

Rating Rationale
Rajendra Nirman Sewa Private Limited

Rating

| Facility | Amount (Rs. In Million) | Rating ¹ | Rating Action |
|----------------------------|----------------------------|-----------------------|------------------|
| Long Term Bank Facilities | 368.67 | CARE-NP BB [Double B] | Assigned |
| Short Term Bank Facilities | 4,055.40 | CARE-NP A4 [A Four] | Assigned |
| Total Facilities | 4,424.07 | | |

Details of 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 Rajendra Nirman Sewa Private Limited (RNS).

Analytical approach:

CRNL has analyzed RNS’s credit profile by considering the standalone financial statements as consolidated financial statements comprising RNS and its joint venture entities related to the construction works was not prepared by the management and the same was not considered for rating purpose.

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of RNS are constrained by leveraged capital structure at the end of FY19 (Provisional, refers to 12 months’ period ended mid-July 2019), tender based nature of operations in highly competitive construction industry and working capital intensive nature of business. The rating is also constrained by planned debt funded capital expenditure and exposure to volatile interest rates. The ratings, however, derive strength from experience of promoters in related fields; established track record in executing diversified construction works; and healthy order book position with mid-term revenue visibility. The ratings also factor in financial risk profile marked by increase in total revenue and profitability in FY19; moderate counter party risk; and escalation clause in majority of the contracts. Ability of the company to successfully execute projects in time and recover contract proceeds; and ability to manage healthy revenue growth and maintain profitability margins without deterioration in its financial risk profile will be key rating sensitivities.

Impact of Covid-19 on the business of the company

The global outbreak of Coronavirus disease 2019 (Covid-19) has affected Nepal as well. Government of Nepal (GoN) imposed travel restrictions and countrywide lockdown since March 24, 2020 halting operations of most of the organizations and slowing down of the economic activities. The construction activities of the company were also subdued on account of the lockdown. Also, since construction activities in Nepal usually takes momentum on second half of the financial year, with country’s economy and construction sector significantly impacted since March 2020 and it may have a negative impact on the revenue, profitability and debt service indicators of the

¹Complete definitions of the ratings assigned are available at www.careratingsnepal.com

company. Considering the impact of Covid-19 in the economy of Nepal, the Central Bank of Nepal has provided an extension for the repayment of debt obligations and rebate in interest rate by 2% for the fourth quarter ending mid-July 2020. The company's ability to achieve its projected revenue, maintain profitability margins will be key rating consideration.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Leveraged capital structure

The capital structure of the company is leveraged with debt equity ratio of 4.76x and overall gearing ratio of 6.86x at the end of FY19. The gearing ratios improved in FY19 mainly on account of repayment of term loans coupled with increase in networth which was partially offset by increase in term loan taken for purchase of machineries/ equipment.

Working capital intensive nature of business

The operations of the company are working capital intensive in nature as company primarily works with government departments and funds are released only after the work certification process is completed and finalization of the bill is done. RNS maintained construction materials as an inventory for around 1 month. The credit period extended by suppliers of raw materials (purchased locally) is generally 60 to 90 days. Also, the cash flows of the company are blocked in retention money which is deducted by the client from running bills and gets refunded only on successful execution of the contracted work. These factors lead to reliance of the company on bank finance to meet its working capital requirements. Accordingly, the company has high utilization of its working capital loans given capital intensive nature of operations.

Tender based nature of operations in highly competitive construction industry

The company receives its work orders from government departments. All government contracts are tender-based 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 a low price to sustain competition. Also, the promoter's reasonable industry experience in related field mitigates risk of competition to some extent. Further, the business also remains dependent on stability in government policies and fiscal position of the government.

Planned debt funded capital expenditure

The company has been making regular investments to expand its infrastructure facilities in the past and is expected to continue in future. The investment in equipment/ machineries was Rs. 114 Mn in FY19 and was mainly funded through bank finance resulting in leveraged capital structure of the company. Further, it is expected that the company will take additional loan for purchase of equipment/ machineries for the new projects proposed to be undertaken in future.

