

Renu Construction Company Private Limited

Ratings

Facilities	Amount (Rs. in Million)	Ratings ¹	Rating Action
Long Term Bank Facilities	159.00	CARE-NP BB [Double B]	Assigned
Short Term Bank Facilities	641.00	CARE-NP A4 [A Four]	Assigned
Total Facilities	800.00 (Eight Hundred Million Only)		

Details of instruments/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 Renu Construction Company Private Limited (RCCPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of RCCPL are constrained by concentrated project portfolio with limited revenue visibility, tender based nature of operations in highly competitive construction industry without escalation clause, working capital intensive nature of operations and exposure to volatile interest rates. The ratings, however, derive strength from experienced promoters & established track record of operations, financial risk profile characterized by moderate capital structure and steady profitability margins during FY21 (unaudited, refers to the twelve-month period ended mid-July 2021). The ratings also factor in low counter party risk.

Going forward, the ability of the company to execute projects and recover contract proceeds in a timely manner leading to sustained revenue growth while maintaining profitability margins without deterioration in its financial risk profile will be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Modest scale of operations and concentrated portfolio with limited revenue visibility

RCCPL's outstanding order book as of mid-December 2021 stood at Rs. 634 Mn which is entirely concentrated towards rural electrification works of Nepal Electricity Authority (NEA) (i.e. ~88%) coupled with electrification works for government municipalities. The present order book to revenue (FY21) is around 1.62x giving limited revenue visibility over the medium term. Also, the company's long-term business growth prospect remains limited by its modest scale of operations and presence in a niche segment. The ability of the firm to scale up to larger-sized contracts is constrained by its comparatively modest total operating income of Rs391 Mn in FY21. The modest scale of operations limits the pricing power and benefits of economies of scale.

Absence of escalation clause in contracts leaving profitability vulnerable to input price hikes

RCCPL procures its construction materials mainly from local vendors. As the company doesn't have price escalation clauses in most of its contracts which could insulate the company from any adverse fluctuation in construction material prices and labour expenses, it is vulnerable to any raw material/labour cost hikes which can adversely impact its profitability margins. Timely completion of the projects while increasing scale of operations and maintaining a stable profitability margin would be critical from credit perspective.

¹Complete definitions of the ratings assigned are available at www.careratingsnepal.com and in other CRNL publications

Working capital intensive nature of business

The operations of the company are working capital intensive in nature marked by high inventory holding period and moderate collection period. RCCPL's inventory holding period was around 70 days at the end of FY21 compared to 97 days at the end of FY20 with major inventory being construction materials such as electricity poles and wires. One of the terms of the contract with NEA is to procure the materials beforehand and get inspected by NEA officials. Furthermore, funds are released only after the work certification process is completed and finalization of the bill is done. Consequently, average collection period of the company was also moderate at 49 days at the end of FY21, compared to 39 days at the end of FY20. These factors lead to increased reliance of the company on borrowings to meet its working capital requirements. The average utilization of RCCPL's working capital limits against drawing power was high at around 95% during the twelve-month period ended mid-March 2022.

Tender based nature of operations in highly competitive construction industry

Majority of the RCCPL's projects are tender-based government contracts wherein the company has to quote a bid. With multiple players active in the industry, RCCPL's business is vulnerable to under bidding at a relatively low cost in order to secure the projects, in the highly competitive construction industry. Furthermore, the business also remains dependent on sustained capital expenditure by the government towards electrification projects, overall stability in government policies and fiscal position of the government.

Exposure to volatile interest rate

The company's interest expense is based on floating rates which reset every quarter. The base rate of the banks and financial institutions in Nepal remain quite volatile as they are impacted by change in liquidity position which leads to change in interest rates. Therefore, funding taken by the company from banks is subject to volatile interest rate.

