

Pioneer Moto Corp (Pvt.) Ltd.: [ICRANP] A3 (Assigned)

December 20, 2018

Summary of rated instruments:

Instrument*	Rated Amount (NPR Million)	Rating Action
Short-term loans, Fund-based	1,350	[ICRANP] A3 (Assigned)
Short-term loans, Non-fund based – Letter of credit	165	[ICRANP] A3 (Assigned)
Total	1,515	

* Instrument details are provided in Annexure-1

Rating action

ICRA Nepal has assigned the short-term rating of [ICRANP] A3 (pronounced ICRA NP A three) to the existing as well as proposed short-term loans (including non-fund based limits) of Pioneer Moto Corp (Pvt.) Ltd. (PMC).

Rationale

The assigned rating factors in the healthy sales growth recorded by PMC over the last few years and the improving market presence despite limited track record (approximately four years) in Nepalese automobile dealership industry. The addition of Nissan dealership in FY2018 and the upcoming models is expected to support sales growth going forward. The rating action also takes into consideration PMC's satisfactory profitability and debt coverage indicators, despite high leverage. The rating further takes comfort from the fact that PMC is promoted by the Sharda Group, which has diversified presence across multiple business sectors in the country. The consequent financial flexibility is reflected in the form of short-term advances and equity infusion by the promoter, based upon incremental business requirements. ICRA Nepal expects promoter group to provide timely financial support in case of financial exigencies.

The ratings, however, are constrained by the intense competition from established players/brands in the automobile dealership industry, wherein PMC is a relatively new player. The rating is also constrained by the recent increase in taxes in the passenger vehicle (PV) segment and the reduced regulatory cap on the bank financing at 50%, which could slowdown demand growth. Liquidity in the banking sector is currently volatile. Hence, the increasing cost of bank borrowings and slowdown in the loan disbursements could deter prospective customers. Additionally, the dealership business is characterised by high working capital intensity and hence the recent increase in interest rates across the banking sector could pressurize PMC's profitability and debt coverage indicators.

Given the increasing business volume, the company's working capital requirements would be growing further. Hence, its ability to timely manage both debt and equity funding to fund incremental working capital requirement would remain a key monitorable. Going forward, the company's ability to sustain growth and profitability amid challenges imposed by increased taxes, reduced bank financing ratio and tight liquidity conditions in banking will remain the key rating sensitivities.

Key rating drivers

Credit strengths

Improving market presence and healthy sales growth - At present, PMC is the sole authorised dealer of Datsun and Nissan vehicles in Nepal. Despite being a relatively new brand for Nepal, Datsun vehicles have reported decent sales growth since the launch in 2014. This was supported by relatively low price of Datsun cars as compared to other vehicles available in Nepal in similar segment. The addition of Nissan dealership from July 2017 provided further revenue diversification opportunities to PMC. As such, the company's revenues increased by ~73% during FY2018¹ (108% CAGR in last three years over small base) despite a decline in sales revenues from Datsun cars by ~32%. With the addition of Nissan dealership, PMC can now cater to a larger customer base, including the price sensitive/entry customers as well as

¹ FY2018 numbers are unaudited and based on provisional data provided by management.

customers opting for upgrade. Going forward, the company's ability to further diversify its revenue streams by adding new models/segments would remain a key monitorable.

Financial flexibility as part of Sharda Group - PMC is a part of the reputed Sharda Group which has an established presence in various lines of businesses in Nepal. In the recent past, the promoters provided timely financial assistance in the form of equity and short-term loans to ease liquidity pressure and support working capital, which lent additional comfort.

Improvement in operating margins and profitability indicators - PMC has been able improve its operating margins over the years (from 4.5% for FY2015 to 7.3% for FY2018), primarily supported by the scale economies as well as addition of Nissan vehicles in FY2018, which have relatively better margins. Additionally, the high-margin servicing and spare parts business is looked after by PMC itself, which provides the scope for margin expansion. However, servicing income is expected to grow gradually with increasing years of dealership.

Credit Challenges:

Limited track record in auto dealership business and intense competitive pressure - PMC has been in the auto dealership business since 2014 and hence has a limited track record in the business. Nepalese automobile dealership industry in the PV segment is dominated mainly by dealerships of incumbents like Maruti Suzuki and Hyundai etc. Stiff competition from incumbents constrains pricing flexibility, especially for dealerships of OEMs having limited presence in the market.

Despite achieving healthy growth in Q1 FY2019, PMC underperformed the underlying PV growth in the industry (~40% volumetric growth vs. ~70% for the industry in similar segment), which remains an area of concern. Company's ability to sustain growth in line with industry trend and regular launches by the principal OEM (Datsun/Nissan) remain crucial for PMC to sustain its growth momentum.

