

## Mahesh Engineering & Builders Private Limited

### Ratings

Facilities	Amount (Rs. in Million)	Ratings <sup>1</sup>	Rating Action
Long Term Bank Facilities	38.19 (Increased from 13.17)	CARE-NP B [ Single B]	Reaffirmed
Short Term Bank Facilities	311.81 (Increased from 10.00)	CARE-NP A4 [A Four]	Reaffirmed
Long Term/ Short Term Bank Facilities	650.00 (Increased from 576.83)	CARE-NP B/A4 [Single B/ A Four]	Reaffirmed
Total Facilities	1,000.00 (One Billion Only)		

*Details of Facilities in Annexure-1*

CARE Ratings Nepal Limited (CRNL) has reaffirmed the rating of 'CARE-NP B' assigned to the long-term bank facilities and the rating of 'CARE-NP A4' assigned to the short-term bank facilities of Mahesh Engineering & Builders Private Limited (MEBPL).

### Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of MEBPL is constrained by its stretched liquidity position attributed to elongated operating cycle. The ratings continue to be constrained by MEBPL's tender based nature of operations in highly competitive construction industry, risk of delay in project execution and timely recovery of contract proceeds, and exposure to volatile interest rate. The ratings also factor in the company's concentrated order book position.

The ratings, however, continue to derive strengths from experienced promoter in the related field with long track record in execution of various construction work, moderate counter party risk, and escalation clause in majority of contracts. The ratings also take comfort from rebound in financial performance in FY23 (Unaudited, FY refers to the twelve-month period ending mid-July) after a subdued FY22.

*Going forward, the ability of the company to successfully execute projects and recover contract proceeds in timely manner, continue to profitably scale up its operations amidst high level of competition, and manage its working capital requirements to support growth will be key rating sensitivities.*

### Detailed Description of the Key Rating Drivers

#### Key Rating Weaknesses

#### Stretched liquidity position attributed to elongated operating cycle

MEBPL's free cash flow generation has been impacted by elongated collection period in the past and consequently the company's liquidity position remains stretched with low cash reserve. Amid increased project execution in FY23 coupled with a relatively low base of FY22, MEBPL's average collection period improved to 46 days in FY23 from 373 days in FY22. Consequently, its operating cycle improved to 54 days in FY23 from 308 days in FY22. Despite year-on-year improvement in operating cycle in FY23, however, there have been some instances of delays in debt servicing by the company during times when realization of receipts from clients have been delayed. Timely debtor realization has been a major challenge for the construction sector in Nepal over the past year or so amid lower-than-expected capital expenditure by the government. The company's ability to improve its liquidity position leading to timely debt servicing on a sustained basis will remain critical from analytical perspective.

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

**Major exposure to a single project heightens concentration risk**

The unexecuted order book of the company was Rs. 929 Mn (share of MEBPL only) as on November 5, 2023, provides revenue visibility over the medium-term. However, one of the projects accounts for ~48% of total order book. Having concentration on single project links the company's performance on the timely execution of project which would be critical for the business prospects of the company and will also have a direct bearing on its margins and liquidity profile.

**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 MEBPL 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. MEBPL enters into construction contracts either individually or through JV entities in order to meet eligibility criteria for these contracts.

There are numerous fragmented and unorganized players operating in this industry which makes the industry highly competitive and the ability of MEBPL 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**

Given the nature of projects awarded, MEBPL 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 rates**

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. Higher interest rates than envisaged could result in squeezed margins of the company. Hence, funding taken by the company from BFIs is subject to volatile interest rate.

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

MEBPL was incorporated as a sole proprietorship in 1985 owned by Mr. Dhurba Prasad Upadhayay. Later on, it was converted into private limited in 2019. MEBPL has a long track record of more than four decades in the construction of roads (majorly), bridge projects, and irrigation projects from small to mid-size projects across the country in different terrains either individually or through its JV entities. Mr. Manoj Kumar Khanal, Managing Director, has experience of more than two decades in the field of construction. He is also the sole owner of another construction company: M K Construction Private Limited. Mr. Dhurba Prasad Upadhayay, Director, has experience of over three decades in the field of construction.

### Improved financial performance in FY23 with moderate capital structure

During FY23, MEBPL's Total Operating Income (TOI) rebounded to Rs.249 Mn (FY22: Rs. 27 Mn), aided by increased execution of orders at hand. PBILDT margin of the company normalized to ~ 8% in FY23, amid increase in cost of contract. Similarly, PAT margin of the company stood at 4.82% in FY23 which improved from 3.47% in FY22. Owing to substantial jump in operating scale, the gross cash accruals of the company improved to Rs. 15 Mn in FY23 from Rs. 4 Mn in FY22. Overall gearing ratio deteriorated to 0.96x in FY23 from 0.33x in FY22, on account of increase in working capital borrowings taken to support the increased scale of operations. However, with improvement in operational performance leading to higher PBILDT in FY23, MEBPL's interest coverage improved to 6.53x in FY23 from 4.97x in FY22. Total debt/ GCA of the company improved to 2.90x in FY23 as compared to 3.17x in FY22 on account of improved operational performance.

### Moderate counter party risk and escalation clause in majority of contracts

Revenue of MEBPL is majorly generated via contracts from government departments including provincial and local bodies. The order book is primarily concentrated towards road projects from government departments. Counter party risk remains moderate given the projects are from government departments. 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.

### 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-FY23. 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 FY23 leading to the slippages in the construction portfolio of BFIs. However, as per the Fiscal Policy for FY24, the government has emphasized spending in infrastructure, energy and industries sector with allocation of budget of Rs. 131,596 Mn. (~8% of total budget) to Ministry of Physical Infrastructure and Transportation and Rs. 87,450 Mn. (~5% of total budget) to Ministry of Energy, Water Resources and Irrigation. The near-term operating environment for construction companies would hinge on the government's ability to spend on capital expenditure as budgeted, which has been on the lower side over FY22-FY23.

### About the Company

Mahesh Engineering & Builders Private Limited (MEBPL) is a 'C' class construction company in Nepal, established in 1985 as a sole proprietorship. It was later changed to a limited liability company based in Bardagat, Nawalparasi, Nepal on 21st August 2019. MEBPL is mainly involved in road projects and a few bridge construction projects. In addition to doing projects independently, MEBPL 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	FY21 (A)	FY22 (A)	FY23 (UA)
Income from operations	105	27	249
PBILDT Margin (%)	8.05	19.85	8.07
Overall Gearing (times)	0.30	0.33	0.96
Interest Coverage (times)	7.09	4.97	6.53
Current Ratio (times)	6.99	4.08	1.38
Total Debt/ GCA	1.83	3.17	2.90

A: Audited; UA: Unaudited

**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	38.19	CARE-NP B [Single B]
Short Term Bank Facilities	Fund Based Limit	311.81	CARE-NP A4[ A Four]
Long Term/ Short Term Bank Facilities	Non-Fund Based Limit	650.00	CARE-NP B/A4[Single B/ A Four]
<b>Total</b>		<b>1,000.00</b>	

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