

G.O. Automobiles Private Limited: [ICRANP] LBBB/A3+ assigned

May 13, 2019

Summary of rated instruments

Instrument*	Rated Amount (NPR Million)	Rating Action
Short-term loans; Fund based	1,180	[ICRANP] A3+ (Assigned)
Long-term loans; Fund based	74	[ICRANP] LBBB (Assigned)
Short-term loans; Non-fund based	460	[ICRANP] A3+ (Assigned)
Total	1,714	

* Instrument details are provided in Annexure-1

Rating action

ICRA Nepal has assigned a long-term rating of [ICRANP] LBBB (pronounced ICRA NP L triple B) to the NPR 74-million long-term loans of G.O. Automobiles Private Limited (GAPL). ICRA Nepal has also assigned a short-term rating of [ICRANP] A3+ (pronounced ICRA NP A three plus) to the short-term loans (including non-fund based limits) of GAPL.

Rationale

The assigned ratings factor in the company's conservative financial policy with modest leverage and satisfactory debt coverage indicators, its established dealership track record and the gradually improving position of its principal OEM, Ford vehicles, in the Nepalese market. The ratings take note of GAPL's healthy sales growth trend during FY2015-18, supported by new model launches by the principal as well as dealership expansion. GAPL is a part of Golchha Organization, which has a long presence (more than eight decades) across diverse business sectors in Nepal. This has also been considered while assigning the ratings.

The ratings, however, are constrained by the intense competition in the industry with the presence of many established players/brands. ICRA Nepal also notes GAPL's high dependence on its top two models, which together accounted for over 75% of the total sales, exposing the company to high product concentration risk. The ratings are also constrained by the recent increase in taxes for the passenger vehicle (PV) segment, along with the reduced regulatory cap on bank financing to 50%, which could slow down demand growth. Liquidity in the banking sector is currently volatile. Hence, the increasing cost of bank borrowings and slowdown in loan disbursements could deter prospective customers. The dealership business itself is characterised by high working capital intensity. As a result, the increasing interest rates across the banking sector will impact GAPL's profitability and debt coverage indicators. Going forward, GAPL's ability to reduce its dependence on the top models, while sustaining growth and profitability, along with judicious working capital management will remain the key rating sensitivities.

Key rating drivers

Credit strengths

Improving market presence despite relatively moderate track record – GAPL has been the sole authorised dealer of Ford vehicles in Nepal since 2010. The increasing brand recall for Ford's vehicles, new launches by the principal and competitive pricing have aided an improvement in GAPL's market position over the years. GAPL has adequate presence across the country through its own showrooms (two) and regional dealership outlets (12) with an increasing share of sales from the regional dealers (~57% of GAPL's total sales in H1 FY2019 were from the dealers compared to ~32% in FY2017). A change in the revenue mix towards regional dealership is likely to moderate the operating margin, going forward. However, the return indicators are likely to remain satisfactory due to the improved asset turnover.

Healthy sales growth and revenue base – GAPL posted healthy sales growth during FY2013 to FY2017 (CAGR of 27%), which led to a good revenue base of ~NPR 4 billion in FY2017. However, sales stagnated in FY2018 mainly due to the tightening liquidity in the banking sector. Supported by the launch of Ford Freestyle, GAPL reported significant sales growth in H1 FY2019 (~22% annualised growth) though the sustainability of the same would remain a key monitorable. The recent relaunch of Figo along with newer/revised 2019 models with multiple new features may provide some support amid a slowdown in the industry.

Comfortable financial profile – GAPL's healthy operating margins (~10% in FY2018) led to strong coverage indicators with a gearing of 0.8x as of mid-July 2018 and interest cover of ~5x in FY2018. With moderation in demand due to the tight liquidity in the banking system and adverse regulatory measures like higher import taxes, the revenue growth is likely to remain muted over the medium term. There could be some moderation in the operating margins (~7% in H1 FY2019) as well. However, the coverage indicators and capital structure are expected to remain comfortable. ICRA Nepal expects the leverage to remain below 0.8x over the next two to three years.

Financial flexibility as part of Golchha Organization – GAPL is a part of the reputed Golchha Organization, which has an established presence in various lines of business in Nepal. The promoters have provided direct and indirect financial support to the company in the form of equity infusions and advances, which lends additional comfort. The promoters have supported GAPL by maintaining low dividend pay-outs in the past (an average of ~17% during the last five years).