Exposure to volatile interest rates

Nepalese banking sectors are fixing lending interest rate based on quarterly base rate and interest rate will be changed accordingly on quarterly basis. Due to tight liquidity in the market, the interest rate has been high and volatile during the last 12 months. Therefore, funding from Bank and Financial Institutions is exposed to volatile interest rate.

Key Rating Strengths***Experienced promoters in the related fields***

The company is a family run business and has total number of two directors in its board. Mr. Surendra Saud, managing director, has work experience of 5 years in the construction sector and oversees day to day operations of the company. Board of directors are further supported by an experienced team across various functions/ departments.

Established track record in executing diversified construction works

RNS has an established track record of over 12 years in the construction of roads, buildings, bridges, irrigation, embankment and water projects etc. ranging from small sized to large sized projects and have executed several projects primarily in western and far-western part of the country in different terrains either individually or through its Joint Venture (JV) entities.

Healthy order book position with mid-term revenue visibility and diversified projects

Till mid-May 2020, the unexecuted orders in hand of the company stood at Rs. 2,402 Mn. The order book of the company reflects medium term revenue visibility for the next 1 to 2 years. The order book is diversified over various projects such as building works, canal works, embankment works, road works and bridge works received from various government authorities. Timely completion of the projects and thereby increasing its scale of operations would be critical from the credit perspective for RNS.

Financial risk profile marked by increase in total revenue and profitability in FY19

Financial risk profile of the company is comfortable marked by increase in scale of operations and gross cash accruals (GCA) over the period. Total revenue of the company increased to Rs. 546 Mn in FY19 (increment of ~19%) mainly on account of increase income from sub-contract work and equipment rental income. However, income from construction contract declined by ~27% to Rs. 279 Mn on account of comparatively less execution of work orders in hand on standalone basis. Further, the company has healthy PBILDT margin and PAT margin during FY19.

Moderate counter party risk

Revenue of RNS is generated via contracts entirely from government departments related to building works, road works, irrigation works, canal works, embankment works etc. Average collection period of the company was at

76 days in FY19 which includes amount due for work done by the company on behalf of the JVs on various construction projects. The debtor days are generally high mainly due to huge billing usually done by construction companies in Nepal including RNS to government departments at the year-end for completed works. However, the counter party risk is moderated by the fact that all of the construction contracts are obtained from government departments and it has been making timely payment to the company in past.

Escalation clause in majority of the contracts

The company has inbuilt price escalation clauses in majority of contracts in order to insulate the company from any adverse fluctuation in construction material prices and labor expenses. This enables the company to pass on increase in raw material prices to its customers. Ability of the company to pass on increased price burden to the customers in a timely manner and maintain profitability margins is critical from credit perspective.

About the Company

RNS, incorporated on September 24, 1999 is a mid-scale construction company based in Dadeldhura, Nepal. The company has been involved in construction of both small and large scale projects such as buildings works, irrigation works, canal works, embankment works, bridge works, road works etc. mainly in western and far-western part of Nepal. In addition to doing projects individually, RNS also enters into JV with other companies in order to meet the eligibility criteria for different construction projects.

Brief financials of RNS for last three years ending FY19 are given below:

(Rs. Million)

| For the year ended Mid July | FY17 | FY18 | FY19 |
|-----------------------------|-----------|-----------|-----------|
| | (Audited) | (Audited) | (Audited) |
| Income from Operations | 360 | 460 | 546 |
| PBILDT | 113 | 188 | 217 |
| PAT | 12 | 16 | 23 |
| Overall Gearing (times) | 10.92 | 9.74 | 6.86 |
| TOL/ TNW (times) | 17.05 | 12.91 | 11.01 |
| Interest Coverage (times) | 3.48 | 2.72 | 2.67 |

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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 | 368.67 | CARE-NP BB |
| Short Term Bank Facilities | Working Capital Loan | 195.00 | CARE-NP A4 |
| Short Term Bank Facilities | Non-Funded Loan | 3,860.40 | CARE-NP A4 |
| Total | | 4,424.07 | |