Yeti Distillery Private Limited: [ICRANP] LA/ A1 assigned

August 5, 2019

Summary of rated instruments

Instrument*	Rated Amount (NPR Million)	Rating Action
Long-term loans; fund-based	178.49	[ICRANP] LA (Assigned)
Short-term loans; fund & non-fund based	2945.00	[ICRANP] A1 (Assigned)
Total	**3123.49**	

* Instrument details are provided in Annexure-1

Rating action

ICRA Nepal has assigned the long-term rating of [ICRANP] LA (pronounced ICRA NP L A) to the ~NPR 178 -million long-term loans of Yeti Distillery Private Limited (YDPL or the company). ICRA Nepal has also assigned the short-term rating of [ICRANP] A1 (pronounced ICRA NP A One) to YDPL's short-term loans (including non-fund based limits).

Rationale

The assigned ratings factor in YDPL's long track record of over 15 years in the liquor industry[1], healthy market share in the domestic liquor industry and strong market positioning within the whiskey and vodka segment, the two most consumed forms of distillery-based alcoholic drinks in Nepal. ICRA Nepal also factors the current promoters' knowledge and experience in the sector which has led to rapid growth and expansion of YDPL's business during a short time span. The rating also factors in the strong financial profile of the company with high revenue growth, healthy operating margins, and good debt coverage ratios. The rating also considers the established supply chain system, positive demand outlook and duty protection accorded to the domestic spirits industry by the Government of Nepal (GoN), through import barriers on finished liquors.

The ratings, however, are constrained by YDPL's limited product diversification - over 90% revenue in the last two years is accounted by two product lines viz. Old Durbar Whiskey and 8848 Vodka, a segment introduced less than five years ago. The rating also remains constrained by the high working capital requirement for the company to support its sizeable inventory, which is currently met through the elongated creditor cycle, resulting in low external working capital financing. However, any change in the credit terms by the suppliers could lead to an increased requirement of working capital financing with commensurate impact on the liquidity profile and the financial flexibility of the company. The rating also remains constrained by the company's high dividend pay-out, which results in moderate capitalisation despite strong revenues and profitability. ICRA Nepal also notes the intense competition in the hard liquor segment and fresh capacity creation in the recent years which could increase the competitive intensity and consequently moderate industry margins going forward. Rating concerns also arise due to significant regulatory risks associated with the liquor industry.

Key rating drivers

Credit strengths

Established track record, good brand recognition of Old Durbar Whiskey & 8848 Vodka

YDPL has its roots in Shankar Distillery which was incorporated by Mr. Santa Kumar Shrestha (SKS, current chairman of YDPL) during the 1970s. Back then the company dealt only in country liquors. The company changed its name in 2003 and YDPL was incorporated. From incorporation till FY2015, YDPL mainly dealt in low-end 70 UP liquors. In FY2015, the company forayed into 25 UP categories through Old Durbar Whiskey, followed by 30 UP categories through 8848 Vodka in FY2016, using European suppliers for the raw materials viz. ENA and malt spirits. These two products have become flagship products for YDPL, fetching over 90% of the sales revenues in FY2017 and FY2018, with the rest coming mainly

1 However, YDPL's flagship whiskey and vodka products were introduced in FY2015 and FY2016 respectively from the 70 UP product lines (brand name Kasturi). Old Durbar & 8848 have become major players in their respective segments (viz whiskey and vodka respectively) accounting for ~40-50% of the domestic sales.

Good financial profile characterised by strong earnings, healthy profitability

The company has reported strong revenues after the addition of whiskey and vodka lines in late FY2015/early FY2016. The company reported a CAGR 157% growth in the operating revenues between FY2015 and FY2018, with ~90% of the revenues coming from Old Durbar Whiskey and 8848 Vodka. Along with high revenue growth, YDPL also reported improving and high operating margin (~11% in FY2016, ~24% in FY2017 and ~28% in FY2018), indicating strong demand and market positioning of YDPL's products. With good brand recognition, established supply chain and duty protection against imported liquors, incremental revenue and profitability outlook for YDPL remains favourable.

YDPL's gearing level remains moderate with total bank debt to net worth ratio of 2 times as of mid-July 2018 vs. 2.4 times in mid-July 2017. However, with high creditor days which supports the working capital requirement of YDPL to a large extent, TOL/TNW is high at ~11 times as of mid-July 2018 vs. ~15 times as of mid-July 2017. Due to strong revenues, bank debt to OPBDITA ratio stands comfortable at 0.45 times as of mid-July 2018 vs. 0.55 times as of mid-July 2017. Accordingly, YDPL has been able to maintain good debt coverage ratios with interest coverage ratio of ~18 times and debt service coverage ratio (DSCR) of ~7 times in FY2018.

