

PRESS RELEASE

NEPAL EKARAT ENGINEERING COMPANY PRIVATE LIMITED

July 2024

Ratings

Instrument/Facilities	Amount (NPR Mn)	Ratings	Rating Action
Long Term Bank Facilities – Term Loan	613.90 (enhanced from 136.98)	IRN BB	Reaffirmed
Short Term Bank Facilities- Fund Based Loan	410.00 (enhanced from 220.00)	IRN A4	Reaffirmed
Long Term/Short Term Bank Facilities- Non Fund Based Loan	1,125.00 (reduced from 3,643.02)	IRN BB/A4	Reaffirmed
TOTAL	2,148.90		

Details of facilities are in Annexure 1 below

Infomerics Credit Rating Nepal Limited (Infomerics Nepal) has reaffirmed rating of IRN BB (Double B) assigned to the long term facilities of NPR 613.90 Mn, rating of IRN A4 (A Four) assigned to the short term bank facilities of NPR 410.00 Mn and IRN BB/A4 (Double B / A Four) assigned to the long term/short term bank facilities of NPR 1,125.00 Mn.

Detailed Rationale

The reaffirmation of ratings assigned to bank facilities of Nepal Ekarat Engineering Company Private Limited (NEEK) continue to derive strength from established track record of operations, experienced directors and a proficient management team. The ratings continue to factor in NEEK's moderate counter-party risk, locational advantage, established brand name & market position and average financial profile. These rating strengths, however, continue to remain constrained by NEEK's existence in a competitive industry as reflected in low capacity utilization. Furthermore, the ratings continue to note NEEK's exposure to client and supplier concentration risk, volatility in prices of raw materials, foreign exchange rates volatility risk, product warranty risk, interest rate volatility risk, and working capital intensive nature of business. Going forward, sustained growth in revenue with improvement in profitability margins and prudent working capital management aiding financial risk profile will remain key rating sensitivities.

Detailed Description of Key Rating Drivers

Key Rating Strengths

Established track record of operations with experienced promoters and management team

NEEK has an operational track record of more than three decades in manufacturing of distribution transformers under the brand name "NEEK". The major operations of the company are overseen by the Chairman, Mr. Kush Kumar Joshi, who has over three decades of experience in managing the company. Similarly, other directors of the company also have a relevant experience in the same line of business. The board is further supported by a team of technically qualified and experienced professionals.

Moderate counter party risk and locational advantage

NEEK generates majority of its revenue from the sales of transformers to various governmental entities and domestic/foreign parties. The majority of orders executed by NEEK is attributable to Nepal Electricity Authority (NEA) resulting in moderate counter party risk as it is fully owned by Government of Nepal and has been regular in making payments to concerned parties. Furthermore, the counterparty risk associated with other parties are moderated to some extent, given its adequate

credit policies and long standing relationship with its clients. NEEK's factory is located in the Hetauda district of Nepal, which is situated near Kathmandu, the primary market for NEEK's products. Also, its proximity to the Indo-Nepal Border, where raw materials are imported, offers a strategic advantage for logistical operations and management of the company.

Average financial risk profile

The total operating income of the company increased by ~72% year-on-year in FY23, mainly attributable to execution of orders related to NEA tenders. However, the EBITDA margin decreased to ~5% in FY23 from ~9% in FY22 primarily due to execution of low margin contracts during FY23. Consequently, PAT margin decreased to ~2% in FY23 from ~5% in FY22 mainly due to lower EBITDA coupled with increased interest expenses. The increase in interest expenses is primarily on account of higher utilization of working capital limits to support the increase in volume of operations. The capital structure of NEEK remains moderately leveraged as reflected by the overall gearing ratio of 1.74x as on mid-July 2023, improved from 2.24x as on mid-July 2022 mainly due to scheduled repayment of loans coupled with improvement in tangible net worth. Going forward, sustained growth in revenue with improvement in overall margins, coverage & capitalization indicator remains crucial.

Key Rating Weaknesses

Low Capacity Utilization

The capacity utilization of NEEK has been on the lower side with an average of ~25% in the past three financial years ended FY23. However, the capacity utilization has improved to ~36% in FY23 mainly on account of execution of orders from government and foreign parties. NEEK has an installed capacity of 18,000 units (in terms of 100 kVA distribution transformer) per annum.

Client and supplier concentration risk

NEEK's revenue concentration from its top-ten clients surged to ~97% in FY23, a significant increase from ~73% in FY22, largely attributed to the execution of orders linked to the NEA. This dependence on a limited customer base exposes NEEK to substantial financial risk, as any reduction in orders from these clients could adversely impact revenue stability and overall financial performance. Similarly, NEEK's supplier concentration remained notably high in FY23, with ~79% of total purchases sourced from its top ten suppliers mainly due to supply agreement with its JV partner for supplying the requisite copper wires. Such a reliance on a small group of suppliers exposes NEEK to risks associated with potential disruptions in supply chains and fluctuations in prices.

Exposure to raw material prices volatility and foreign exchange rates

NEEK imports cold rolled grain oriented (CRGO) silicon steel, transformer oils, transformer tanks from India while copper wires are typically sourced from the domestic market. These raw materials correspond to ~80-90% of the total production costs and prices of these raw materials are highly volatile in nature as prices are guided by international demand-supply scenario due to their global linkages. This exposes NEEK to any major adverse raw material price fluctuations. Nevertheless, the presence of supplier agreement for copper wires for significant portion of the outstanding order in hand provides comfort to an extent. Furthermore, NEEK is exposed to foreign exchange fluctuation risk due to the mismatch in currency, as majority of its key raw materials are imported (in USD) while significant portion of the revenue is realization in local currency.

