

## Royal Construction

### Ratings

Facilities	Amount (Rs. in Million)	Ratings <sup>1</sup>	Rating Action
Long Term Bank Facilities	24.89	CARE-NP BB- [Double B Minus]	Reaffirmed
Short Term Bank Facilities	55.00	CARE-NP A4 [A Four]	Reaffirmed
Long Term/ Short Term Bank Facilities	1,450.00	CARE-NP BB-/A4	Reaffirmed
Total Facilities	1,529.89 (One billion five hundred twenty-nine million eight hundred and ninety thousand only)		

*Details of Facilities in Annexure 1*

Care Ratings Nepal Limited (CRNL) has reaffirmed 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 Royal Construction (ROC).

### Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of ROC are constrained by its fluctuating scale of operations with low capital base, concentrated revenue mix and working capital intensive nature of operations. The ratings also factor in ROC's presence in highly competitive construction industry coupled with tender based nature of operations, risk of delay in project execution, exposure to volatile interest rates, and proprietorship nature of constitution. The ratings however derive strengths from experienced promoter and established track record of operations, decent order book position with mid-term revenue visibility, moderate gearing profile and coverage indicators, moderate counter party risk and escalation clause in majority of contracts. *Going forward, the ability of the firm to profitably scale up its operations amidst high level of competition and manage its working capital requirements to support growth will be the key rating sensitivities.*

### Detailed Description of the Key Rating Drivers

#### Key Rating Weaknesses

#### Fluctuating scale of operations with concentrated portfolio

ROC has had fluctuating total operating income (TOI) during last 3 years ending FY23 (FY refers to the twelve-month period ending mid-July). During FY23, ROC's TOI grew by 6% year-on-year to Rs. 555 Mn from Rs. 523 Mn during FY22 amid increased project execution. It had declined from Rs. 681 Mn in FY21. Profitability remains modest with PBILDT margins around 8% leading to nominal net profits of Rs. 11 Mn in FY23. Although the share capital has increased to Rs. 10 Mn at FY23 end from Rs. 3.5 Mn at FY22 end, the capital base has remained on the lower side. The firm's revenue base comprises mostly of construction works related to buildings (accounting for around 87% of total outstanding order book as on Mid-Jan, 2024) received mostly from various government departments. This exposes the firm to revenue concentration risk in terms of business segment.

#### Working capital intensive nature of operations

The operations of the firm are working capital intensive in nature. ROC primarily works with various government departments and payments for the contracts are generally received only after the completion of work certification process and finalization of bills. Lengthy certification processes normally lead to high work in progress and inventory levels. Although ROC had creditor period of 47 days in FY23 on account of good supplier relationship, the firm's average collection period and average

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

inventory holding period were 42 days and 24 days respectively during the year. Furthermore, retention deposit is deducted by the clients from running bills which gets refunded to the contractor only after completion of defect liability period, usually twelve months after successful execution of the contracted work indicating ROC's need for reliance on external borrowings to manage its working capital requirements.

### **Tender based nature of operations in a highly competitive construction industry**

Majority of the ROC's projects are tender-based government contracts (including provincial and local bodies) wherein the company has to quote a bid. With multiple players active in the industry, the firm'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, ROC 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 firm'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 promoter and established track record of operations albeit proprietorship nature of constitution**

ROC was established in 2001 by Mr. Prakash Bahadur Sethi, the firm's sole proprietor, who has more than two decades of experience in the field of construction business which bodes well for the overall business prospects of the company in an increasingly competitive industry. The firm has an established track record of operations in the construction of various infrastructure projects all over Nepal, especially buildings and roads for public entities, local government and provincial government. However, ROC, being a sole proprietorship firm, is exposed to inherent risk of the proprietor's capital being withdrawn at time of personal contingency and firm being dissolved upon the death/retirement/insolvency/decision of the proprietor.

#### **Moderate order book position with mid-term revenue visibility**

As on mid-January 2024, the unexecuted orders in hand of ROC stood at Rs. 825 Mn (share of ROC only). The outstanding order book is 1.49x of its income from contract during FY23. The order book is primarily concentrated towards construction of road. This exposes the company towards risk of sectoral concentration. 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 completion of the projects, including ROC's ability to regularly bill and realize projects under progress, would be critical for the business prospects of the company and also has a direct bearing on its margins.

