

Pokhara Noodles Private Limited: [ICRANP] LBB/ A4 (Assigned)

May 20, 2019

Summary of rated instruments:

Instrument*	Rated Amount (NPR Million)	Rating Action
Long-term; Fund-based Limits	162.67	[ICRANP]LBB; assigned
Short-term; Fund-based Limits	295.00	[ICRANP]A4; assigned
Short-term; Non-fund Based Limits	250.30	[ICRANP]A4; Assigned
Total	707.97	

* Instrument details are provided in Annexure-1.

Rating action

ICRA Nepal has assigned the long-term rating of [ICRANP]LBB (pronounced ICRA NP L Double B) to the NPR 162.67-million long-term loans of Pokhara Noodles Private Limited (PNPL or the company). ICRA Nepal has also assigned the short-term rating of [ICRANP]A4 (pronounced ICRA NP A four) to the NPR 295 million fund-based limits and the NPR 250.3 million non-fund based limits of PNPL.

Rationale

The assigned ratings factor in the long track record of PNPL (operating since 1992) and its experienced promoter group. The key products of the company, including Rambha White Noodles and Bonus Brown Noodles, enjoy good brand recognition in Nepal, with PNPL estimated to have a market share of ~8% (as per the company) in the overall noodles market and ~40% in the white noodles market in Nepal. The ratings also derive comfort from the established sales channel (with over 200 distributors) and fairly diversified customer profile of PNPL. The ratings also factor in the duty protection accorded to the domestic industries by the Government of Nepal (GoN) through import barriers on finished noodles and snacks

The ratings are, however, constrained by the muted sales outlook for the company (amid the current situation of excess capacity in the instant noodles manufacturing industry), its moderate financial profile and tight liquidity position. Following the earthquake of FY2015 and the blockade of FY2016, the noodles industry witnessed capacity expansion by the existing as well as new players to meet the surge in demand during the aforementioned events. However, as this demand subsided from FY2018 onwards post normalcy, there is an oversupply in the industry. PNPL thus, witnessed a decline in sales during FY2018 (decline of ~14%) and FY2019 (annualised decline of 23%¹). Coupled with high interest expenses (due to debt-funded capacity expansion in FY2017) and continued dividend payouts, this impacted the cash accruals of the company over the last two years. PNPL's working capital intensity also increased during the last two years on account of the increase in receivables and inventory days, due to poor offtake, which further led to an increase in the external working capital financing. The financial profile of the company, thus, remained moderate, with total debt to OPBDITA² of 4.2 times as of January 2019, net cash accruals to total debt (NCA/TD) of 11% and interest cover of 1.9 times for H1 FY2019. The liquidity position of the company also remains tight, given its significant debt repayment obligations over the medium term and limited headroom in working capital utilisation. This could also necessitate additional external financing and/or equity injection from the promoters.

The management expects this excess capacity situation to continue over the medium term, following which some players might exit this industry. ICRA, also takes note of the increased marketing initiatives being undertaken by the company to

¹ Muted growth in H1FY2019 is due to the seasonality in sales. Sales has picked up in Q3FY2019 and the improvement is expected to continue in Q4FY2019.

² Operating profit before depreciation, interest, tax and amortization.

improve its sales in the Kathmandu region, where PNPL, currently has a limited brand presence. The company's ability to improve its sales and profitability while maintaining the working capital intensity at reasonable levels, would be the key rating sensitivities. This apart, continuation of the import duty on instant noodles would be critical for improvement in revenues. Hence, any change in Government policy towards the same would also be a key rating sensitivity.

Key rating drivers

Credit strengths

Long track record and experienced promoters – Incorporated in 1992, PNPL is one of the early entrants into instant noodles manufacturing in Nepal. The promoters have been involved in this industry for the last 25 years and were also involved in another noodle manufacturing company before starting PNPL as a separate venture.

Established brands - Rambha white noodle is the oldest brand of PNPL and enjoys a strong market share of ~40% in the white noodles segment. PNPL has a market share of ~8% in the overall noodles market.

Established sales channel - The company has an established supply chain comprising over 200 distributors across the country. The sales of the company remain fairly diversified across its customers with the top 10 customers accounting for ~30% of sales in FY2018.

