

Rating Rationale
Apex Construction Company Private Limited

Rating

Facility	Amount (Rs. In Million)	Rating ¹	Rating Action
Long Term Bank Facilities	291.35	CARE-NP BB [Double B]	Assigned
Short Term Bank Facilities	3,223.50	CARE-NP A4 [A Four]	Assigned
Total Facilities	3,514.85		

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 Apex Construction Company Private Limited (ACC).

Analytical approach:

CRNL has analysed ACC’s credit profile by considering the consolidated financial statements (comprising ACC and its joint venture entities related to the construction works) owing to financial and operational linkages between ACC and the JV entities.

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of ACC are constrained by leveraged capital structure and moderate debt coverage indicators of the company at the end of FY19 (Provisional, refers to 12 months’ period ended mid-July 2019), tender based nature of operations in highly competitive construction industry and working capital intensive nature of business. The rating is also constrained by planned debt funded capital expenditure and exposure to volatile interest rates. The ratings, however, derive strength from experience of promoters in construction field; established track record in executing diversified construction works and healthy order book position with mid-term revenue visibility. The ratings also factor in financial risk profile marked by increase in total revenue despite decline in profitability margins in FY19; 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.

Impact of Covid-19 on the business of the company

The outbreak of Coronavirus disease 2019 (Covid-19) which was recognized as Pandemic has affected Nepal as well. Government of Nepal (GoN) imposed travel restrictions and countrywide lockdown since March 24, 2020 halting operations of most of the organizations and slowing down economic activities. The construction activities of the company were also subdued on account of lockdown. Also, since construction activities in Nepal usually takes momentum on second half of the financial year, with country’s economy and construction sector

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

significantly impacted since March 2020, it may have a negative impact on the revenue, profitability and debt service indicators of the company. Considering the impact of Covid-19 in the economy of Nepal, GoN has introduced various packages to ease out the impact across different sectors including construction sector. Further, the Central Bank of Nepal has provided an extension for the repayment of debt obligations and rebate in interest rate by 2% for the fourth quarter ending mid-July 2020. The company's ability to achieve its projected revenue, maintain profitability margins and liquidity position will be key rating consideration.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Leveraged capital structure and moderate debt coverage indicators

The capital structure of the company is leveraged with debt equity ratio of 1.40x and overall gearing ratio of 3.40x at the end of FY19. Further, total debt to GCA and interest coverage of the company stood moderate at 5.03x and 3.31x respectively in FY19.

Tender based nature of operations in highly competitive construction industry

The company receives its work orders 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. Also, the promoter's reasonable industry experience in related field mitigates risk of competition to some extent. 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 as company primarily works with government departments and funds are released only after the work certification process is completed and finalization of the bill is done. Also the cash flows of the company are blocked in retention money which is deducted by the client from running bills. These factors lead to reliance of the company on bank finance to meet its working capital requirements. Accordingly, the company has high utilization of its working capital loans given capital intensive nature of business operations.

Planned debt funded capital expenditure

The company has been making regular investments to expand its infrastructure facilities in the past and is expected to continue in future. The purchase of fixed assets was mainly funded through bank finance without any infusion of equity resulting in increase of debt component. Further, it is projected that the company will take additional loan for purchase of equipment/machineries for the new projects.

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 construction fields***

ACC has total number of 4 directors in its board. The company is being promoted by Mr. Rajan Kumar Bastola who holds majority shares in the company. Mr. Bastola, managing director, has long experience of over 20 years in construction business and looks after day to day operations of the company. Mr. Ramesh Bahadur Adhikari, director, has over 20 years of work experience in the construction business. Similarly, other directors of the company have related experience in the field of construction contract business. Board of directors are further supported by an experienced team across various functions/ departments.

Established track record in executing diversified construction works

ACC has an established track record of over 10 years in the construction of roads, bridges, buildings, airport projects, irrigation and water projects ranging from small sized to large sized projects and have executed several projects across the country in different terrains either individually or through its Joint Ventures (JV) entities.

Healthy order book position with mid-term revenue visibility

Till mid- June, 2020, the unexecuted orders in hand of the company stood at Rs. 3,772 Mn. The present order book to FY19 revenue is around 2.59x which provides mid-term revenue visibility. The order book is mainly concentrated in road works (accounting for ~60% of total work order) along with other various projects such as irrigation works, bridge works, airport works and railway works received from various government departments. Timely completion of the projects and thereby increasing its scale of operations would be critical from the credit perspective for ACC.

Financial risk profile marked by increase in total revenue despite decline in profitability margins in FY19

Total revenue of the company on consolidated basis increased by ~6% over FY18 on back of increase in execution of the contracts in hand. PAT margin of the company was moderate at 2.29% in FY19 declined from 3.25% in FY18. Further, income from construction contract business on standalone basis substantially increased to Rs. 991 Mn in FY19 with growth of ~155% over FY18 mainly due to increase in number of additional projects undertaken by ACC and execution of the same. However, PBILDT margin for construction activities declined significantly from 25.02% in FY18 to 13.51% in FY19 mainly on account of low margin contracts executed.

Moderate counter party risk

Revenue of ACC is generated via contracts from government departments related to road works, irrigation and water works, bridge works, airport works, railway works etc. Average collection period of the company was at 69 days in FY19 (vis-à-vis 24 days in FY18) which mainly includes amount receivable for work done from JVs. The debtor days increased in FY19 mainly due to high billing usually done by construction companies in Nepal including ACC to government departments at the year-end for completed works. However, the counter party risk is moderated by the fact that majority of the construction contracts are obtained from government departments and it has been 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 raw material prices 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 perspective.

About the Company

Apex Construction Company Private Limited, incorporated on May 19, 1985 is a mid-scale construction company based in Kathmandu, Nepal. The company has been involved in construction of both small and large scale projects such as buildings works, irrigation works, airport works, bridge works, road works etc. across Nepal. In addition to doing projects individually, ACC also enters into JV with other construction companies in order to meet the eligibility criteria for different construction projects.

Brief financials of ACC for last three years ending FY19 on Consolidated Basis are given below:

(Rs. Million)

For the year ended Mid July	FY17	FY18	FY19
	(Audited)	(Audited)	(Provisional)
Income from Operations	670	1,367	1,453
PBILDT	73	132	136
PAT	18	44	33
Overall Gearing (times)	5.65	5.38	3.40
TOL/ TNW (times)	7.72	8.09	6.74
Interest Coverage (times)	2.34	3.57	3.31

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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	291.35	CARE-NP BB
Short Term Bank Facilities	Working Capital Loan	236.80	CARE-NP A4
Short Term Bank Facilities	Non-Funded Loan	2,986.70	CARE-NP A4
Total		3,514.85	