

Rating Rationale

BKOI Builders Private Limited

Rating

| Facility | Amount (Rs. In Million) | Rating¹ | Rating Action |
|----------------------------|------------------------------------|---------------------------|----------------------|
| Long Term Bank Facilities | 338.93 | CARE-NP BB [Double B] | Assigned |
| Short Term Bank Facilities | 4,380.00 | CARE-NP A4 [A Four] | Assigned |
| Total Facilities | 4,718.93 | | |

Details of Facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has assigned rating of ‘CARE-NP BB’ to the long term bank facilities and ‘CARE-NP A4’ to the short term bank facilities of BKOI Builders Private Limited (BBPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of BBPL are constrained by tender based nature of operations in highly competitive construction industry and working capital intensive nature of business. The rating is also constrained by leveraged capital structure, planned debt funded capital expenditure and exposure to volatile interest rates. The ratings, however, derive strength from experienced promoters in related field; established track record in executing construction projects; and healthy order book position with mid-term revenue visibility. The ratings also factor in financial risk profile marked by increased revenue; healthy profitability margins and satisfactory debt service coverage indicators during FY19 (Provisional, refers to 12 months' period ended mid-July 2019); moderate counter party risk; and escalation clause in majority of the contracts. Ability of the company to successfully execute projects in time and recover contract proceeds; and ability to manage healthy revenue growth and maintain profitability margins without deterioration in its financial risk profile will be key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Tender based nature of operations in highly competitive construction industry

The company receives its work orders from government departments and private entities with majority of the order coming from government departments. All government contracts are tender-based wherein the company has to quote the bid and hence it has to face the risk of successful bidding for the same, which again comes with the risk of quoting a low price to sustain competition. With regard to private contracts, the contract is generally awarded on negotiation basis. The promoter's reasonable experience in related field mitigates risk of competition to some extent. Since there are numerous fragmented and unorganized players operating in this industry which makes the civil construction space highly competitive, the ability of BBPL to sustain its profitability margins and

¹Complete definitions of the ratings assigned are available at www.careratingsnepal.com

growth in future remains crucial. Further, the business also remains dependent on stability in government policies and fiscal position of the government.

Working capital intensive nature of business

The operations of the company are working capital intensive in nature. The company primarily works with government departments and payments for contracts are received in a timely manner within 1-2 months generally. The retention money is deducted by the client from running bills submitted by the company. Also, there is huge amount of work-in-progress amounting to Rs. 188 Mn in FY19 which mainly includes works that are completed by the company, but not yet verified resulting in low revenue booking coupled with delay in fund realization. These factors lead to reliance of the company on bank finances to meet its working capital requirements. The average working capital utilization of the company was at ~83% for last twelve months ending mid- October, 2019.

Leveraged capital structure

The capital structure of the company is leveraged with debt equity ratio and overall gearing ratio of 1.46x and 3.80x respectively at the end of FY19 (vis-à-vis 0.97x and 2.73x respectively at the end of FY18). The gearing ratios of the company increased mainly on account of term loans availed for purchase of equipment/ machinery coupled with increase in working capital loans taken from banks and unsecured loan taken from promoters.

Planned debt funded capital expenditure

The company has been making regular investments to expand its machinery base in the past and is expected to continue in future. The purchase of fixed assets by the company was mainly funded through bank finance resulting in increase of debt component. Further, the company plans to take additional loan for purchase of equipment/machineries for the new projects proposed to be undertaken in future.

Exposure to volatile interest rates

Nepalese banking sectors are fixing lending interest rate based on quarterly base rate and interest rate will be changed accordingly on quarterly basis. Due to tight liquidity in the market, the interest rate has been high and volatile during the last 12 months. Therefore, funding from Bank and Financial Institutions is exposed to volatile interest rate.

Key Rating Strengths

Experienced promoters in the related fields

BBPL is managed under the overall guidance of the company's three board of directors (BOD) who possess experience in related field. The company is promoted by Mr. Humnath Koirala, managing director, who has long experience of over 38 years in the field of construction business. Similarly, other directors of the company have related experience in construction business. BOD are further supported by an experienced team across various functions/ departments.

