

Aarogya Construction Private Limited

Ratings

Facilities	Amount (Rs. in Million)	Ratings ¹	Rating Action
Long Term Bank Facilities	64.32 (Decreased from 66.00)	CARE-NP B [Single B]	Revised from CARE-NP B+
Short Term Bank Facilities	317.32 (Decreased from 318.70)	CARE-NP A4 [A Four]	Reaffirmed
Long Term/ Short Term Bank Facilities	1,850.00 (Decreased from 2,350.00)	CARE-NP B/A4 [Single B/ A Four]	Revised from CARE-NP B+ /A4
Total Facilities	2,231.64 (Two Billion Two Hundred Thirty One Million and Six Hundred Forty Thousand Only)		

Details of instruments/facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has revised the rating assigned to the long term bank facilities of Aarogya Construction Private Limited (ACPL) to 'CARE-NP B' from 'CARE-NP B+' and has reaffirmed the rating of 'CARE-NP A4' assigned to the short term bank facilities of ACPL.

Detailed Rationale & Key Rating Drivers

The revision in the ratings assigned to the bank facilities of ACPL takes into account its highly elongated operating cycle resulting to working capital intensive nature of business and stretched liquidity position amid non-recovery from debtors during in FY23 (Unaudited; FY refers to the twelve-month period ending mid-July). The ratings also factor in ACPL's moderately leveraged capital structure and its presence in highly competitive construction industry coupled with tender based nature of operations, exposure to volatile interest rates and government regulations and risk of delay in project execution.

The ratings, however, derive strengths from experienced promoters and moderate track record of operations, moderate order book 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 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

Highly elongated operating cycle resulting in stretched liquidity position

The operations of the company are working capital intensive in nature. Net Operating cycle of the company remained very high at 721 days in FY23, which increased from 278 days in FY22. This was on account of increase in average collection period to 708 days in FY23 from 342 days in FY22 coupled with high inventory holding period of 523 days in FY23 from 181 days in FY22. The major factor that resulted in high inventory was accumulation of inventory on account of unexecuted projects due to delay in clearance from the government authorities for laying of fibre optic cables. The funds are released only after the work certification process is completed and finalization of the bill is done. Customer base includes government departments and private entities. The certification and realization of the bill generally takes a period of around three months. There have been procedural delays in the recovery of debtors, and at times, the same have exceeded two years. Furthermore, there is spill over of some receivables from FY21 and FY22 into FY23. Consequently, average collection

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

period of the company was high at around 708 days in FY23. An elongated operating cycle resulted in a stretched liquidity position of the company, increasing its reliance on the bank finance for meeting its working capital needs, resulting in increased debt levels. Accordingly, ACPL has been fully utilizing its working capital loans against its sanctioned limits. Interest coverage ratio of the company was modest at 1.54x in FY23 which deteriorated from 2.01x in FY22 on account of increased interest expenses due to increased working capital loans availed by the company. Furthermore, Total debt/GCA of the company deteriorated substantially to 25.19x in FY23 from 16.04x in FY22, with impact of increased working capital borrowings of the company. Timely receipt of contract proceeds as envisaged will be a key monitorable aspect.

Declining scale of operations and moderately leveraged capital structure

Total Operating income of the ACPL decreased by ~56% in FY23 to Rs. 182 Mn from Rs. 413 Mn in FY22 on account of lower execution of outstanding projects. With decrease in revenue, PBILDT of the company also decreased to Rs. 50 Mn in FY23 from Rs. 65 Mn in FY22, however with increase in PBILDT margin to ~28% in FY23 from ~16% in FY22 due to lower raw materials cost incurred in some of the major projects of the company which were at final phase during FY23. Furthermore, the company booked PAT of Rs. 2 Mn with PAT margin of ~1% in FY23 from Rs. 10 Mn in FY22 with PAT margin of 2.46%. Decrease in PAT margin was mainly on account of increase in interest cost due to increase in short-term loans along with increased interest rates during FY23. Furthermore, Gross Cash Accrual (GCA) of the company decreased to Rs. 17 Mn in FY23 from Rs. 28 Mn in FY22.

Capital structure of the company stood moderately leveraged on account of higher short-term debts availed by ACPL for funding the working capital needs of the company and the same has been reflected in overall gearing of 2.29x as on mid-July 2023, however slightly improving from 2.41x as on mid-July 2022. Furthermore, Total Outside Liabilities (TOL)/ TNW of the company slightly improved to 3.29x in FY23 from 3.40x in FY22.

Tender based nature of operations in highly competitive construction industry

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

The company's interest rates are based on a floating interest rate regime, where a certain premium is added to the monthly base rate and interest rate is changed accordingly on monthly 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. 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, ACPL 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.

Key Rating Strengths

Experienced promoters and moderate track record of operations

ACPL is promoted by Mr. Amod Jung Thapa, Managing Director, who has been leading the company since November 2012. Mr. Thapa has experience of more than two 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 moderate track record of operations of around a decade in the construction of various infrastructure projects all over Nepal.

Moderate order book position with diversified projects

As on February 29, 2024, the unexecuted orders in hand of the company stood at Rs. 1,355 Mn, which is 7.5x of the income from contract of FY23, providing moderate revenue visibility. ACPL's TOI deteriorated by ~56% year-on-year to Rs. 182 Mn during FY23 on account of lower execution of outstanding projects. The order book is moderately diversified and consists of various construction projects but remain primarily concentrated towards laying/installation of underground optical fibre cable (~70%) and others include, building, road, bridge and hydropower 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.

Moderate counter party risk

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, remains a 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 a 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. Additionally, 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. Near term operating environment for construction companies, including ACPL, remains challenging and will remain a key monitorable aspect.

Analytical Approach

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

About the Company

ACPL is a Class "D" construction company of Nepal incorporated on November 17, 2011 with its registered office based in Kathmandu, Nepal. The company is involved in building construction, optical fibre installation and maintenance, road construction. In addition to doing projects independently, ACPL also enters into Joint Ventures (JVs) with other companies in order to meet the eligibility criteria for different construction projects.

Financial Performance

(Rs. In Million)

For the year ended mid-July	FY21 (A)	FY22 (A)	FY23 (UA)
Income from Operations	195	413	182
PBILDT Margin (%)	25.49	15.72	27.64
Overall Gearing (times)	1.71	2.41	2.29
Total Outstanding Liabilities/Tangible Net worth (times)	3.57	3.40	3.29
Interest Coverage (times)	2.12	2.01	1.54
Current Ratio (times)	1.24	1.16	1.15
Total Debt/Gross Cash Accruals (times)	11.08	16.04	25.19

A: Audited; UA: Unaudited

Annexure 1: Details of the Facilities Rated

Nature of the Facility	Type of the facility	Amount (Rs. in Million)	Ratings
Long Term Bank Facilities	Term Loan	64.32	CARE-NP B
Short Term Bank Facilities	Fund Based Limits	317.32	CARE-NP A4
Long Term /Short Term Bank Facilities	Fund/Non-Fund Based Limits	1,850.00	CARE-NP B/A4
Total		2,231.64	

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