Increased taxes, reduced bank financing ratio and increasing borrowing rates could impact demand growth – PVs, which were already a highly taxed commodity in Nepal, witnessed a sharp increment in taxes for FY2019. Additionally, reduced cap on bank financing at 50%² by the banking sector regulator could deter prospective customers. Since PV sales are mostly bank financed, slower loan disbursements amid current tight liquidity conditions in banking could further impact sales growth. Moreover, bank interest rates have increased swiftly in the last two years, which coupled with the inherent cyclicity in auto dealership could constrain the revenue growth for PMC. This is also evident from the slump in unit sales of Datsun cars by ~32% in FY2018 to 973 vehicles. Sales of Nissan vehicles have reported relatively low seasonal fluctuation compared to Datsun cars. However, the growth trend of Nissan remains to be seen, given the limited track record of PMC in managing this dealership.

Modest capitalization and coverage indicators – Despite some improvement through equity infusion of ~NPR 37 million in FY2018, PMC's capital structure has remained moderate with gearing of ~4.2x as on mid-July 2018. High dividend payout (average of ~75% for FY2016 and FY2017) has also impacted the capital position of the company. Nonetheless, debt coverage indicator has improved over this period and is currently comfortable (Total Debt/OPBDITA of 3.1x for FY2018 compared with 7.4x for FY2016). PMC's capital structure and coverage indicators are likely to remain stretched over the medium term, given thin cash accruals and elongated working capital cycle (higher working capital debt). Additionally, interest cover has been declining over the last few years (3.0x for FY2016 to 2.15x for FY2018), which remains an area of concern, especially given the rising interest rates in the recent periods.

High working capital intensity and stretched working capital cycle – Being a working capital intensive business, most of the funding requirement in the automotive dealership is for inventory financing. PMC's inventory holding periods, despite some moderation, remains high (189 days for FY2017 and 124 days for FY2018). This, along with elevated debtor days (26 days for FY2017 increasing to 73 days in FY2018), has resulted in high working capital borrowings. The company's ability to timely manage working capital funding for peak sales season (around major festive seasons and new year) would have a key bearing over its ability to achieve the targeted sales growth.

² 50% introduced in March 2017 vs. no caps earlier; later moderated to 65% in August 2017; now again reduced to 50% from October 2018.

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:

Incorporated in August 2014, Pioneer Moto Corp (Pvt.) Ltd. (PMC) is Nepal's sole authorised dealer for Nissan and Datsun brand vehicles. PMC was promoted by Mr. Sandeep Kumar Sharda, who is also the sole shareholder and managing director of the company. It is also involved in selling the genuine spares/accessories and servicing of the Nissan and Datsun brand vehicles. PMC has three showrooms/sales outlets of its own (two in Kathmandu and one in Biratnagar) and 13 dealership outlets across major cities of Nepal.

Key financial indicators of PMC:

	FY2016 (Audited)	FY2017 (Audited)	FY2018 (Provisional)
Operating Income-OI (NPR Million)	765	1,571	2,712
Profit After Tax (NPR Million)	23	39	78
OPBDITA/OI (%)	5.97%	6.28%	7.28%
ROCE (%)	16.72%	21.69%	30.36%
Total Debt/TNW (times)	8.20	7.78	4.20
Total Outside Liabilities/ TNW (times)	9.57	9.83	7.68
Total Debt/OPBDITA (times)	7.38	4.76	3.11
Interest Coverage (times)	3.00	2.19	2.15
DSCR (times)	2.51	1.90	1.87
NWC/OI (%)	48%	33%	27%

Source: Company data

Annexure-1: Instrument Details

Instrument	Limit (Amount in NPR Million)	Rating Action
Existing limits		
Fund-based, Short-term (Demand loan)	575	[ICRANP] A3
Fund-based, Short-term (Overdraft)	165	[ICRANP] A3
Fund-based, Short-term (Trust receipt -TR loans) *	(95)	[ICRANP] A3
Fund-based, Short-term (TR loans)	90	[ICRANP] A3
Fund-based, Short-term (Working capital loan - within TR)	(40)	[ICRANP] A3
Non-fund based, Short-term (Letter of credit)	165	[ICRANP] A3
Non-fund based, Short-term (Bank Guarantee) *	(70)	[ICRANP] A3
Total of Existing Loan Limits	995	
Proposed short-term, fund-based limits:	520	[ICRANP] A3
Total	1,515	

* These are complimentary limits to LC limit.

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