

Sigma Con. Private Limited

Ratings

Facilities	Amount (Rs. in Million)	Ratings ¹	Rating Action
Long Term Bank Facilities	169.83	CARE-NP BB+ [Double B Plus]	Assigned
Short Term Bank Facilities	1,480.00	CARE-NP A4+ [A Four Plus]	Assigned
Long Term Bank Facilities/ Short Term Facilities	3,300.00	CARE-NP BB+ /A4+ [Double B Plus /A Four Plus]	Assigned
Total Facilities	4,949.83 (Four Thousand Nine Hundred Forty- Nine Million and Eight Hundred Thirty Thousand 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 Sigma Con. Private Limited (SCPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of SCPL are constrained by its working capital intensive nature of operations marked by highly elongated collection period in FY22 (Audited; FY refers to the twelve-month period ending mid-July). Slower debtor realization trend in the construction sector could spill over into FY23, particularly given the lower than expected government revenue collections so far this fiscal. Hence, a sustained high collection period could add to the financial burden of the company over the near-term, which could be a challenge given the ongoing credit crunch in the Nepalese banking sector. The ratings take note of the year-on-year moderation in the capital structure and debt service coverage indicators of the company in FY22 amid higher debt levels and increased interest outgo. The ratings also factor in the tender based nature of operations in the highly competitive construction industry without escalation clause, exposure to volatile interest rates and regulatory risk and risk of delay in project execution.

The ratings, however, derive strength from the experienced promoters & established presence of the company with proven execution track record in a niche power distribution segment that requires substantial technical expertise. The ratings take note of the growing scale of operations, which is expected sustain over near-term supported by the healthy accretion in the company's order book position over the past six months, providing decent near-to-mid-term revenue visibility. Although presence in the niche power distribution segment, currently amongst a high priority sector for the government, provides the company a clear advantage vis-à-vis other civil contractors, the long term prospects of the company could be limited given its less diversified portfolio. With majority of the current order book towards rural electrification projects, revenue visibility and the company's ability to maintain its scale of operations at the current levels, over the medium term, remains to be seen. Furthermore, the ratings also take cognizance of the near-term challenges faced by the overall construction sector in Nepal amid lower government spending vis-à-vis prior budget allocations leading to stretched liquidity position of contractors. *Going forward, the ability of the company to execute projects and recover contract proceeds in a timely manner leading to sustained revenue growth as envisaged while maintaining profitability margins without deterioration in its financial risk profile will be the key rating sensitivities.*

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

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Working capital intensive nature of business

The operations of the company are working capital intensive in nature marked by higher collection period. SCPL's average collection period elongated to 136 days at the end of FY22 from 128 days at the end of FY21. SCPL's customers base includes NEA and other governmental bodies, with certification and realization of bills generally taking around 1-2 months. Furthermore, funds are released only after the work certification process is completed and finalization of the bill is done. A substantially elongated collection period could be a concern, particularly amid the slowdown in government capital expenditures and revenue collection over the last year or so coupled with the ongoing liquidity stress/credit crunch in the banking industry. Amid increasing working capital intensity, the company's reliance on borrowings to meet its working capital requirements is only likely to increase further. Hence, timely receipts of payment from clients will remain critical from credit perspective.

Exposure to volatility in input process and foreign exchange fluctuation risk

As the company doesn't have price escalation clauses in most of its contracts which could insulate the company from any adverse fluctuation in construction material prices and labour expenses, it is vulnerable to any raw material/labour cost hikes which can adversely impact its profitability margins. Additionally, SCPL imports various equipments from India, China and European countries and has payables in foreign currency, while its collections are in domestic currency. The company does not hedge its foreign exposure and remains exposed to fluctuation in foreign currency exchange.

Tender based nature of operations in highly competitive construction industry

Majority of the SCPL's projects are tender-based government contracts. With multiple players active in the industry, SCPL'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 electrification 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. 5,000 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

SCPL had Rs.26 Mn finance cost in FY22, which had increased from Rs.6 Mn in FY21, leading to squeezing its net profitability. SCPL's interest expenses are based on 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 only added to the upward pressure on interest rates, evident in the rate hikes taken by BFIs in the first half of FY23, which has since softened a little bit in the last month or so. However, any further sustained higher rates 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, SCPL 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**Experience promoters and long track record of operations**

SCPL is promoted by Mrs. Nutan Devi Shrestha, Chairman, who has been leading the company since its inception in 1994. She has experience of more than 2 decades in the field of construction. Mr. Gunja Prasad Shrestha, Managing Director, has qualification of post-graduation in electric power distribution and has experience of more than 47 years in related field. He was involved in Nepal Electricity Authority since 1976 and has successfully completed construction of many transmission line, substation. Mr. Manish Prasad Shrestha, director, has qualification of Master of Science in electrical engineering and has experience of more than 20 years in related field.

