

Rating Rationale

Narendra Nirman Sewa Private Limited

Rating

Facility/ Instrument	Amount (Rs. In Million)	Rating ¹	Rating Action
Long Term Bank Facilities –Term Loan	28.70	CARE-NP BB- [Double B Minus]	Assigned
Short Term Bank Facilities- Fund Based Limits	75.00	CARE-NP A4 [A Four]	Assigned
Long Term/Short Term Bank Facilities- Non-Fund Based Limits	486.30	CARE-NP BB-/A4 [Double B Minus/A Four]	Assigned
Total Bank Facilities	590.00		

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 Narendra Nirman Sewa Private Limited (NNSP).

Analytical approach:

CRNL has analyzed NNSP’s credit profile by considering the standalone financial statements.

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of NNSP are constrained by small scale of operations and leveraged capital structure and debt service coverage indicators of the company at the end of FY20 (Audited, refers to 12 months’ period ended mid-July 2020). The rating is also constrained by no escalation clause with defect liability clause in majority of contracts, tender based nature of operations in highly competitive construction industry, working capital intensive nature of business and exposure to volatile interest rates. The ratings, however, derive strength from increase in revenue and profitability with improvement in PBILD margin in FY20 and moderate order book position with mid-term revenue visibility and concentrated projects majorly 66% for substation works from single government client Nepal Electricity Authority (NEA) which significantly reduces the counter party risk. The ratings also factor in experienced promoters in related fields with established track record of above three decades in construction of transmission line, substation and bridge works.

Ability of the company to increase its scale of operations and profitability while managing the debt levels will be the key rating sensitivity. Also company’s ability to execute projects timely and bid projects with reasonable contract price after considering future price escalation impact on the profitability will be the key rating sensitivity.

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

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Leveraged capital structure and debt service coverage indicators of the company

The capital structure of the company is leveraged marked with debt equity ratio of 4.32x and overall gearing ratio of 5.21x at the end of FY20. The gearing ratio deteriorated at the end of FY20 mainly on account of increase in long term loan for funding purchase of land and increase in mobilization advance with the growth in order book position of the company which was partially offset by improvement in Tangible Networth (TNW). Interest coverage ratio of the company stood at 2.68x in FY20. Total Outside Liabilities/ Tangible Net-worth (TOL/TNW) and Total debt/ GCA of the company was high and stood at 8.27x and 31.37x respectively at the end of FY20.

No escalation clause in any of the contracts with fixed tenure and defect liability clause in most of the contracts

With no escalation clause in contracts with NEA, NNSP is exposed to risk of volatility in raw material prices due to time overrun. NNSP mainly completes the projects within the tenure assigned to mitigate the risk of price escalations. Ability of the company to execute projects timely and bid projects with reasonable contract price after considering future price escalation impact on the profitability remains critical from credit perspective. Also, all of the contract with NEA has the clause of defect liability which state final 5% of price for construction and installation works are paid against issuance of Defect Liability Certificate which is received after fulfilling all regulatory requirements. If the company fails to clear all the required outstanding obligations, such money is deducted from its portion of the retention money.

Tender based nature of operations in highly competitive construction industry

The company receives its entire work orders from government departments and other construction companies on sub-contract basis. 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 generally working capital intensive in nature as the company primarily works with government departments and funds are released only after the work certification process is completed and finalization of the bills. Average debtor days stood at 136 days at the end of FY20 which majorly includes amount receivable from JVs for the work done on subcontract basis. Due to continuous procurement from few selected vendors, company receives sufficient credit period which resulted into creditors' days of 302 at the end of FY20. Booking of inventory is done by the company at the time of delivery but installation, testing and commissioning is time consuming process which resulted into high

inventory days of 171 at the end of FY20. These factors lead to reliance of the company on bank finance to meet its working capital requirements.

Key Rating Strengths

Moderate order book position with mid-term revenue visibility and concentrated projects from single government party

As on March 15, 2021, the unexecuted orders in hand of the company stood at Rs. 813 Mn. (share of NNSP). Most of the projects are of NEA which are received through subcontract basis or by entering into JVs. The order book of the company reflects mid-term revenue visibility for the next 3 to 4 years which is 9.97x of income from contract of FY20. Increasing order book position of the company with timely completion of the work in hand projects would be critical from the credit perspective for NNSP.

Experienced promoters in the related field and moderate track record of operations

NNSP is promoted by three individual promoters belonging to the same family namely Mr. Narendra Man Lalchan, Mr. Jasman Lalchan and Mr. Prabindra Lalchan holding 100% of total share capital of the company. Mr. Narendra Man Lalchan, Chairman, has been leading the company since its inception from November 1989. Mr. Jasman Lalchan, Managing Director, has work experience of over 2 decades in the field of construction business through NNSP and manages company's operation activities. Further, the board is supported by an experienced team across various functions.

Established track record in executing various construction works, however small scale of operations

NNSP has an established track record of above 3 decades in construction of transmission line, substation and bridge works ranging from small sized to medium sized projects. The company has executed several projects (majority of which are transmission line projects) across the country either individually or through its JV entities. Although the company has been in operation for almost 3 decades, the order book executed in the past is on lower side. However, due to the long track record of the company, company's ability to successfully bid for high value construction contracts increases. Ability of the company to improve its order book position and revenue profile over the years remains key rating consideration.

Improved financial performance in FY20 with growth in revenue and profitability

The revenue of the company improved by ~7% in FY20 to Rs. 82 Mn from Rs. 76 Mn in FY19 mainly due to execution of work in hand in FY20. Also, the PBILDT margins of the company improved during FY20 due to decline in direct cost. With improved revenue being booked, profitability and Gross Cash Accruals of the company improved in FY20.

Moderate counter party risk

Revenue of NNSP is generated via construction contracts entirely from government departments (majorly NEA). Average collection period of the company was at 136 days at the end of FY20 (vis-à-vis 233 days at the end of FY19) which primarily includes the amount receivable from JVs for the work done on

subcontract basis. However, the counter party risk is moderated by the fact that contracts are obtained from government departments.

About the Company

Narendra Nirman Sewa Private Limited, incorporated and started operation from November 05, 1989, is a Class-A construction company of Nepal with registered office based in Gangabu, Kathmandu, Nepal. The company has been involved for more than 3 decades in construction of both small and mid-scale projects of transmission line, substation works and bridge works. In addition to doing projects independently, NNSP also enters into JVs with other companies in order to meet the eligibility criteria for different construction projects.

Brief financials of NNSP (standalone) for last three years ending FY20 are given below:

(Rs. Million)

For the year ended Mid July	FY18	FY19	FY20
	(Audited)	(Audited)	(Audited)
Income from Operations	113	76	82
PBILD Margin (%)	5.67	6.90	8.41
Overall Gearing (times)	1.54	1.65	5.21
Total Outstanding Liabilities/Tangible Net worth (times)	3.92	4.17	8.27
Interest Coverage (times)	5.75	2.12	2.68
Current Ratio (times)	1.44	1.40	1.53
Total Debt/ Gross Cash Accruals (times)	5.87	12.90	31.37

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Annexure 1: Details of the Facilities Rated

Nature of the Facility	Type of the Facility	Amount (Rs. Million)	Rating
Long Term Bank Facilities	Term Loans	28.70	CARE-NP BB-
Short Term Bank Facilities	Working Capital Loans	75.00	CARE-NP A4
Long Term/ Short Term Bank Facilities	Non-Funded Loans	486.30	CARE-NP BB-/A4
Total		590.00	