

PRESS RELEASE

SAGAR DISTILLERY LIMITED

July 2024

Rating

Instruments/ Facilities	Amount (NPR Mn)	Rating	Rating Action
Issuer Rating	NA	IRN B+ (Is)	Assigned

Infomerics Credit Rating Nepal Limited (Infomerics Nepal) has assigned the issuer rating of IRN B+ (Is) [Single B Plus (Issuer)]. Issuers with this rating are considered to have the high risk of default regarding timely servicing of financial obligations.

Detailed Rationale

The issuer rating assigned to Sagar Distillery Limited (SDL) derive comfort from its experienced promoters and support from resourceful promoter's group. The rating also factors moderate capital structure and debt indicators.

However, these rating strengths are partially constrained by limited track record of operation and small scale of operations, albeit improving revenue trend. The rating also factors company's elongated operating cycle and input price fluctuations alongwith restricted pricing authority. Similarly, regulatory risk relating to change in tariffs has also been factored. Going forward, the company's ability to maintain a healthy profitability profile, enhance capitalization and coverage metrics, while discreetly handling working capital levels and successfully executing an IPO, will be key rating sensitivities.

Detailed Description of Key Rating Drivers

Key Rating Strengths

Experienced promoters and support from resourceful promoter's group

Mr. Sandeep Jalan and Mr. Ashutosh Khetan, the principal shareholders of SDL, possess extensive experience in a wide range of industries including brokerage, information technology, media, real estate, and manufacturing. Furthermore, the company's plant is managed by Mr. Nitesh Thakur, who brings over ten years of expertise in the distillery industry. The experience of promoters, coupled with their understanding of local market conditions and relationships with suppliers and customers, is anticipated to support the company's future growth trajectory and operational stability.

Moderate Capital Structure and Debt Indicators

The overall gearing ratio improved significantly to 0.26x in FY24 vis-à-vis 1.56x in FY23 and 2.18x in FY22 on account of repayment of debt and improved tangible net worth. Similarly, Total Outside Liabilities (TOL) to Tangible Net Worth (TNW) ratio also saw an improvement to 0.30x in FY24 vis-à-vis 2.02x in FY23 and 2.36x in FY22. However, Total Debt to Gross Cash Accruals (GCA) ratio deteriorated significantly, falling to negative 11.41x in FY24 vis-à-vis negative 3.93x in FY23 and negative 8.74x in FY22 due to negative GCA.

Key Rating Weaknesses

Limited track record of operations

Sagar Distillery Limited (SDL) initiated its full-fledged operations from FY22, which results to an operational track record of only three years. This limited history poses inherent uncertainties regarding the company's capacity to sustain its current level of operations and, more importantly, to scale up its operations effectively while maintaining its profit margins over the long term. The ability of SDL to navigate the complexities of the market, manage its cost structures efficiently, and achieve growth in a competitive landscape remains to be seen. This factor will be crucial in assessing the company's long-term viability and stability from a credit rating perspective.

Small scale of operation, albeit improving revenue trend

SDL started commercial operation from FY22. In FY22, the total operating income (TOI) was NPR 66 Mn which rose to NPR 94 Mn in FY23 and NPR 176 Mn in FY24 on account of gradual brand stabilisation. However, EBITDA Margin remained negative in FY22 and FY23 on account of heavy expense on selling and advertisement. In FY24, EBITDA Margin improved significantly to ~16% on account of decrease in raw material cost and selling & distribution cost. However, PAT Margin remained negative at ~16% in FY24 due to high interest expense. Also, GCA remained negative at NPR 19 Mn in FY24.

Elongated Operating Cycle

The operations of the company are working capital intensive in nature. The average collection period increased to 188 days in FY24 vis-à-vis 153 days in FY23 and 41 days in FY22. The significant increase in FY24 was on account of flexible credit periods allowed in order to increase the market shares. Conversely, the inventory holding period decreased to 57 days in FY24 from 106 days in FY23 and 71 days in FY22. The improvement was on account of brand acceptance by the public with increase in demand and efficient distribution channel. Similarly, the creditors period decreased to 28 days in FY24 from 59 days in FY23 and 39 days in FY22. The credit period allowed to SDL is around 30 days. Combining all, the total operating cycle of the company remained elongated at 217 days in FY24 which was 199 days in FY23 and 72 days in FY22.

Input Price Fluctuations and Restricted Pricing Authority

SDL utilizes ENA (Extra Neutral Alcohol) and Rectified Spirit as primary raw materials in its production processes. Due to the high price volatility of these raw materials, the company faces significant challenges. Additionally, SDL has limited bargaining power when it comes to the cost of packing materials, primarily because of the relatively low order quantities involved.

Regulatory Risk

The high import tariff on finished liquors provides duty protection while relatively high entry barriers to the domestic spirits industry, supporting the position of domestic liquor producers. 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 SDL'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 SDL.

Analytical Approach: Standalone

Applicable Criteria:

[Issuer Rating Methodology](#)

About the Company:

Incorporated in 2014 AD, and converted to a public limited company on May 21, 2023, Sagar Distillery Limited (SDL), is modern liquor blending and bottling unit, manufacturing high-grade spirits like Vodka, Whiskey, Gin, etc. SDL features a liquor production capacity of 5,000,000 Litres annually. The products of SDL include Lalipop Gold/ Apple/ Lemon/Orange (70 UP), Royal Blue (40 UP), Grey Wolf (40 UP), Beries & Blues (40 UP) and Nepse Bulls (30 UP). Company is promoted by Mr. Sandeep Jalan, Mr. Ashutosh Khetan and Alka Goyal holding majority shareholding i.e., 17.48%, 19.08% and 15.10% respectively.

Financial Indicators (Standalone)

For the year ended* As on	FY22	FY23	FY24
	Audited	Audited	Unaudited
Total Operating Income (NPR Mn)	66	94	176
EBITDA Margin (%)	Negative	Negative	15.74
Interest Coverage Ratio (x)	Negative	Negative	0.60
DSCR (x)	Negative	Negative	0.60
Overall Gearing Ratio (x)	2.18	1.56	0.26
Total Debt/EBIDTA (x)	Negative	Negative	7.65
TOL/TNW (x)	2.36	2.02	0.30

Earnings before Interest Tax Depreciation Amortization (EBITDA)

Total Outside Liabilities/Tangible Net Worth (TOL/TNW)

*Classification as per Infomerics Nepal standards

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About Infomerics Credit Rating Nepal Limited:

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