

Thodung Construction Private Limited

Ratings

Facilities	Amount (Rs. in Million)	Ratings ¹	Rating Action
Long Term Bank Facilities	11.93	CARE-NP BB- [Double B Minus]	Assigned
Short Term Bank Facilities	30.00	CARE-NP A4 [A Four]	Assigned
Long Term/ Short Term Bank Facilities	770.00	CARE-NP BB-/A4 [Double B Minus/ A Four]	Assigned
Total Facilities	811.93 (Eight Hundred Eleven Million and Nine Hundred Thirty Thousand Rupees Only)		

Details of Facilities in Annexure-1

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

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of TCPL are constrained by its modest scale of operations with low capital base. The ratings also factor in the tender based nature of operations in highly competitive construction industry, risk of delay in project execution and timely recovery of contract proceeds, particularly amid a slowing economy. The ratings also factors in the high potential gearing of the company owing to the relatively large non-fund based exposure.

The ratings, however, derive strengths from experienced promoter in the related field with long track record in execution of various construction works, stable financial performance trend with steady income levels and profitability leading to adequate debt service coverage ratio, moderate order book position of the company, for its scale, providing mid-term revenue visibility although with high concentration in road construction, moderate counter party risk with escalation clause in majority of contracts.

Going forward, the ability of the company to successfully execute projects and recover contract proceeds in timely manner, profitably scale up the operations of the company leading to sustained revenue growth while maintaining profitability margins while improving its overall financial risk profile will be key sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Modest scale of operations with low capital base

The financial risk profile of TCPL is marked by its modest scale of operations with Total Operating Income (TOI) of Rs. 222 Mn during FY22 (Audited; FY refers to twelve-month period ending mid-July). Although the company's scale of operations has remained fairly stable over the past three financial years (FY20-FY22), its ability to substantially scale up to larger sized contracts having better operating margins is constrained by its comparatively low paid-up capital of Rs. 6 Mn as on mid-July 2022. Furthermore, amid a low net worth base coupled with high non-fund based exposure, the company's potential gearing levels stood relatively high at ~20x at the end of FY22. Small scale of operations in a competitive industry limits the pricing power and benefits derived from economies of scale.

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

Tender based nature of operations in highly competitive construction industry

The company receives its majority work orders from government departments and local authorities. All contracts are tender-based for which TCPL has to participate in the tenders, wherein the company has to quote the bid and hence it has to face the risk of successful bidding for the same, which again comes with the risk of quoting at low price through e-bidding to sustain the competition. TCPL enters into construction contracts either individually or through JV entities in order to meet eligibility criteria for these contracts. TCPL also receives subcontract from the various contractors.

There are numerous fragmented and unorganized players operating in this industry which makes the industry highly competitive and the ability of TCPL to sustain its profitability margins and growth in future remain crucial. Furthermore, the business also remains dependent on 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.

Risk of delay in project execution and timely realization of proceeds from contracts

Given the nature of projects awarded, TCPL 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 payments received from clients. Although counter party risk over the medium term remains moderate given the projects are from government departments, which have been making timely payment to the company in the past, timely debtor realization, particularly at times of economic downturn, remain key challenge for the construction sector. Presence of escalation clause in majority of the contracts enable the company to pass increase in raw material prices to its customers. Ability of the company to pass increased burden to the customer in a timely manner and maintain profitability margins is critical from credit perspective.

Key Rating Strengths**Experienced promoter in the related field with long track record in operations**

TCPL has three directors in its Board of Directors chaired by Mr. Ang Nema Sherpa, who has experience of more than 2 decades in the field of construction. He is also a director in Three Star Hydropower, which an operational 6.6 MW hydropower project. Mr. Nagwang Chodden Sherpa, an Executive Director, has Masters in System Network Engineering and experience of almost two decades in the field of construction.

TCPL has a long track record of 27 years in construction business having executed several small to mid-size roads and commercial buildings projects across the country in different terrains either individually or through its JV entities.

Stable profitability leading to moderate debt service coverage indicators

Along with the operating income, the PBILDT margin of the company also remained fairly stable at around 12% over FY21-FY22. The company has been able to manage impact of the input price escalations, resulting in satisfactory debt service coverage indicators of the company, marked by interest coverage ratio of 5.98x and 7.16x in the last two FYs (FY21 and FY22). Total debt to gross cash accruals (GCA) improved to 1.62x in FY22 from 2.31x in FY21. As on mid-July 2022, overall gearing ratio (including mobilization advance) of TCPL has improved to 1.07x from 1.86x as on mid-July 2021 aided by repayment of term loan coupled with accretion of profits to net worth. The ability of TCPL to sustain its profitability margin while managing working capital requirements and maintaining debt service coverage indicators will remain key from credit perspective.

Moderate order book position, albeit concentrated in road projects

The unexecuted orders in hand of the company as on March 03, 2023 stood at Rs.975 Mn, which is 3.64x of income booked from contracts of FY22, providing mid-term revenue visibility. However, the order book is primarily concentrated towards road projects (~68%). This exposes the company to revenue concentration risk in terms of business segment. Concentration of government orders exposes the company with risk related to allocation of fund or regulatory changes mainly in the Public Procurement Act and other related regulations. Timely execution of the orders would be critical for the business prospects of the company and will have a direct bearing on its financial risk profile.

Industry Outlook

The construction sector in Nepal has been impacted by lower execution in the aftermath of the covid-19 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 road construction, building materials and other construction equipment, has added to the margin pressure. Furthermore, as government capital expenditure continues to remain substantially lower than budgeted amount, income prospects remain subdued over the near-term which coupled with delays in payments to contractors has led to some stress in the construction sector in H1FY23 leading to the slippages in the construction portfolio of BFIs. Near term operating environment for construction companies, including RCPL, remains challenging and will remain a key monitorable aspect.

About the Company

Thodung Construction Private Limited (TCPL) is a Class "A" construction company in Nepal, incorporated on February 15, 1996, with registered office, Bouddha, Kathmandu. TCPL is mainly involved in road projects and a few building construction projects. In addition to doing projects independently, TCPL 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 ended/ as at mid-July	FY20 (A)	FY21 (A)	FY22 (A)
Income from operations	207	203	222
PBILDT Margin (%)	13.94	12.58	11.90
Overall Gearing (times)	2.75	1.86	1.07
Interest Coverage (times)	3.10	5.98	7.16
Current Ratio (times)	0.71	0.93	0.72
Total Debt/ GCA	2.77	2.31	1.62

A: Audited;

Annexure 1: Details of the Facilities rated

Nature of the Facility	Type of the Facility	Amount (Rs. in Million)	Rating
Long Term Bank Facilities	Term Loan	11.93	CARE-NP BB- [Double B Minus]
Short Term Bank Facilities	Fund Based Limit	30.00	CARE-NP A4 [A Four]
Long Term/ Short Term Bank Facilities	Non Fund Based Limit	770.00	CARE-NP BB-/A4[Double B Minus/A Four]
Total		811.93	

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