Credit challenges

Intense competition and high dependence on a few models – The PV automobile dealership industry is highly fragmented with stiff competition from the dealerships of established players like Maruti Suzuki and Hyundai among others as well as relatively new entrants like Datsun, Renault, etc. Additionally, GAPL is highly dependent on limited vehicle models with ~75-80% of its sales in FY2017-18 coming from the Ecosport and Figo models. This remains an area of concern in terms of diversity of the revenue stream. Additionally, the sales of its top-selling model, Ecosport (accounting for >50% of sales), declined in recent periods because of the increasing number of competing models in the segment. However, the launch of Freestyle towards the end of FY2018 has provided some diversification. Freestyle accounted for about one third of the overall sales in H1 FY2019.

Working capital intensive operations – Being a working capital intensive industry, short-term working capital loans account for almost the whole of GAPL's debt. Given the expected increase in the inventory holding period due to a slowdown in the sales growth momentum, the overall working capital requirement is expected to increase in the near to medium term. This will lead to moderation of the coverage indicators. GAPL maintains around 50-80 days of inventory, which, along with elongated receivables from financiers, stretches the working capital cycle. The volatility witnessed in the working capital intensity in recent periods and the rising interest rates will also have a bearing on the company's net profitability.

Higher taxes, reduced bank financing ratio and increasing borrowing rates could impact demand growth – PVs have been a highly-taxed commodity in Nepal with a further sharp tax increment in FY2019. Additionally, a reduced loan-to-value (LTV) on bank financing of vehicles at 50%¹ by the banking sector regulator also deters prospective customers. As PV sales are mostly financed by banks, slower loan disbursements amid the current tight liquidity conditions in banking could impact sales growth. Moreover, bank interest rates have increased swiftly in the last two years, which, coupled with the inherent cyclicity in automotive demand, could constrain GAPL's revenue growth. Nonetheless, GAPL's sales are dominated by vehicles in the up to 1,500 CC segment, for which the extent of tax increments is relatively lower, thereby providing some comfort.

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](#)

¹ 50% introduced in March 2017 vs no caps earlier; later moderated to 65% in August 2017; reduced to 50% from October 2018

About the company

Incorporated in 2007, G.O. Automobiles Private Limited (GAPL) is the national dealer for Ford vehicles in Nepal. The company is promoted by three individuals from the Golchha family with a major stake (~70%) being held by Mr. Akash Golchha, the Managing Director of the company. GAPL is a part of the Golchha Organization, which has a presence of more than eight decades with operations across various manufacturing and trading sectors in Nepal. GAPL has a presence across the country through a network of 12 dealer showrooms and two own showrooms/sales outlets.

Key financial indicators

	FY2016 (Audited)	FY2017 (Audited)	FY2018 (Audited)	H1 FY2019 (Provisional)
Operating income (OI; NPR million)	2,980	4,041	4,118	2,501
OPBDITA/OI (%)	10%	12%	10%	7%
Total debt/Tangible net worth (TNW; times)	1.2	0.6	0.8	0.7
Total outside liabilities/TNW (times)	1.4	0.8	0.9	0.8
Total debt/OPBDITA (times)	2.7	1.1	2.1	2.4
Interest coverage (times)	9.9	11.0	4.8	3.1
DSCR (times)	7.8	8.6	3.9	2.4
Net working capital/OI (%)	40%	25%	36%	27%

Source: Company data

Annexure-1: Instrument details

Instrument	Limit (Amount in NPR Million)	Rating Action
Non-fund based facilities; Short term		
Letter of credit - LC	390	ICRANP] A3+
Bank guarantee - BG	70	ICRANP] A3+
Total non-fund based (A)	460	
Fund-based facilities; Short term		
Demand loans – DL	550	ICRANP] A3+
Trust receipt loans - TR loans (within LC)	(325)	ICRANP] A3+
Short-term loans	600	ICRANP] A3+
Overdraft	30	ICRANP] A3+
Fund-based long-term loans	74	[ICRANP] LBBB
Total fund-based (B)	1,254	
Grand total (A+B)	1,714	

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About ICRA Nepal Limited:

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