Established track record in executing construction projects

BBPL has an established track record of over 10 years in the construction of buildings, roads, bridges, reservoirs, irrigation and water projects ranging from small sized to large sized projects and have executed several projects (majority of which are building projects) across the country in different terrains either individually or through its joint venture (JV) entities.

Healthy order book position with mid-term revenue visibility

Till November 2019, unexecuted orders in hand of the company stood at Rs. 1,920 Mn. Due to government initiative towards the infrastructure projects, the order book of the company is expected to increase in future. The order book of the company reflects medium term revenue visibility for the next 1 to 2 years. The order book is mainly concentrated in building works (accounting for ~71% of total work order) along with other various projects such as irrigation and water works, bridge works and road works received from various government authorities as well as private entities. Timely completion of the projects and increasing its scale of operations would be critical from the credit perspective for BBPL.

Financial risk profile marked by increase in total revenue, healthy profitability margins and satisfactory debt service coverage indicators

Financial risk profile of the company is comfortable marked by increase in scale of operations, profitability margins and cash accruals over the period ended FY19 (UA). Total revenue of the company increased from Rs. 833 Mn in FY18 to Rs. 881 Mn in FY19 (~6% growth Y-o-Y) mainly due to significant increase in income from leasing of construction equipment despite decline in revenue from construction contracts during the year. Further, the company has healthy PBILDT margin which increased to ~22% in FY19 from ~14% in FY18 mainly due to substantial increase in leasing income. PAT margin of the company was at ~8% in FY19 which improved from ~5% in FY18 mainly on account of increase in PBILDT and non- operational income which was partially offset by increased interest and depreciation expense. The debt service coverage indicators were at a moderate level marked by total debt to gross cash accruals and interest coverage of 5.88x and 2.75x respectively in FY19.

Moderate counter party risk

Revenue of BBPL is generated via contracts from government departments and private entities related to building works, road works, irrigation and water works etc. Average collection period of the company was high at 134 days in FY19 (vis-à-vis 105 days in FY18) as one major bill amount with reference to building works being executed was raised at end of FY19 ultimately resulting in high collection period. However, the counter party risk is moderated by the fact that majority of the construction contracts are obtained from government departments and they are making timely payment to the company in past.

Escalation clause in majority of the contracts

The company has inbuilt price escalation clauses in majority of contracts in order to insulate the company from any adverse fluctuation in construction material prices and labor expenses. This enables the company to pass on increase in construction cost to its customers. Ability of the company to pass on increased price burden to the customers in a timely manner and maintain profitability margins is critical from credit prospective.

About the Company

BKOI Builders Private Limited, incorporated on December 21, 1997, is a mid-scale construction company based in Kathmandu, Nepal. The company is promoted by Mr. Humnath Koirala who holds 62% of total shares of the company. The company has been involved in construction of both small and large scale projects such as buildings works, irrigation works, water supply works, road works etc. across Nepal. BBPL also enters into JV with other companies in order to meet the eligibility criteria for different construction projects. BBPL is being promoted by 5 shareholders who have infused total paid-up equity of Rs. 70 Mn as on July 16, 2019.

Brief financials of BBPL for last three years ending FY19 are given below:

(Rs. Million)

| For the year ended Mid July | FY17 | FY18 | FY19 |
|------------------------------------|------------------|------------------|--------------------|
| | (Audited) | (Audited) | (Unaudited) |
| Income from Operations | 733 | 833 | 881 |
| PBILDT | 87 | 115 | 197 |
| PAT | 33 | 44 | 71 |
| Overall Gearing (times) | 0.78 | 2.73 | 3.80 |
| Interest Coverage (times) | 3.31 | 3.55 | 2.75 |

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Annexure 1: Details of the Facilities rated

| Nature of the Facility | Type of the Facility | Amount (Rs. In Million) | Rating |
|-------------------------------|-----------------------------|--------------------------------|---------------|
| Long Term Bank Facilities | Term Loan | 338.93 | CARE-NP BB |
| Short Term Bank Facilities | Working Capital Limit | 520.00 | CARE-NP A4 |
| Short Term Bank Facilities | Non-Funded Limit | 3,860.00 | CARE-NP A4 |
| Total | | 4,718.93 | |