#### **Moderate gearing profile and coverage indicators**

Capital structure of ROC has remained moderate as indicated by its overall gearing ratio, including mobilization advance, and TOL/TNW of 1.45x and 2.24x respectively at FY23 end. The debt coverage indicators also stood moderate in FY23, marked by interest coverage ratio of 3.44x (FY22: 2.97x). ROC's total debt to gross cash accruals (GCA) in FY23 was 3.14x, improving from 3.60x in FY22 majorly on account of improvement in GCA to Rs. 25 Mn from Rs 20 Mn in FY22.

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

Revenue of ROC is majorly generated via contracts from government departments including provincial and local bodies. The order book is primarily concentrated towards building construction projects from government departments. Counter party risk remains moderate given the projects are from government departments, which have been making timely payment to the firm in the past. This enables the firm to pass increase in raw material prices to its customers. Ability of the firm to pass increased burden to the customer in a timely manner and improve profitability margins is critical from credit perspective.

### About the Company

Royal Construction (ROC) was founded as a sole proprietorship business in September 5, 2001 by Mr. Prakash Bahadur Seti. The Class 'A' construction firm has been involved for more than two decades in construction of both private and public sector projects, mainly building and road construction works across Nepal. The firm's operations is concentrated mainly in the western region of Nepal, centered at Kailali district.

### Financial Performance

For the period ended	FY21 (Audited)	FY22 (Audited)	FY23 (Audited)
Income from operations	681	523	555
PBILDT Margin (%)	6.36	8.03	8.56
Overall Gearing (times)	1.94	1.83	1.45
Interest Coverage (times)	3.16	3.20	3.44
Current Ratio (times)	1.02	1.16	1.20
Total Debt/ Gross Cash Accruals	3.07	3.60	3.14

### Annexure 1: Details of the Facilities rated

Nature of the Facility	Type of the Facility	Amount (Rs. in Million)	Rating
Long Term Bank Facilities	Fixed Term Loan	24.89	CARE-NP BB-
Short Term Bank Facilities	Fund Based Limits	55.00	CARE-NP A4
Long Term/Short Term Bank Facilities	Non Fund Based Limits	1,450.00	CARE-NP BB-/A4
<b>Total</b>		<b>1,529.89</b>	

### Contact us

#### Analyst Contact

Ms. Sonu Chouhan

Contact No.: + 977-02-364212

Email: [sonu.chouhan@careratingsnepal.com](mailto:sonu.chouhan@careratingsnepal.com)

Mr. Santosh Pudasaini

Contact No.: + 977 9802312855

Email: [pudasaini.santosh@careratingsnepal.com](mailto:pudasaini.santosh@careratingsnepal.com)

#### Relationship Contact

Mr. Achin Nirwani

Contact No.: +977 9818832909

Email: [achin.nirwani@careratingsnepal.com](mailto:achin.nirwani@careratingsnepal.com)

**About CARE Ratings:**

CARE Ratings Nepal Limited (CRNL) is licensed by the Securities Board of Nepal w.e.f. November 16, 2017. CRNL is supported by CARE Ratings Limited through a technical services agreement to provide technical support in the areas such as rating systems and procedures, methodologies, etc. from CARE Ratings on an ongoing basis. The technical support shall ensure that CRNL has adequate resources to provide high quality credit opinions in Nepal.

Our parent company, CARE Ratings Limited commenced operations in April 1993 and over two decades, it has established itself as one of the leading credit rating agencies in India. CARE is registered with the Securities and Exchange Board of India (SEBI) and also recognized as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI).

**Disclaimer**

CRNL's ratings are opinions on credit quality and are not recommendations to sanction, renew, disburse or recall the concerned bank facilities or to buy, sell or hold any security. CRNL has based its ratings on information obtained from sources believed by it to be accurate and reliable. CRNL does not, however, guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. Most entities whose bank facilities/instruments are rated by CRNL have paid a credit rating fee, based on the amount and type of bank facilities/instruments.

In case of partnership/proprietary concerns, the rating assigned by CARE is, inter-alia, based on the capital deployed by the partners/proprietor and the financial strength of the firm at present. The rating may undergo change in case of withdrawal of capital or the unsecured loans brought in by the partners/proprietor in addition to the financial performance and other relevant factors. CARE is not responsible for any errors and states that it has no financial liability whatsoever to the users of CARE's rating.