

## Sagun Construction and Engineering Private Limited

### Ratings

Facilities	Amount (Rs. in Million)	Ratings <sup>1</sup>	Rating Action
Long Term Bank Facilities	145.90	CARE-NP BB+ [Double B Plus]	Rating revised from CARE-NP BB
Short Term Bank Facilities	50.00	CARE-NP A4+ [A Four Plus]	Rating revised from CARE-NP A4
Long Term/ Short Term Bank Facilities	1,304.10	CARE-NP BB+ / A4+ [Double B Plus/ A Four Plus]	Rating revised from CARE-NP BB/A4
<b>Total Facilities</b>	<b>1,500.00</b>		

*Details of instruments/facilities in Annexure 1*

CARE Ratings Nepal Limited (CRNL) has revised the rating assigned to the long term bank facilities of Sagun Construction and Engineering Private Limited (SGC) to 'CARE-NP BB+' from 'CARE-NP BB'. CRNL has also revised the rating assigned to SGC's short term bank facilities to 'CARE-NP A4+' from 'CARE-NP A4'.

### Detailed Rationale & Key Rating Drivers

The revision in the ratings assigned to the bank facilities of SGC takes into account the improving financial risk profile of the company marked by growth in total operating income (TOI) coupled with moderate profitability margins during FY21 (Audited, refers to the twelve-month period ended mid-July 2021) and increase in its order book position. However, the ratings continue to be constrained by its leveraged capital structure and its presence in highly competitive industry coupled with tender based nature of operations. The ratings also factor in its exposure to volatile interest rates and government regulations and risk of delay in project execution.

The ratings, continues to derive strength from experienced promoters and moderate track record of operations, moderate counter party risk and escalation clause in majority of the 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 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

#### Leveraged capital structure

Capital structure of SGC stood leveraged with overall gearing ratio (including mobilization advance) of 3.31x as on mid-July 2021 which deteriorated from 1.51x as on mid-July 2020 amid higher bank borrowings availed by SGC during FY21 to support business growth. Total debt of the company, which mainly comprises of equipment loans, loans from promoter, mobilization advance & working capital borrowings, increased in FY21 to Rs. 803 Mn from Rs. 188 Mn in FY20. Increase in equipment loans was for funding purchase of construction machineries and working capital loans for funding the working capital needs of the company. Increase in mobilization advance was on account of improved order book position. Also, total outside liability to total net worth and total debt to gross cash accruals remained high at 4.72x and 11.15x respectively as on mid-July 2021 (2.58x and 7.11x, respectively, as on mid-July 2020). However, the interest coverage was moderate at 3.17x in FY21 which deteriorated from 3.52x in FY20 on account of increases in interest due to increased bank borrowings of the company.

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

**Concentrated though healthy order book position**

As on July 16, 2022, the unexecuted orders in hand of the company stood at Rs. 10,903 Mn, which is around 7.50x of the income from contract of FY21, providing moderate term revenue visibility. The order book position of the company remains healthy, however, remain primarily concentrated towards road projects (~74%) and others include water management, building, bridge and river training projects by entering into JVs.

One road project related to Construction & Improvement of Road, accounts for ~49% of total order book position. Having a concentrated order book on a single project links the company's performance to the same and any delays in execution of one such project can materially impact the company's financial health. 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 SGC's projects are tender-based government contracts wherein the company has to quote a bid. With multiple players active in the industry, SGC'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, SGC 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 moderate track record of operations**

SGC is promoted by Mr. Sahadev Khadka, Managing Director, who has been leading the company since its inception from 2015. Mr. Khadka has experience of around fifteen years 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 management and the execution of projects undertaken by the company. Furthermore, the board is supported by an experienced team across

various functions. The company has moderate track record of operations of around seven years in the construction of various infrastructure projects all over Nepal.

### **Improving financial risk profile marked by increase in TOI and profitability margins**

SGC's TOI grew ~134% year-on-year to Rs. 1,456 Mn during FY21 boosted by execution of projects after being impacted by the pandemic during FY20 when total operating income had declined less than a percent over FY19. 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 has remained moderate and was range bound between 6%-9% during the last 3 financial years (FY19-FY21). PBILDT margin improved to 8.45% in FY21 from 7.00% in FY20 amid increased execution of higher margin projects. Furthermore, PAT margin of SGC improved by 94 bps to 1.95% in FY21. Consequently, GCA of the company increased to Rs. 72 Mn in FY21 from Rs. 26 Mn in FY20 mainly on account of increase in PAT and depreciation expense of the company.

