

Sapana Nirman Sewa Private Limited

Ratings

Facilities	Amount (Rs. in Million)	Ratings ¹	Rating Action
Long Term Bank Facilities	30.00	CARE-NP BB [Double B]	Assigned
Short Term Bank Facilities	1,758.08	CARE-NP A4 [A Four]	Assigned
Total Facilities	1,788.08		

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 Sapana Nirman Sewa Private Limited (SNS).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of SNS are constrained by its fluctuating scale of operations in last three FY's (FY19-FY21; FY refers to the twelve-month period ending mid-July) with concentrated project portfolio, leveraged capital structure, tender based nature of operations in the highly competitive construction industry, working capital intensive nature of operations, exposure to volatile interest rates and regulatory risk and risk of delay in project execution.

The ratings, however, derive strength from experienced promoters and established track record of operations, moderate order book position providing mid-term revenue visibility. The ratings also factor in moderate counter party risk and escalation clause in majority of contracts.

Going forward, the ability of the company to successfully execute projects and recover contract proceeds in a timely manner, profitably scale up the operations of the company leading to sustained revenue growth while maintaining profitability margins while improving its overall financial risk profile will be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Below average financial risk profile as reflected from fluctuating scale of operations and leveraged capital structure

SNS has fluctuating scale of operations over the past three years (FY19-FY21). SNS's Total Operating Income (TOI) grew ~65% year-on-year to Rs. 350 Mn during FY21 boosted by execution of projects after being impacted by the pandemic during FY20 when total operating income had declined ~23% year-on-year. The business generation of the company is through bidding and tendering process and profitability margins are directly associated with the nature of contracts executed by the company. The PBILDT margin fluctuated in between 20%-31% during the said period. PAT margin of SNS improved to 2.50% in FY21 from 1.62% in FY20.

Capital structure of SNS stood moderately leveraged with overall gearing ratio (including mobilization advance) of 3.28x as on mid-July 2021 which improved from 7.21x as on mid-July 2020. Total debt of the company, which mainly comprises of hire purchase loans, mobilization advance & working capital borrowings, decreased in FY21 to Rs. 321 Mn from Rs. 353 Mn at in FY20 on account of decreased mobilization advance due to lower number of contracts awarded during FY21. Also, total outside liability to total net worth and total debt to gross cash accruals remained high at 4.18x and 7.85x respectively as on mid-July 2021 (7.92x and 9.82x, respectively, as on mid-July 2020). However, the interest coverage was moderate at 2.10x in FY21 as compared to 1.76x in FY20.

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

Elongated inventory holding

The operations of the company are working capital intensive in nature marked by high inventory holding period. SNS's inventory holding period was around 188 days in FY21 compared to 344 days in FY20 with major inventory being construction materials such as cement and rods. High inventory period of the company majorly due to piling up of construction materials as the company has to maintain inventory at various sites for smooth execution of project works. Furthermore, funds are released only after the work certification process is completed and finalization of the bill is done. Lengthy certification process led to high work in progress and inventory levels at the end of financial year. Furthermore, SNS books its revenue only after the funds are released by the employers. Consequently, debtors stood almost nil at the end of the FY21. High inventory holding lead to increased reliance of the company on external borrowings to meet its working capital requirements.

Tender based nature of operations in highly competitive construction industry

Majority of the SNS's projects are tender-based government contracts wherein the company has to quote a bid. With multiple players active in the industry, SNS'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 construction projects, overall stability in government policies and fiscal position of the government. Government of Nepal (GoN) has put certain restrictions on the contractors to participate in tenders such as prohibiting foreign companies to participate in tenders having value less than Rs. 3,000 Mn, which augurs well for domestic players. Furthermore, the GoN has also placed a cap on total active projects of construction companies at five, which could limit growth prospects.

Exposure to volatile interest rate

Nepalese banking sector has a floating interest rate regime, where a certain premium is added to the quarterly base rate and interest rate is changed accordingly on quarterly basis. The base rates of the banks and financial institutions (BFIs) in Nepal remain quite volatile as they are impacted by available liquidity in the system which leads to change in interest rates. The volatility in interest rate is more evident currently on account of the ongoing liquidity stress in the economy. Furthermore, increased bank rates announced in the Monetary Policy for FY23 is likely to add to the upward pressure on interest rates going forward. Any significant rate hikes could put increased interest burden on the company, squeezing its profitability and impacting its liquidity position. Therefore, funding taken by the company from BFIs is subject to volatile interest rate.

Risk of delay in project execution

Given the nature of projects awarded, SNS is exposed to inherent risk in terms of delays in certain projects undertaken by the company due to delay in procedural approvals and clearance of project sites, etc, thus exposing the company towards the risk of delay in projects resulting in a delay in the realization of revenue growth. Furthermore, the company ability to execute a project in timely manner would be led by its own operational efficiency and timely stage payments received from clients.

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

SNS is promoted by Mr. Hari Prasad Dhakal, Managing Director, who has been leading the company since its inception in July 1984. Mr. Dhakal has experience of more than three decades in the construction sector which bodes well for the overall business prospects of the company in an increasingly competitive industry. He is responsible for execution of

projects undertaken by the company. Mr. Bisharjan Bartaula and Mr. Keshav Kumar Gautam, directors, has considerable experience in construction sector and look after overall operations of the company. Furthermore, the board is supported by an experienced team across various functions. The company has long track record of operations of more than three decades in the construction of various infrastructure projects all over Nepal.

Moderate order book position with mid-term revenue visibility

As on April 13, 2022, the unexecuted orders in hand of the company stood at Rs. 1,500 Mn, which is 4.29x of the income from contract of FY21, providing moderate revenue visibility. The order book is primarily concentrated towards bridge projects (~60%) and others include roads and irrigation projects by entering into JVs. Timely completion of the projects would be critical for the business prospects of the company and also has a direct bearing on its margins.

Moderate counter party risk

Revenue of SNS is majorly generated via contracts from government departments. The order book is primarily concentrated towards bridge and road projects from government departments. Counter party risk remains moderate given the projects are from government departments, which have been making timely payment to the company in the past.

About the Company

SNS is a Class "A" construction company in Nepal, incorporated on July 18, 1984 with registered office in Hetauda, Nepal. The company is mainly involved in various type of construction projects which includes road works, bridge works, irrigation works and river training works. In addition to doing projects independently, SNS also enters into Joint Ventures (JVs) with other companies in order to meet the eligibility criteria for different construction projects.

Financial Performance

(Rs. Million)

For the Period Ended / as at Mid-July,	FY19 (A)	FY20 (A)	FY21 (A)
Income from Operations	277	213	350
PBILDT Margin (%)	25.72	31.19	19.90
Overall Gearing (times)	6.77	7.21	3.28
Interest Coverage (times)	2.22	1.76	2.10
Current Ratio (times)	2.26	2.12	1.80
Total Debt/ Gross Cash Accruals (times)	7.57	9.82	7.85

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	30.00	CARE-NP BB [Double B]
Short Term Bank Facilities	Fund Based Limits	274.00	CARE-NP A4 [A Four]
Short Term Bank Facilities	Non-Fund Based Limits	1,484.08	CARE-NP A4 [A Four]
Total		1,788.08	

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About CARE Ratings Nepal Limited:

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