

Rayamajhi Construction Private Limited

Ratings

Facilities/Instrument	Amount (Rs. in Million)	Ratings ¹	Rating Action
Long Term Bank Facilities	43.69	CARE-NP BB- [Double B Minus]	Assigned
Short Term Bank Facilities	61.01	CARE-NP A4 [A Four]	Assigned
Long Term/ Short Term Bank Facilities	1,395.30	CARE-NP BB-/A4 [Double B Minus/A Four]	Assigned
Total Facilities	1,500.00 (One Thousand Five 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 Rayamajhi Construction Private Limited (RCPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of RCPL are constrained by its below average financial risk profile marked by small scale of operations with low capital base limiting scope for substantial growth in operations. The ratings also factor in RCPL's moderately leveraged capital structure, working capital intensive nature of operations, tender based nature of operations in highly competitive construction industry, risk of delay in project execution, and exposure to volatile interest rates.

The ratings, however, derive strengths from experienced promoters in the related field and established track record in executing various construction works, moderate order book position with mid-term revenue visibility, moderate counter party risk and escalation clause in majority of the contracts.

Going forward, the ability of the company to profitably scale up its operations while successfully executing the projects on time and managing its working capital requirements to support growth will be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Below average financial risk profile marked by small scale of operations with low capital base and moderately leveraged capital structure

Despite being operational for more than two decades, the scale of operations has remained relatively small with total operating income (TOI) of Rs. 227 Mn during FY22 (Unaudited; refers to the twelve-month period ended mid-July 2022). With networth base of Rs. 64 Mn as on mid-July 2022, the ability of company to scale up larger sized contracts having better operating margins is constrained by its comparatively low capital base. Small scale of operation in a competitive industry could limit the pricing power and benefits derived from economic of scale.

The capital structure of RCPL stood moderately leveraged with overall gearing ratio (including mobilization advance) of 1.85x at the end of FY22. Total debt of the company, which mainly comprises of hire purchase loans, mobilization advance & working capital borrowings, increased in FY22 to Rs. 118 Mn from Rs. 86 Mn at the end of FY21. Although debt service coverage indicators remain adequate with interest coverage of 3.91x during FY22 (PY: 4.05x). Furthermore, the company's total outside liabilities to networth base stood high at around 3.07x at the end of FY22.

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

Working capital intensive nature of business

RCPL primarily works with various government departments and payments for the contracts are generally received only after the work certification process is completed and finalization of the bill is done. Lengthy certification processes normally lead to high work in progress and inventory levels. The company had inventory period of two months during FY22. Furthermore, retention deposit is deducted by the clients from running bills which gets refunded to the contractor after some period, usually twelve months, on successful execution of the contracted work. These factors lead to reliance of the company on bank finance to meet its working capital requirements. Although RCPL has high average payable period of around three to four months on account of good relationship with suppliers, over reliance on creditors for working capital management may not be sustainable over the long term. The average monthly fund-based working capital utilization for the past twelve months ended mid-October 2022 was around 60% of the sanctioned limits. Ability of the company to efficiently manage its working capital requirements is critical from credit perspective.

Tender based nature of operations in highly competitive construction industry

Majority of the RCPL's projects are tender-based government contracts wherein the company has to quote a bid. With multiple players active in the industry, RCPL'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, RCPL 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 further resulting a delayed realization of revenue growth. Furthermore, the company's ability to execute projects in timely manner would be led by its own operational efficiency and timely stage payments received from clients.

Exposure to volatile interest rate risk

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 in related field**

RCPL is managed under the overall guidance of the company's board of directors who possess wide industry experience. RCPL has four Board of directors, chaired by Mr. Bharat Jung Rayamajhi, who has more than 2 decades of work experience

in construction sector. Similarly, other directors of the company also have work experience in related sector. The BOD are further supported by a team of experienced management team members.

Moderate order book position with mid-term revenue visibility

As on November 01, 2022, the unexecuted orders in hand of the company stood at Rs. 1,577 Mn which is ~6.95x of its operating income for FY22, providing mid-term revenue visibility. The current order book is diversified into roads, bridge, infrastructure and irrigation projects. Majority of the works are for bridge projects ~ 50% and roads projects ~ 44% by majorly 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 and escalation clause in majority of the contracts

Revenue of RCPL 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. Furthermore, the company has inbuilt price escalation clauses in majority of contracts in order to insulate the company from any adverse fluctuation in construction material prices and labour expenses. This enables the company to pass on increase in raw material prices to its customers (employers). Ability of the company to pass on increased price burden to the customers in a timely manner and maintain profitability margins is critical from credit perspective.

About the Company

RCPL is a Class "A" construction company in Nepal, incorporated on September 09, 1999 with registered office in Kathmandu, Nepal. The company is mainly involved in various type of construction projects which includes road works, bridge works, irrigation works and other infrastructure work mainly in western region of Nepal. In addition to doing projects independently, RCPL also enters into Joint Ventures (JVs) with other companies in order to meet the eligibility criteria for different construction projects.

Brief financial performance of RCPL during last 3 years is given below:

(Rs. In Million)

For the Period	FY20 (A)	FY21 (A)	FY22(UA)
Income from Operations	165	228	227
PBILDT Margin (%)	20.65	17.04	18.94
Overall Gearing (times)	1.82	2.28	1.85
Interest Coverage (times)	2.50	4.05	3.91
Current Ratio (times)	0.98	1.03	0.88
Total Debt/Gross Cash Accruals (times)	2.83	3.26	3.93

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	43.69	CARE-NP BB-
Short Term Bank Facilities	Fund Based Limits	61.01	CARE-NP A4
Long Term/ Short Term Bank Facilities	Non Fund Based	1,395.30	CARE-NP BB-/A4
Total		1,500.00	

Contact Us

Analyst Contact

Ms. Anusha Thapa

+977-01-4012628

anusha.thapa@careratingsnepal.com

Mr. Santosh Pudasaini

+977-01-4012629

pudasaini.santosh@careratingsnepal.com

Relationship Contact

Mr. Achin Nirwani

+977-9818832909

achin.nirwani@careratingsnepal.com

About CARE Ratings:

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