Rating Rationale

Kumar Shrestha Nirman Sewa Private Limited

Rating

Facility	Amount (Rs. In Million)	Rating[1]	Rating Action
Long Term Bank Facilities	632.94	CARE-NP BBB- [Triple B Minus]	Assigned
Short Term Bank Facilities	8,380.00	CARE-NP A3 [A Three]	Assigned
Total Facilities	**9,012.94**		

Details of Facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has assigned rating of 'CARE-NP BBB-' to the long term bank facilities and 'CARE-NP A3' to the short term bank facilities of Kumar Shrestha Nirman Sewa Private Limited (KSNS).

Analytical approach:

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

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of KSNS derives strength from long track record of operations and experienced promoters in the related fields, established track record in executing diversified construction works and strong operational and financial profile characterized by healthy growth in sales, increase in PAT margins & internal cash accruals in FY19 (Provisional, refers to 12 months' period ended mid-July 2019). The ratings also factor in healthy liquidity profile, ownership of sizeable equipment and machineries, moderate counter party risk and escalation clause in majority of the contracts. The ratings are however constrained by relatively low order book position in comparison to past operations of the company, 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. Ability of the company to successfully execute projects in time, timely recovery of contract proceeds, manage revenue growth and maintain profitability margins are the 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 countrywide lockdown since March 24, 2020 halting operations of most of the organizations and slowing down of the economic activities. The construction activities of the company were also subdued on account of the lockdown. Also, since construction activities in Nepal usually takes momentum in second half of the financial year, with country's economy and construction sector 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 Strengths

Long track record of operations and experienced promoters in the related fields

The company has long track record of operations of more than 40 years in construction of various infrastructure projects all over Nepal. KSNS is promoted by Mr. Prem Kumar Shrestha and his family members. Mr. Prem Kumar Shrestha, Managing Director, has extensive experience of over 40 years in the field of construction contract business and is responsible for day to day operations of the business. He is assisted by his sons Mr. Sushil Kumar Shrestha (Executive Director) and Mr. Sujeet Kumar Shrestha (Director) who have significant experience in the construction sector. Board of Directors are further supported by an experienced team across various functions/ departments.

Established track record in executing various construction works

KSNS has an established track record of more than 40 years in the construction of roads, bridges, irrigation and river training activities, building, water supply and sanitation etc. ranging from small sized to large sized projects across the country in different terrains either individually or through its JV entities. Further, the company has track record of completing the construction projects on time and even before the intended deadline.

Strong operational and financial profile characterized by healthy growth in sales, increase in PAT margins & internal cash accruals in FY19

Total revenue of the company on consolidated basis increased to by 102% in FY19 over FY18 on back of increase in execution of the contracts in hand. Further, the company has moderate PBILDT margin which decreased to 8.32% in FY19 mainly due to higher proportionate increase in cost of construction and significant increase in administrative & other expenses of the company. PAT margin was at moderate level at 3.33% in FY19 which improved from 2.47% in FY18.

The revenue of the company on standalone basis increased to Rs. 2,191 Mn in FY19 (increment of ~143%) on account of increase in execution of contracts in hand. However, PBILDT margin deteriorated in FY19 from 19.26% in FY18 to 11.05% in FY19. Also, PAT margin of the company was moderate at 2.31% in FY19 which declined from 3.91% in FY18.

Healthy liquidity profile of the company

The company has comfortable liquidity position on account of surplus funds available in the form of advance mobilization money. The current ratio of the company was comfortable at 1.63x in FY19 vis-à-vis 1.40x in FY18 depicting healthy liquidity profile of the company.

Ownership of sizeable equipment and machineries

KSNS has built up adequate asset base to meet the working requirements of its projects with total fixed asset of Rs. 1,182 Mn at the end of FY19 on standalone basis. Efficient deployment of the resources and investment in machineries/ equipment during the past years has helped in timely execution of projects and to further acquire new projects.

Moderate counter party risk

Revenue of KSNS is generated via contracts from government departments related to road works, building works, irrigation and river training works, bridge works etc. Average collection period of the company improved from 43 days in FY18 to 39 days in FY19 reflecting timely collection of amount dues form government department. Further, 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.

Key Rating Weaknesses

Relatively low order book position in comparison to past operations of the company

Till mid- June, 2020, the unexecuted orders in hand of the company stood at Rs. 3,948 Mn. The order book of the company was Rs. 6,564 Mn in FY19 which reduced to Rs. 3,948 Mn in FY20 mainly due to execution of orders in hand. The present order book of the company reflects short term revenue visibility for the next 1 year. However, the order book of the company is diversified over various projects such as building works, road works, irrigation and water works, bridge works and railway work received from various government authorities. Timely completion of the projects and thereby increasing its scale of operations would be critical from the credit perspective for KSNS.

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 for which KSNS has to participate in the tenders, 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 at low price through e-bidding to sustain the 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. KSNS maintained construction materials as an inventory which was around 1 month. 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. However, the average working capital utilization of the company was moderate at ~56% for last five quarters ending mid- April, 2020.

Leveraged capital structure of the company

The capital structure of the company is marked with debt equity ratio of 0.87x and overall gearing ratio of 3.27x at the end of FY19. Interest coverage ratio of the company was comfortable at 5.01x in FY19. Also, TOL/ TNW and total debt/ GCA of the company was 4.79x and 6.77x respectively in FY19.

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 by the company was majorly funded through bank loans. Further, it is expected that the company will take additional loans 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.

About the Company

Kumar Shrestha Nirman Sewa Private Limited is Class "A" construction company of Nepal which was incorporated in the year 1977 but later on converted into private limited company in February 28, 1998 and has registered office based in Mahendranagar, Kanchanpur, Nepal. The company is promoted by Mr. Prem Kumar Shrestha and his family, with considerable experience in civil construction. The company is mainly involved in construction of roads, bridges, irrigation & river training works, water supply & sanitation works, buildings,

canals structures etc. across Nepal. In addition to doing projects independently, KSNS also enters into Joint Ventures with other companies in order to meet the eligibility criteria for different construction projects.

Brief financials of KSNS on consolidated basis for last three years ending FY19 are given below:

(Rs. Million)

For the year ended Mid July	FY17 (Audited)	FY18 (Audited)	FY19 (Provisional)
Income from Operations	2,125	2,110	4,256
PBILDT	206	209	354
PAT	93	52	142
Overall Gearing (times)	1.43	3.97	3.27
TOL/ TNW (times)	3.44	6.69	4.79
Interest Coverage (times)	12.13	5.34	5.01

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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	632.94	CARE-NP BBB-
Short Term Bank Facilities	Working Capital Loan	360.00	CARE-NP A3
Short Term Bank Facilities	Non-Funded Loan	8,020.00	CARE-NP A3
Total		**9,012.94**	