

## Rating Rationale

### Sumo Construction and Engineering Private Limited

#### Rating

Facilities	Amount (Rs. In Million)	Rating <sup>1</sup>	Rating Action
Long Term Bank Facilities	771.19	CARE-NP BB [Double B]	Assigned
Short Term Bank Facilities	728.81	CARE-NP A4 [A Four]	Assigned
<b>Total Facilities</b>	<b>1,500.00</b>		

*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 rating of ‘CARE-NP A4’ to the short-term bank facilities of Sumo Construction and Engineering Private Limited (SCEPL).

#### Detailed Rationale & Key Rating Drivers

The ratings assigned to bank facilities of SCEPL constrained by short track record of operation including lack of prior experience in construction of hydropower projects, working capital intensive nature of business, leveraged capital structure, however sufficient debt coverage indicators and exposure to volatile interest rate. The ratings, however, derives strength from association with strong promoter group, experienced management team, ownership of sizeable equipment fleet, low counter party risk, escalation clause in majority of the contracts and large amount of contract in hand with mid-term revenue visibility with its own group companies. The rating also derives strength from moderate financial risk profile with increase in revenue and PAT during FY20 (Provisional, refers to 12 months period ended mid-July 2020). Ability of SCEPL to manage the growth and maintain profitability margins without deterioration in its financial risk profile along with successful execution of projects would be the key rating sensitivities.

#### Detailed Description of the Key Rating Drivers

##### Key Rating Weakness

##### *Working capital intensive nature of business*

The operations of the company are working capital intensive in nature as company receives contract related to civil work, road construction work, and bridge construction work of hydropower project from its own group company, payments for the same are received generally in 1 month from the day of submission of the bill. The credit period extended by the suppliers of raw material is on the basis of negotiation power of the company. Average Collection period during FY20 was 42 days with average inventory holding period of 133 days. Though, creditor period was 119 days during FY20 due to delay in payments on the back of COVID-19, creditors usually allow shorter credit terms which impacts working capital cycle. Further, inventory holding period was high due to holding of raw materials on different sites for different contracts and delay on civil work on sites due to Covid-19 lockdown. The company has high

<sup>1</sup>Complete definitions of the ratings assigned are available at [www.careratingsnepal.com](http://www.careratingsnepal.com)

reliance on working capital loan to meet its working capital requirements. The average working capital utilization of the company was at ~73% for the last 12 months ending mid-July 2020.

***Short track record of operation including lack of prior experience in construction of hydropower project***

SCEPL has been involved in construction business since FY18 and the promoter group has no prior experience in construction business. Till July 15, 2020, the company has entered into 20 contract agreements (including three large contract) for Rs 8,609 Mn out of which Rs 259 Mn contract work mainly related to construction of road and bailey bridge. Due to short track record of operation its ability to timely and successfully completion of contract work remains to be seen.

***Leveraged capital structure, however sufficient debt coverage indicators***

The capital structure of the company was highly leveraged as reflected by overall gearing ratio of 3.56x at the end of FY20 which improved from the FY19. The high leverage in the company is due to relatively low capital base and high quantum of term loans for equipment financing for the construction of the projects and working capital loans to funds the operations of the company. This improvement in gearing ratio is mainly on account of increase in net worth as a result of accrual of profit during the year and infusion of capital by promoters. Total Debt/Gross Cash Accruals (GCA) was at 2.27x in FY20 which decreased from 3.19x in FY19 on back of increase in GCA which was higher than increase in total debt. Further, the interest coverage ratio was comfortable at 6.53x in FY20 which improved from 5.45x in FY19 due to increase in PBILDT.

**Key Rating Strength**

***Association with strong promoter group and experienced management team***

SCEPL derives strength from its strong promoter group belonging to MV Dugar Group. MV Dugar Group is involved in diversified business like Construction, Automobiles trading, Insurance and Banking. MV Dugar group is also the sole distributor in Nepal for world renowned brands like Mahindra (Commercial Vehicles and construction Equipment), John-Deere tractors, Royal Enfield, Piaggio etc. SCEPL is promoted by Mr. Vivek Dugar, who is also the chairperson of the company. Mr. Dugar has more than 2 decades of business experience. He is chairperson of Gurans Life Insurance Company Ltd. Day to day operations of the company is looked by Mr. Deepak Paudyal, who have working experience in Energy and Development sector. He has been supported by the experienced management team, who had experience of managing large hydropower projects.