SCPL has long track record of more than 28 years in the construction of transmission lines, overhead and underground distribution systems, communication system and substations from small to large size projects and has executed several projects across the country in different terrains either individually or through its JV entities.

Growing trend in income with fairly steady profitability, albeit moderation in debt coverage indicators in FY22

SCPL's total operating income increased by 25% year-on-year to Rs. 1, 070 Mn in FY22 boosted by increased project execution during the year. The business generation of the company is through bidding and tendering process and profitability margins directly associated with the nature of contracts executed by the company during the financial year. PBILDT margin has been range bound in between 11%-12% over last 3 financial years (FY20-FY22). During FY22, PAT margin of the company, however, moderated to 5.88% from 6.80 % amid higher interest expense. Though PAT margin, gross cash accruals of SCPL has remained almost stable in the last 2 financial years (FY22:Rs.101,FY21:Rs.108 Mn FY22) due to growing scale of operations.

Similarly, overall gearing ratio of the company was moderate at 1.45x (includes mobilization advances and excludes advances from director) at the end of the FY22 deteriorating from 0.76x at the end of the FY21 majorly on account of increase in hire purchase loans, working capital borrowings and mobilization advance amid increasing scale. Interest coverage ratio remained adequate at 4.87x in FY22, although declining from 15.60x in FY21. Further, total debt/ gross cash accrual (GCA) of the company increased to 5.52x during FY22 from 2.01x during FY21.

Healthy current order book position though concentrated

As on February 10, 2023 the unexecuted orders at hand of the company stood at Rs. 4,799 Mn, which is 4.49x of the TOI of FY22, providing reasonable revenue visibility over near term. The order book is primarily concentrated towards rural electrification (~62%) and others include transmission line and substation by entering into JVs. Addition of new projects in the last six months has boosted the order book position of the company and scale of operations is likely to see substantial growth in FY23. However, having a concentrated order book on few projects links the company's performance to the same and any delays in execution of any such project may impact the company's financial health. Nevertheless, 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, although slowed payment clearance in the recent periods could be a concern

SCPL generates income via transmission line, substation and rural electrification contracts from NEA and government departments. While counter party risk remains relatively lower given the projects are from NEA and government municipalities, which have been making timely payment to the company in the past. However, the company's collection period has remained somewhat inflated over the last couple of years, majorly on account of works done by the company on behalf of its joint-ventures.

Industry Outlook

The construction sector in Nepal, in general, has been impacted by lower execution in the aftermath of the covid19 pandemic with slower pace of economic growth coupled with relatively lower infrastructure spending by the government. Furthermore, contractors' cash flows have also come under pressure as a result of highly inflated construction costs leading to shrinking margins over FY22-H1FY23. Increasing trend in fuel price, which is a key input for majority of contractors, has added to the margin pressure. Furthermore, the slowdown in the pace of government capital expenditure, substantially lower than earlier budgeted amount, could also impact the income prospects of the company going forward if this sustains for a longer period. Also due to increased slippages in the construction portfolio of majority of banks in the last couple of quarters, the banks are reluctant to enhance the sanction borrowings which would impact the growth prospects and also liquidity in the industry. Although Government of Nepal's demonstrated focus towards growing power generation capabilities and improving electrification throughout Nepal which argues well for players like SCPL; however, timely allocation of budget and clearance of payments in a timely manner will remain a key monitorable aspect from analytical perspective.

About the Company

Sigma Con. Private Limited (SCPL) is Construction Company of Nepal and was incorporated in the year 1994 with registered office based in Kathmandu, Nepal. It is a construction company in the field of Electrical and Communication Engineering. It offers a wide range of Overhead transmission line, overhead and underground electrical work power distribution system, communication system, substation. In addition to doing projects independently, SCPL also enters into Joint Ventures (JV) with other companies in order to meet the eligibility criteria for different construction projects.

Financial Performance

(Rs. Million)

For the Period	FY20 (A)	FY21 (A)	FY22 (A)
Income from Operations	703	859	1,070
PBILDT Margin (%)	11.90	11.55	11.60
Overall Gearing (times)	0.86	0.76	1.45
Total Outstanding Liabilities/Tangible Net worth (times)	3.39	2.69	2.86
Interest Coverage (times)	9.45	15.60	4.87
Current Ratio (times)	1.26	1.15	1.36
Total Debt/Gross Cash Accruals (times)	3.04	2.01	5.52

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	169.83	CARE-NP BB+ [Double B Plus]
Short Term Bank Facilities	Fund Based Limits	1,480	CARE-NP A4 + [A Four Plus]
Long Term Bank Facilities/Short Term Bank Facilities	Non Fund Based Limits	3,300	CARE-NP BB +/A4+ [Double B Plus /A Four Plus]
Total		4,949.83	

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About CARE Ratings Nepal Limited:

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