Credit challenges

Decline in sales amid increased competitive intensity; sales outlook remains muted - PNPL sales for the past three to four years have shown volatility caused by event-driven demands. The earthquake in FY2015 led to a spike in the sale of instant noodles with the rising demand for noodles as relief material and alternative food for the affected population. Demand remained strong in FY2016 in the aftermath of the earthquake and during the blockade. However, PNPL's production couldn't keep up with the demand because of the lack of raw material and fuel (amid custom blockade), leading to a decline in production and sales in FY2016. High growth continued in FY2017 with the company adding an extra production line and ramping up production. However, in FY2018 and H1 FY2019, the industry witnessed slackness in demand after the event-induced demand subsided. At the same time, there was a situation of excess supply in the industry because of the fresh capacity creation by older players as well as new entrants in FY2016 and FY2017. Over the short to medium term, the sales growth of PNPL is likely to remain moderate. Also rising competition in the industry because of new players could exert pricing pressure, resulting in a margin moderation.

Moderate financial profile - The financial profile is moderate owing to high debt levels and moderate profitability, with TD/OPBDITA of 4.2 times as of January 2019, NCA/TD of 11% and an interest cover of 1.9 times for H1 FY2019. While long-term debt levels have increased since FY2017 on account of the debt-funded capex, increased working capital borrowings are largely on account of the increase in working capital intensity of PNPL, amid a decline in sales.

Tight liquidity position - The company's liquidity position is stretched, given its moderate profitability, significant debt repayment obligations over the medium term and limited headroom in working capital utilisation. This could also necessitate additional external financing and/or equity injection from promoters

Limited product diversification – PNPL's revenue profile remains dominated by instant noodles, which accounted for over 95% of company's revenue in the last two to three years. As such, PNPL's product profile is concentrated and any

impact on sales and/or the margin of noodles, especially with the increased competition in the industry, could have a corresponding impact on the company's financial profile and debt coverage metrics.

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

Pokhara Noodles Private Limited (PNPL) is a privately held company incorporated in March 1992. It is one of the early entrants into the instant noodles manufacturing industry, with its flagship product Rambha white noodles. The company also manufactures brown noodles under the brand name Bonus, JoJo and Sulav, among others.

The major equity owners of the company include Mrs. Tulasa Pandey (~20%), Mr. Shreeram Pandey (~20%), Mr. Hari Prasad Pandey (~18%), Mr. Baburam Pant (~8%), Mrs. Sita Pandey (~6%), Mr. Shankar Prasad Pandey (~5%) among others. As on mid-January 2019, the company had two adjoining manufacturing units in Pokhara Industrial District (PID), producing 16 different types of products which mostly include instant noodles. PNPL purchases its key raw materials- wheat flour (maida), palm oil, wrappers and card box, from the suppliers within Nepal. As on mid-January 2019, the company's distribution channel comprises over 200 dealers across the country.

Key financial indicators

	FY2015 (Audited)	FY2016 (Audited)	FY2017 (Audited)	FY2018 (Audited)	H1FY2019 (Provisional)
Operating Income-OI (NPR Million)	902.63	818.74	1,150.97	995.19	383.14
OPBDITA/OI (%)	7.02%	11.58%	8.99%	10.52%	12.38%
Total Debt/Tangible Net Worth TNW (times)	1.49	1.84	2.02	2.37	2.14
Total Outside Liabilities/ TNW (times)	3.02	2.79	3.47	3.37	3.91
Total Debt/OPBDITA (times)	2.61	3.62	3.76	4.09	4.19
Interest Coverage (times)	5.64	5.87	3.65	2.53	1.86

Source: Company data

Annexure-1: Instrument Details

Instrument	Limit (NPR in Million)	Ratings
Long-term, fund based		
Term loan	157.81	[ICRANP] LBB
Hire purchase loan	4.86	[ICRANP] LBB
Total long term, fund based (A)	162.67	
Short-term		
Fund based (OD/TR/DL/STL)	295.00	[ICRANP] A4
Non-fund based (LC/GT)	250.30	[ICRANP] A4
Total short term, fund/non-fund based (B)	545.30	
Grand total (A+B)	707.97	

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About ICRA Nepal Limited:

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