***Large amount of contract in hand with mid-term revenue visibility with its own group companies***

All contracts entered by SCEPL are with its group companies which are Pan Himalaya Energy Private Limited [(CARE-NP BB); 77 MW hydropower project], Global Hydropower Associate Private Limited [(CARE-NP BB); 55 MW Hydropower project], and Number Himalayan Hydropower Limited [(CARE-

NP BB); 29 MW hydropower project]. As on July 15, 2020, SCEPL has Rs 3,826 Mn pending works in hand. All these works are expected to be completed within FY22.

***Moderate financial risk profile with increase in revenue and PAT during FY20***

SCEPL reported total revenue of Rs 3,624 Mn during FY20 which increased substantially from Rs 1,517 Mn during FY19. Total revenue increased substantially due to increase in income from contract work as a result of high execution of work in hand of hydropower projects, which also lead to high improvement in PBILDT. However, PBILDT margin decreased marginally to 19.35% in FY20 from 20.36% in FY19 due to increase in Cost of goods sold as a percentage of total revenue and increment in administration expenses. SCEPL has reported healthy net profit of Rs. 242 Mn during FY20. Further, the PAT margin of the company improved to 6.69% in FY20 (2.18% in FY19) on back of high PBILDT in spite of increase in interest expenses.

***Ownership of sizable equipment fleet***

SCEPL has built up adequate asset base including human resources to meet the requirement of its projects. The investments in the equipment/machineries of the company has increased by Rs. 164 Mn in FY20 and by Rs. 1,142 Mn during FY19. Efficient deployment of the resources and investment in machinery during the past years has helped in active execution of projects. The major machinery of the company includes mine master, loader, crusher, boomer, excavator, dozer etc. which are essential for the construction works.

***Escalation clause in majority of the contracts***

SCEPL procures its raw materials from the local vendors, which has risk of volatility in raw material prices. The company has inbuilt price escalation clauses in contracts for price volatility of cement, diesel and steel (which comprise majority of contract) to insulate the company from any adverse fluctuation in raw material prices. This enables the company to pass on the 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 the credit prospective.

***Low counter party risk***

Majority of the revenue of SCEPL is generated via contract related to civil work, road construction work, and bridge construction work of hydropower projects from its group entities, payments for the same are received in a month from the day of submission of the bill. Further, the financial closure for all the three hydropower projects has already been completed. Accordingly, the counter party risk is low by the fact that all of the construction contracts are obtained from group companies where the debt and equity portion is already tied up for the construction of the projects and it has been making timely payment to the company in the past.

**About the Company**

Sumo Construction and Engineering Private Limited is private limited company, incorporated as Sumo Engineering Consultant Pvt. Ltd on June 7, 2009; later on November 28, 2017 its name was changed to SCEPL. It is involved in construction of hydropower projects with all the projects currently under construction belonging to Group Companies.

**Brief Financial Performance during last 3 years:**

(Rs in Million)

Particulars	FY18	FY19	FY20
	Audited	Audited	Provisional
Income from operations	101	1,517	3,624
PBILDT	8	309	701
PAT	(19)	33	242
Interest Coverage ratio (times)	NM	5.45	6.53
Overall gearing (times)	NM	34.46	3.56

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**Annexure 1: Details of the Facilities rated**

Nature of Facility	Type of Facility	Amount (Rs. Million)	Rating
Long Term Bank Facilities	Term Loan	771.19	CARE-NP BB
Short Term Bank Facilities	Working Capital Loan	340.00	CARE-NP A4
Short Term Bank Facilities	Working Capital(Proposed)	33.81	CARE-NP A4
Short Term Bank Facilities	Non-Fund Based Limit	355.00	CARE-NP A4
<b>Total</b>		<b>1,500.00</b>	