.50 | [ICRANP] A4 |
| Non-fund based (LC) | (50.00) | [ICRANP] A4 |
| Non-fund based (BG/PB/APG) | (20.00) | [ICRANP] A4 |
| Non-fund based (BG) | 10.00 | [ICRANP] A4 |
| | | |
| **Total short term, fund/non-fund based (B)** | **1,347.50** | |
| **Grand total (A+B)** | **1,757.50** | |

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## About ICRA Nepal Limited:

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