

Ramechhap Sherpa Construction Private Limited

Ratings

Facilities	Amount (Rs. in Million)	Ratings ¹	Rating Action
Long Term Bank Facilities	140.80	CARE-NP BB [Double B]	Reaffirmed
Short Term Bank Facilities	98.70	CARE-NP A4 [A Four]	Reaffirmed
Long Term/ Short Term Bank Facilities	1,000.50	CARE-NP BB/ A4 [Double B/ A Four]	Reaffirmed
Total Facilities	1,240.00 (One Thousand Two Hundred Forty Million only)		

Details of instruments/facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has reaffirmed the rating of 'CARE- NP BB' assigned to the long term bank facilities and 'CARE- NP A4' assigned to the short term bank facilities of Ramechhap Sherpa Construction Private Limited (RSC).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of RSC continue to be constrained by concentrated though moderate order book position, working capital intensive nature of business, high counter party risk and its presence in highly competitive construction industry coupled with tender based nature of operations. The ratings are also constrained by exposure to volatile interest rates and government regulations and risk of delay in project execution.

The ratings, however, derive strengths from experienced promoters and long track record of operations, improving trend in financial risk profile marked by growing total operating income (TOI) in FY22 (Unaudited, refers to the twelve-months period ended mid-July 2022), moderate capital structure and debt service indicators of the company 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

Concentrated order book position

As on November 15, 2022, the unexecuted orders in hand of the company stood at Rs. 5,245 Mn, which is 5.90x of the income from contract of FY22, providing mid-term revenue visibility. The order book is concentrated and consists of various construction projects; however, remain primarily concentrated towards hydropower projects (~94%) and others include irrigation, bridge and road 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.

High counter party risk

Revenue of RSC is generated via contracts from both government departments and private parties. The order book is primarily concentrated towards hydropower projects from private parties. Counter party risk remains high given the projects are from private parties and revenue billing and payment recovery is dependent on availability of funds and liquidity of the private parties which may significantly impact RSC's financials.

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. RSC's inventory holding period stood at 138 days in FY22. The relatively higher inventory holding period was on account of stocking up of construction materials as the company is required to maintain inventory at various sites for smooth execution of project works. Although inventory days declined from 244 days in FY21, it continued to remain at higher side. The funds are released only after the work certification process is completed and finalization of the bill is done. Customer base includes private parties and government departments/ bodies; therefore, the certification and realization of the bill generally takes the period of around a month. Average collection period of the company was moderate at around 13 days in FY22 which improved from 30 days in FY21. These factors lead to increased reliance of the company on borrowings to meet its working capital requirements.

Tender based nature of operations in highly competitive construction industry

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

Risk of delay in project execution

Given the nature of projects awarded, RSC 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.

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, with substantial upward pressure on interest rates in the last few quarters. A contractionary monetary policy for FY23 coupled with increasing inflation has only added to the upward pressure on interest rates, resulting in the rate hikes taken by BFIs in the first quarter of FY23. Any further 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.

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

RSC is promoted by Mr. Gelje Lama, Managing Director, who has been leading the company since its inception in 1997. Mr. Lama 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 planning business strategies of the

company. Furthermore, the board is supported by an experienced team across various functions. The company has long track record of operations of over two decades in the construction of various infrastructure projects all over Nepal.

Moderate financial risk profile marked by increase in TOI

RSC's TOI grew ~109% year-on-year to Rs. 889 Mn during FY22 boosted by execution of projects during the 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 has remained moderate and was range bound between 13%-16% during the last 3 financial years (FY20-FY22). PBILDT margin declined to 14.16% in FY22 from 16.00% in FY21 amid increased input prices. Consequently, PAT margin of RSC declined by 22 bps to 4.17% in FY22. Gross Cash Accruals (GCA) of the company increased to Rs. 92 Mn in FY22 from Rs. 46 Mn in FY21 mainly on account of increase in PAT and depreciation expense of the company.

Moderate capital structure and debt service indicators of the company

Capital structure of RSC stood moderate with overall gearing ratio (including mobilization advance) of 1.80x as on mid-July 2022 which improved from 2.47x as on mid-July 2021 mainly on account of increase in net worth of the company with accretion of profits to the reserves of the company and decrease in mobilization advance during FY22. Total debt of the company, which mainly comprises of hire purchase loans, mobilization advance & working capital borrowings decreased at the end of FY22 to Rs. 378 Mn from Rs. 417 Mn as on mid-July 2021. Also, total outside liability to total net worth and total debt to gross cash accruals remained moderate at 2.54x and 4.11x respectively as on mid-July 2022 (3.05x and 9.38x respectively, as on mid-July 2021). However, the interest coverage was adequate at 5.75x in FY22 showing improvement from 3.94x in FY21 aided by increase in PBILDT with increase in TOI.

Analytical Approach

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

About the Company

Ramechhap Sherpa Construction Private Limited (RSC) is a class "A" construction company of Nepal incorporated in year 1997 with its registered office based in Kathmandu, Nepal. The company is involved in hydropower projects, construction of roads, bridges, irrigation works etc. across Nepal. In addition to doing projects independently, RSC also enters into Joint Ventures (JVs) with other companies in order to meet the eligibility criteria for different construction projects.

Financial Performance

For the Period	(Rs. Million)		
	FY20 (A)	FY21 (A)	FY22 (UA)
Income from Operations	373	426	889
PBILDT Margin (%)	13.77	16.00	14.16
Overall Gearing (times)	2.45	2.47	1.80
Total Outstanding Liabilities/Tangible Net worth (times)	2.81	3.05	2.54
Interest Coverage (times)	3.85	3.94	5.75
Current Ratio (times)	3.36	3.20	1.77
Total Debt/Gross Cash Accruals (times)	8.65	9.38	4.11

A: Audited; UA; Unaudited

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	140.80	CARE-NP BB [Double B]
Short Term Bank Facilities	Fund Based Limits	98.70	CARE-NP A4 [A Four]
Long Term/ Short Term Bank Facilities	Non Fund Based Limits	1,000.50	CARE-NP BB/ A4 [Double B/ A Four]
Total		1,240.00	

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