Muktinath Krishi Company Limited: Rating reaffirmed

January 16, 2023

Summary of rating action:

Facility/Instrument	Rated amount (NPR million)	Rating action
Issuer Rating	NA	[ICRANP-IR] BB-; reaffirmed

Rating action

ICRA Nepal has reaffirmed the issuer rating of Muktinath Krishi Company Limited (MKCL) at **[ICRANP-IR] BB-** (pronounced ICRA NP Issuer Rating Double B minus). Issuers with this rating are considered to have a moderate risk of default regarding timely servicing of financial obligations. The sign of + (plus) or – (minus) appended to the rating symbol indicates their relative position within the rating categories concerned. The rating is only an opinion on the general creditworthiness of the rated entity and not specific to any debt instrument.

Rationale

The rating continues to factor in the established track record, reputation, and diverse business network of the company's largest promoter viz. Muktinath Bikas Bank Limited (MNBBL). MKCL is likely to benefit from the traction and experience of MNBBL in the micro and small-scale agricultural project financing, which has supported the company's revenue growth so far, with similar expectations going forward. The rating further remains supported by MKCL's established organisational structure, its experienced management team and a growing product portfolio. In addition, MKCL's objectives of offering value-chain based support and financing for the agriculture sector (which is among the largest sector contributing to Nepalese GDP) also remains among the rating positives.

The rating, however, is constrained by the company's short track record of operations (since FY2020) and relatively small scale so far, with a steadily high working capital cycle. In addition, the rating also remains impacted by the sizeable losses sustained by the company in FY2022 due to write-off expenses of ~NPR 92 million after it was unable to deliver the chemical fertilizer to the government of Nepal (GoN), thereby leading to a eroded capital base. Moreover, the seasonality in revenues, as evident in its initial years of operations, also exposes the company to revenue volatility risks. Rating concerns also arise from the inherent risks and infrastructural bottlenecks in the agriculture business like competition from imported agricultural products, challenges in domestic productions because of reasons such as lack of minimum support prices (MSP), timely unavailability of seeds and fertilizers, land fragmentation, vulnerability to environmental and biological conditions, among others. Going forward, MKCL's ability to scale up the business as anticipated, while ensuring sustainability of the recent improvement in margins and improve its working capital cycle would remain the key rating sensitivities.

Key rating drivers

Credit strengths

Established track record and diverse network of the largest promoter – MKCL has been mainly promoted by Muktinath Bikas Bank Limited (MNBBL) with 27.8% equity stake in the company. MNBBL is a national level class B bank licensed by the Nepal Rastra Bank (the Central Bank) and has been operating since 2007 with current network of 178 branches across the country. MNBBL started off as a regional level development bank with strong microfinance operations in western Nepal before its upgradation to a national level player and therefore has a strong traction with various stakeholders in the areas of grassroot agricultural financing. The experience, network, and expertise of MNBBL is expected to benefit MKCL in the long run. In addition, the leadership of MKCL comprises experienced professionals in the agricultural and allied arena, which has led to an established organisational structure.

Diverse product range – MKCL is targeting to become a relatively large-scale player in an industry dominated by small-scale vendors, which is expected to provide it with benefits of economies of scale. In addition, MKCL's product portfolio comprises a wide variety of machinery, equipment, supplies and biological inputs related to agriculture. The company is in the process of further building its product portfolio to provide a comprehensive range of agriculture related products and services. This is expected to reduce the company's sales volatility and impart benefits of operational synergies.

Large size of agriculture sector providing growth opportunity – The agriculture sector remains the largest production sector in Nepal with gross domestic product (GDP) contribution from agriculture, forestry and fishing at ~23.9% for FY2022[1]. The scale of the industry has grown to ~NPR 983 billion in FY2022 from ~NPR 529 billion in FY2012 (CAGR of ~6.4%; as per preliminary figures from Central Bureau of Statistics). The large and growing scale of the agriculture sector provides good potential for business growth as envisaged by MKCL.

Credit challenges

Early phase of operations; long-term revenue and profitability trend yet to be established – MKCL was established in 2018 and recorded its first revenues in FY2020. Despite the recent scale-up, the FY2022 revenues at ~NPR 192 million remained inadequate to achieve breakeven status for the year, which raises concern regarding the sustainability of improved profit margins as reported during 5M FY2023. Furthermore, the company also had to write off ~NPR 92 million in FY2022, after it failed to deliver the chemical fertilizers as per the contractual terms with the GoN. MKCL's ability to scale-up and run a sustainable and adequately profitable operations would remain crucial, in light of the sizeable accumulated losses due to this event. However, the recent equity infusion by promoters has aided the company in managing the liquidity stress to an extent, which remains a positive.

Steadily high working capital intensity – MKCL reported a cash cycle of 433 days in FY2022 with significantly high working capital intensity (net working capital to operating income) of ~117% for the year (despite improvement from ~185% in FY2021). This was partly due to the penetrative market strategy adopted by the company, which has eroded its cash cushion and could necessitate external financing, as evident from the recent increase in bank borrowings.

Inherent risk in agriculture business and seasonality in sales – The revenue stream of MKCL is exposed to inherent risks in agriculture business like relatively unpredictable output, volatile realisations, vulnerability of margins to raw material price fluctuations, as well as weather dependent agricultural output etc. In Nepal, the sector remains further exposed to infrastructural bottlenecks like lack of established MSP mechanism, timely unavailability of seeds and fertilizers, land fragmentation and high land prices, etc. Further, the annual sales pattern of the company is highly skewed with most of its sales (~76% in FY2021 and ~65% in FY2022) being recorded in the months of April-July. Any impact on the operation/sales during those periods would have a disproportionately high impact on the company's financial profile.

Analytical approach

For arriving at the rating, ICRA Nepal has applied its rating methodology as indicated below.

Links to applicable criteria:
Issuer Rating Methodology

Link to the last rating rationale:
114.-Muktinath-Krishi-Company-Ltd_Issuer-Rating_Rationale_January_2022.pdf

[1] *Source: https://cbs.gov.np/wp-content/upLoads/2022/08/Neapl-In-Figures-2022.pdf*

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About the company

Established in 2018, Muktinath Krishi Company Limited (MKCL) is involved in a wide range of agriculture-based business activities which includes retail, trading, research and development and supply chain management amongst others. The company's revenues are currently dominated by its retail operations with over 90% contribution to sales for FY2022. The company's major promoter is Muktinath Bikas Bank Limited (MNBBL) with a 27.8% stake (on current paid up capital; would dilute after proposed IPO), followed by 862 other shareholders with highest individual stake of 2.4%. The company's registered office is in Ward No. 3, Basundhara, Kathmandu. Mr. Bharat Raj Dhakal is the company's chairman.

Key financial indicators

	FY2020 (Audited)	FY2021 (Audited)	FY2022 (Audited)	5M FY2023 (Provisional)
Operating income (OI; sales in NPR million)	15	98	192	70
OPBDITA/OI (%)	-53.2%	-21.9%	-6.1%	12.3%
Total debt/Tangible net worth (TNW; times)	-	-	0.20	0.27
Total outside liabilities/TNW (times)	0.01	0.04	0.47	0.51
Total debt/OPBDITA (times)	-	-	-4.68	4.30
Interest coverage (times)		-107.74*	-1.85	2.84
DSCR (times)		-107.74*	-1.85	2.84
Net working capital/OI (%)	145.8%	185.3%	117.2%	163.5%

Source: Company data

** The interest expenses reported in FY2021 is not for bank borrowings but paid to its suppliers. MKCL did not avail any bank financing for the year.*

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