Key Rating Strengths**Experienced promoters and moderate track record of operations**

RCCPL is promoted by Mr. Pramod Kumar Mahaseth, Chairman, who has been leading the company since its inception in January 2014. Mr. Mahaseth has experience of more than two decades in the field of rural electrification contract business which bodes well for the overall business prospects of the company in an increasingly competitive industry. He is responsible for overall planning, management and execution of projects undertaken by the company. Ms. Renu Kumari Shah, Director, has an experience of more than seven years in rural electrification contracts and looks after overall operations of the company. Furthermore, the board is supported by an experienced team across various functions.

Moderate Financial Risk Profile

RCCPL's total operating income increased by 34% year on year to Rs. 391 Mn in FY21 majorly on account of execution of projects which were at maturity phase. The business generation of the company is through bidding and tendering process and profitability margins directly associated with the nature of contracts executed by the company during the financial year, attributed to same, PBILDT margin has remained range bound in between 10.50%-12% during the said period. Backed by higher sales, gross cash accruals of RCCPL increased to Rs.19 Mn in FY21 from Rs. 14 Mn in FY20. Also, PAT margin of the company increased to 3.86% in FY21 from 3.33% in FY20.

Total gearing ratio of the company was moderate at 1.55x at the end of FY21 improving from 1.93x at the end of FY20 majorly on account of lower term debt and mobilization advances as on mid-July 2021. The company's short-term debt increased to Rs. 127 Mn at the end of FY21 from Rs. 70 Mn at the end of FY20 on account increased working capital

requirements to support growth in scale of operations. However, RCCPL's long term debt decreased to Rs. 38 Mn at the end of FY21 from Rs. 65 Mn at the end of FY20.

RCCPL's interest expense remained at the similar levels of around Rs. 18 Mn during FY21 in comparison with FY20. Improvement in PBILDT with interest expense remaining in similar level led to improvement in interest coverage ratio to 2.38x during FY21 from 2.04x during FY20. However, total debt/ gross cash accrual (GCA) of the company continued to remain high at 11.43x during FY21, which however decreased from 16.68x during FY20.

Low counter party risk

Revenue of RCCPL is generated via rural electrification contracts from NEA and government municipalities. Receivables at the end of FY21 increased to Rs. 53 Mn from Rs. 31 Mn at the end of FY20 which also includes amount due for work done by the company on behalf of its joint-ventures. Counter party risk remains low given the projects are from NEA and government municipalities, which have been making timely payment to the company in the past.

About the Company

Renu Construction Company Private Limited (RCCPL) is Class "D" Construction Company of Nepal and was incorporated in the year 2014 with registered office based in Siraha, Nepal. The company is involved in rural electrification projects of Nepal Electricity Authority and Government municipalities. In addition to doing projects independently, RCCPL also enters into Joint Ventures (JV) with other companies in order to meet the eligibility criteria for different construction projects.

Financial Performance

(Rs. Million)

For the Period	FY19 (A)	FY20 (A)	FY21 (A)
Income from Operations	260	292	391
PBILDT Margin (%)	11.72	12.04	10.74
Overall Gearing (times)	1.29	1.93	1.55
Total Outstanding Liabilities/Tangible Net worth (times)	1.80	2.64	2.33
Interest Coverage (times)	2.03	2.04	2.38
Current Ratio (times)	1.83	2.52	1.76
Total Debt/Gross Cash Accruals (times)	21.20	12.74	4.27

A: Audited

Annexure 1: Details of the Facilities Rated

Name of the Bank Facilities	Type of the Facility	Amount (Rs. In Million)	Ratings
Long Term Bank Facilities	Term Loan	159.00	CARE-NP BB [Double B]
Short Term Bank Facilities	Fund Based Limits	111.00	CARE-NP A4 [A Four]
Short Term Bank Facilities	Non Fund Based Limits	530.00	CARE-NP A4 [A Four]
Total		800.00	

Contact Us

Analyst Contact

Mr. Girish Bhatta
+977-9802335866
girish.bhatta@careratingsnepal.com

Mr. Santosh Pudasaini
+977-01-4012629
santosh.pudasaini@careratingsnepal.com

Relationship Contact

Mr. Achin Nirwani
+977-9818832909
achin.nirwani@careratingsnepal.com

About CARE Ratings Nepal Limited:

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