### **Moderate operating cycle**

The working capital cycle of SGC appears to be moderate at 77 days, primarily because the company receives a high payable period of around 60-90 days from its suppliers. SGC's inventory holding was moderate at around 43 days in FY21 as the company has to maintain inventory at various sites for smooth execution of project works. The funds are released only after the work certification process is completed and finalization of the bill is done. Customer base includes government departments / bodies; therefore, the certification and realization of the bill generally takes the period of around two months. There is usually a delay in the recovery of debtors, and at times, the same exceeds more than three months. Consequently, average collection period of the company was moderate at around 94 days in FY21 which improved from 142 days in FY20 on account of better debtor realization.

### **Moderate counter party risk**

Revenue of SGC is generated via contracts from both government departments and private parties. 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 SGC's credit profile by considering the consolidated financial statements comprising SGC and its joint venture entities related to the construction projects.

### **About the Company**

Sagun Construction was incorporated in 2015 as a proprietorship firm which was later converted into private limited company as Sagun Construction and Engineering Private Limited (SGC) on June 01, 2022. It is a Class-B construction company of Nepal with registered office based in Butwal, Nepal. The company is mainly involved in construction of both small and large scale projects mainly relating to road, water supply, building, bridges and river training projects in different parts of Nepal. In addition to doing projects independently, SGC also enters into Joint Ventures (JVs) with other companies in order to meet the eligibility criteria for construction projects.

## Financial Performance

(Rs. Million)

For the Period	FY19 (A)	FY20 (A)	FY21 (A)
Income from Operations	624	621	1,456
PBILDT Margin (%)	6.04	7.00	8.45
Overall Gearing (times)	1.08	1.51	3.31
Total Outstanding Liabilities/Tangible Net worth (times)	2.88	2.58	4.72
Interest Coverage (times)	3.78	3.53	3.17
Current Ratio (times)	1.35	1.96	2.17
Total Debt/Gross Cash Accruals (times)	3.78	7.11	11.15

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	145.90	CARE-NP BB+ [Double B Plus]
Short Term Bank Facilities	Fund Based Limits	50.00	CARE-NP A4+ [A Four Plus]
Long Term/ Short Term Bank Facilities	Non Fund Based Limits	1,304.10	CARE-NP BB+/ A4+ [Double B Plus/ A Four Plus]
<b>Total</b>		<b>1,500.00</b>	

## Contact Us

### Analyst Contact

Mr. Girish Bhatta

+977-01-4012630

[girish.bhatta@careratingsnepal.com](mailto:girish.bhatta@careratingsnepal.com)

Mr. Santosh Pudasaini

+977-01-4012629

[pudasaini.santosh@careratingsnepal.com](mailto:pudasaini.santosh@careratingsnepal.com)

### Relationship Contact

Mr. Achin Nirwani

+977-9818832909

[achin.nirwani@careratingsnepal.com](mailto:achin.nirwani@careratingsnepal.com)

## About CARE Ratings Nepal Limited:

CARE Ratings Nepal Limited (CRNL) is licensed by the Securities Board of Nepal w.e.f. November 16, 2017. CRNL is supported by CARE Ratings Limited through a technical services agreement to provide technical support in the areas such as rating systems and procedures, methodologies, etc. from CARE Ratings on an ongoing basis. The technical support shall ensure that CRNL has adequate resources to provide high quality credit opinions in Nepal.

Our parent company, CARE Ratings Limited commenced operations in April 1993 and over two decades, it has established itself as one of the leading credit rating agencies in India. CARE is registered with the Securities and Exchange Board of India (SEBI) and also recognized as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI).

### Disclaimer

CRNL's ratings are opinions on credit quality and are not recommendations to sanction, renew, disburse or recall the concerned bank facilities or to buy, sell or hold any security. CRNL has based its ratings on information obtained from sources believed by it to be accurate and reliable. CRNL does not, however, guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. Most entities whose bank facilities/instruments are rated by CRNL have paid a credit rating fee, based on the amount and type of bank facilities/instruments.

In case of partnership/proprietary concerns, the rating assigned by CARE is, inter-alia, based on the capital deployed by the partners/proprietor and the financial strength of the firm at present. The rating may undergo change in case of withdrawal of capital or the unsecured loans brought in by the partners/proprietor in addition to the financial performance and other relevant factors. CARE is not responsible for any errors and states that it has no financial liability whatsoever to the users of CARE's rating.