Competitive industry with working capital intensive nature of operations

The company remains exposed to competitive pressure by ways of import from countries such as India along with presence of few domestic manufacturers. The competitive nature of the industry coupled with tender or quotation based procurement by majority of the customers has resulted in pressure on pricing and margins for players like NEEK. Furthermore, the operations of the company are working capital intensive especially due to high inventory holding of key raw materials and distribution transformers to ensure availability during periods of demand. Nevertheless, total

operating cycle of the company decreased to 86 days in FY23 vis-à-vis 144 days in FY22 with company's inventory management efforts. Despite the reduction in the operating cycle of NEEK the reliance on working capital loans remains high as the average utilization of fund-based working capital limit against drawing power was above 80% during FY23.

Analytical Approach: Standalone

Applicable Criteria:

[Corporate Credit Rating Methodology](#)

Past Rating Rationale:

[Nepal Ekarat Engineering Company Private Limited: Bank Facilities Rating Assigned](#)

About the Company:

Incorporated on January 1991, NEEK is a private company having its plant located at Thana Bharyang, Hetauda for manufacturing distribution transformer with total installed capacity of 18,000 units per annum. The company manufactures distribution transformers in a range between 1kVA and 10 MVA and voltage up to 132kV.

Financial Indicators (Standalone)

For the year ended* As on	FY21	FY22	FY23
	Audited	Audited	Audited
Total Operating Income (in NPR Mn.)	559	1,447	2,463
EBITDA Margin (%)	13.80	9.07	5.25
Interest Coverage Ratio (x)	6.84	2.62	1.11
Total Debt/EBITDA (x)	2.71	6.00	5.40
Current Ratio (x)	2.88	1.13	1.13
Overall Gearing Ratio (x)	0.52	2.24	1.74

*Classification as per Infomerics Nepal standards

Annexure:1 Detail of Facilities:

Name of Instruments/ Facilities	Type of Facilities	Amount (NPR Mn)	Rating
Fund Based Bank Facilities- Term Loan	Long Term	118.90	IRN BB
Fund Based Bank Facilities- Term Loan (Proposed)	Long Term	495.00	IRN BB
Fund Based Bank Facilities- Short Term Loan	Short Term	120.00	IRN A4
Fund Based Bank Facilities- Short Term Loan (Proposed)	Short Term	290.00	IRN A4
Non Fund based Bank Facilities- LC/BG ¹	Long Term/ Short Term	150.00	IRN BB/A4
Non Fund based Bank Facilities- LC/BG (Proposed)	Long Term/ Short Term	975.00	IRN BB/A4
Total Facilities		2,148.90	

¹Letter of Credit/Bank Guarantee

Analyst Contacts

Mr. Saphal Maharjan

Tel No.+977-1-4583304/4585906

saphal.maharjan@infomericsnepal.com



Infomerics Credit Rating Nepal Limited

Ms. Samigya Acharya

Tel No. +977-1-4583304/4585906

samiqya.acharya@infomericsnepal.com

Relationship Contact

Mr. Rabin Pudasaini

Tel No. +977-1-4583304/4585906

rabin.pudasaini@infomericsnepal.com

About Infomerics Credit Rating Nepal Limited:

Infomerics Credit Rating Nepal Ltd. is Nepal's third Credit Rating Agency licensed by the Securities Board of Nepal (SEBON) on March, 2022. Infomerics Nepal is a subsidiary of Infomerics Valuation and Rating Private Limited (Infomerics India) which is a SEBI registered and RBI accredited Credit Rating Agency licensed in 2015. Infomerics Nepal aims to provide investors with objective analysis and evaluation of credit worthiness of Banks, NBFCs, Large Corporates and Small and Medium Scale Units (SMUS) via its rating and grading services. Thus, it is playing a key role in serving the financial markets by reducing the information asymmetry among varied lenders and investors and facilitating borrowers/issuers to various fundraising opportunities/avenues. Infomerics observes and maintains ethical standards in its activities. For more information, visit <https://infomericsnepal.com/>

Infomerics Credit Rating Nepal Limited

Tanka Prasad Marga, Baneshwor Height, Kathmandu

Phone: +977-1-4583304/4585906

Email: info@infomericsnepal.com

Web: www.infomericsnepal.com

Disclaimer: Ratings assigned by Infomerics Nepal are an opinion on the credit risk of the issue / issuer and not a recommendation to buy, hold or sell securities. Infomerics Nepal reserves the right to change, suspend or withdraw the credit ratings at any point in time. Ratings assigned by Infomerics Nepal are opinions on financial statements based on information provided by the management and information obtained from sources believed by it to be accurate and reliable. The credit quality ratings are not recommendations to sanction, renew, disburse or recall the concerned bank facilities or to buy, sell or hold any security. We, however, do not guarantee the accuracy, adequacy or completeness of any information, which we accepted and presumed to be free from misstatement, whether due to error or fraud. We are not responsible for any errors or omissions or for the results obtained from the use of such information. Most entities whose bank facilities/instruments are rated by us have paid a credit rating fee, based on the amount and type of bank facilities/instruments. In case of partnership/proprietary concerns/Association of Persons (AOPs), the rating assigned by Infomerics Nepal is based on the capital deployed by the partners/proprietor/ AOPs and the financial strength of the firm at present. The rating may undergo change in case of withdrawal of capital or the unsecured loans brought in by the partners/proprietor/ AOPs in addition to the financial performance and other relevant factors.