Experienced and knowledgeable promoters

50% stake in YDPL is held by Mr. Abhishek Shrestha (son of SKS) and his family while the balance 50% is held by Mr. Rabi K.C. Mr. Shrestha is the second generation entrepreneur in the family which has stakes in distillery and hotel segment. Mr. Shrestha with a background in hospitality, brewery and management looks after the technical aspect of the business while Mr. K.C. (current Vice president-marketing with Surya Tobacco Company Pvt Ltd, an ITC group company) looks after the marketing aspect of the business.

Credit challenges

High working capital intensity masked by high creditor days

YDPL maintains a high level of inventory (both finished goods and raw materials) which coupled with moderate debtor days results in high working capital requirement. For FY2018, YDPL's inventory days stood at 193 with debtor days of 43. This is supported by equally high creditor days (264 days in FY2018). As a result, the net working capital requirement for YDPL remains low to moderate. This has also helped the company maintain a low gearing level, despite high dividend pay-out. Tightening of supplier credit terms could, therefore, necessitate additional external working capital financing, which is likely to increase the gearing, especially considering the low profit retention practice of YDPL (average dividend pay-out ratio of ~80% in FY2017 and FY2018).

Limited product diversification, over 90% of sales revenue from top three products

YDPL has a concentrated product profile. Although the company produces 6-7 different brands of alcohol (including vodka, whiskey, gin & low end 70 UP alcohol), its revenue remains driven by the high-volume low-value Old Durbar Whiskey and 8848 Vodka. During FY2018, ~92% of its sales revenues were accounted for by these two product lines vis-à-vis ~90% in FY2017. Given the competitive nature of the industry, any impact on the top two product lines could affect the overall financial profile of YDPL.

Regulatory risk

The Government's high import tariff on finished liquors provides duty protection and high entry barriers to the domestic spirits industry. Nevertheless, this also exposes YDPL to any import tariff-related regulation change. Reduction or removal of import-duty/ tariff could have a significant impact on the company's revenue profile, profit margin and debt coverage indicators. Also, liquors remain one of the highest taxed commodities in Nepal with the excise tariff increasing steadily on a year-on-year basis. Continued increase in tariff and competitive pressure could diminish YDPL's ability to pass on the incremental cost to the consumers, which could reduce profit margins. Furthermore, any restriction by the regulatory agency in promotion, sales and distribution of liquor could also have an impact on YDPL.

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

Yeti Distillery Private Limited (YDPL) was incorporated in December 2003 as a liquor-manufacturing company dealing mainly in 70 UP low-end liquors till FY2015. From FY2015, the company also entered into 25 UP and 30 UP segments through its flagship products Old Durbar Whiskey and 8848 Vodka respectively, using imported raw materials (malt spirits and ENA) from European suppliers. With sales volume of ~9 lakh cases in FY2018 and strong market share within the domestic whiskey and vodka market, YDPL is among the large players in the liquor industry in Nepal.

As of mid-April 2019, YDPL's stake is owned by Mr. Rabi KC (50%) and Mr. Abhishek Shrestha and his family (50%) with a manufacturing facility that does the blending and bottling works. There are five processing lines used to produce different products with a combined bottling capacity of 9,000 cases per day. At present, the company's distribution channel comprises a national distributor and a network of ~120 distributors across the country.

Key financial indicators

	FY2016 (Audited)	FY2017 (Audited)	FY2018 (Audited)	9MFY19 (Provisional)
Operating Income-OI (NPR Million)	460.11	1,913.46	3,268.99	3,036.52
OPBDITA/OI (%)	11.17%	24.28%	27.87%	31.99%
Total Debt/Tangible Net Worth TNW (times)	5.77	2.42	2.00	0.92
Total Outside Liabilities/ TNW (times)	14.29	14.73	11.42	2.45
Total Debt/OPBDITA (times)	3.36	0.55	0.45	0.58
Interest Coverage (times)	4.30	27.28	18.39	21.35
DSCR (times)	1.28	5.58	6.95	12.45

Source: Company data

Annexure-1: Instrument Details

Instrument	Limit (Amount in NPR Million)	Rating Action
Fund-based, Long-term	178.49	[ICRANP] LA
Fund-based, Short-term (Overdraft/ Trust receipt (within LC)/ Demand loan)	955.00	[ICRANP] A1
Non-fund based, Short-term (Letter of Credit)	1,990.00	[ICRANP] A1
Non-fund based, Short term (Bank Guarantee) (within LC)	(2.30)	[ICRANP] A1
Total	**3123.49**	

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About ICRA Nepal Limited:

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