

Apex Construction Company Private Limited

Ratings

Facilities	Amount (Rs. in Million)	Ratings ¹	Rating Action
Long Term Bank Facilities	71.07	CARE-NP BB- [Double B Minus]	Rating revised from CARE-NP BB
Short Term Bank Facilities	280.00	CARE-NP A4 [A Four]	Reaffirmed
Long Term/ Short Term Bank Facilities	3,148.93	CARE-NP BB-/ A4 [Double B Minus/ A Four]	Rating revised from CARE-NP BB/A4
Total Facilities	3,500.00		

Details of instruments/facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has revised the rating assigned to the long term bank facilities of Apex Construction Company Private Limited (ACC) to 'CARE-NP BB-' from 'CARE-NP BB'. CRNL has reaffirmed the rating of 'CARE-NP A4' assigned to short term bank facilities of ACC.

Detailed Rationale & Key Rating Drivers

The revision in the ratings assigned to the bank facilities of ACC takes into account its weakening of financial risk profile marked by deterioration in profitability margins and leveraged capital structure in FY21 (Audited, refers to the twelve-month period ended mid-July 2021). The ratings also factor in ACC's working capital intensive nature of business, presence in highly competitive construction industry, modest and concentrated order book position coupled with tender based nature of operations, exposure to volatile interest rates and government regulations and risk of delay in project execution. The ratings, however, derive strengths from experienced promoters and established track record of operations, moderate counter party risk and escalation clause in majority of the contracts. The ratings also take cognizance of growth in total operating income (TOI) in FY21.

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 and rationalization of its debt through efficient working capital management would be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Weakening of financial risk profile marked by volatile profitability margins and leveraged capital structure

After a decline of around 42% in TOI in FY20 amid the initial wave of the covid19 pandemic, ACC's TOI remained impacted by the lingering impact of the pandemic in FY21, growing only by 2% year-on-year to Rs. 858 Mn in FY21 over previous 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.

PBILDT margin of the company deteriorated to 12.98% in FY21 from 22.04% in FY20 on account of execution of lower margin contracts coupled with increased input prices. With decline in PBILDT margin, PAT margin of the company deteriorated to 1.87% in FY21 from 8.45% in FY20. Consequently, Gross Cash Accruals of the company decreased to Rs. 62 Mn in FY21 from Rs. 117 Mn in FY20.

Capital structure of the company stood leveraged on account of higher short-term debts availed by ACC for funding the working capital requirements of the company resulting in an overall gearing ratio of 3.18x as on mid-July 2021, deteriorating from 2.72x as on mid-July 2020. Furthermore, Total Outside Liabilities (TOL)/ TNW of the company deteriorated to 6.06x in FY21 from 4.83x in FY20. Interest coverage ratio of the company was moderate at 2.51x in FY21

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

which deteriorated from 4.09x in FY20 on account of decline in PBILDT, however interest expenses remaining at similar level as FY20. Also, Total debt/ GCA of the company deteriorated to 7.03x in FY21 from 4.24x in FY20, with impact of decline in GCA of the company.

Working capital intensive nature of business

The operations of the company are working capital intensive in nature marked by high collection period. Net operating cycle of the company was moderate at 46, which increased from 42 days in FY20. The funds are released only after the work certification process is completed and finalization of the bill is done. Customer base includes government departments. The certification and realization of the bill generally takes a period of around two months. There are usually procedural delays in the recovery of debtors and, at times, this exceeds three months. Consequently, average collection period of the company was high at around 132 days in FY21. Similarly, ACC's creditors' days remained high at 91 days, emanating from the challenges faced by the company to effectively manage its working capital cycle. However, ACC's inventory holding period was around 6 days in FY21 compared to almost negligible in FY20 with major inventory being construction materials such as cement and rods as the management procured construction materials mostly on need basis and the same was considerably utilized near the year-end.

Modest and concentrated order book position

As on April 13, 2022, the unexecuted orders in hand of the company stood at Rs. 972 Mn, which is 1.13x of the income from contract of FY21, providing near-term revenue visibility. The order book is majorly concentrated towards road projects (~71%) and other construction projects such as bridge, building, railway, airport 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.

Tender based nature of operations in highly competitive construction industry

Majority of the ACC's projects are tender-based government contracts wherein the company has to quote a bid. With multiple players active in the industry, ACC'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, ACC 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

ACC is promoted by Mr. Rajan Kumar Bastola, Managing Director, who has been leading the company for more than two decades. Mr. Bastola has experience of more than two 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 overall operational management of the company. Mr. Ramesh Bahadur Adhikari and Ms. Rupa Adhikari, 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 two decades in the construction of various infrastructure projects all over Nepal.

Moderate counter party risk

Revenue of ACC is generated majorly via contracts from government departments. The order book is primarily concentrated towards 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.

Analytical Approach

CRNL has analysed ACC's credit profile by considering the consolidated financial statements comprising ACC and its joint venture entities related to the construction projects.

About the Company

ACC is a Class "A" construction company of Nepal incorporated on May 19, 1985 with its registered office based in Kathmandu, Nepal. The company is involved in construction of road, building, irrigation projects, bridges and railway works. In addition to doing projects independently, ACC 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	FY19 (A)	FY20 (A)	FY21 (A)
Income from Operations	1,454	844	858
PBILDT Margin (%)	9.38	22.04	12.98
Overall Gearing (times)	3.40	2.72	3.18
Total Outstanding Liabilities/Tangible Net worth (times)	6.74	4.83	6.06
Interest Coverage (times)	3.31	4.09	2.51
Current Ratio (times)	1.18	1.30	1.13
Total Debt/Gross Cash Accruals (times)	3.28	2.25	2.47

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	71.07	CARE-NP BB- [Double B Minus]
Short Term Bank Facilities	Fund Based Limits	280.00	CARE-NP A4 [A Four]
Long Term/ Short Term Bank Facilities	Non Fund Based Limits	3,148.93	CARE-NP BB- / A4 [Double B Minus/ A Four]
Total		3,500.00	

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