

Rating Rationale

Ramechhap Sherpa Construction Private Limited

Rating

Facility	Amount (Rs. In Million)	Rating ¹	Rating Action
Long Term Bank Facilities	37.38	CARE-NP BB [Double B]	Assigned
Short Term Bank Facilities	954.20	CARE-NP A4 [A Four]	Assigned
Total Facilities	991.58		

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 Ramechhap Sherpa Construction Private Limited (RSC).

Analytical approach:

CRNL has analysed RSC’s credit profile by considering the consolidated financial statements (comprising RSC and its joint venture entities related to the construction works) owing to financial and operational linkages between RSC and the JV entities.

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of RSC are constrained by deteriorated financial performance in FY20 (Unaudited, refers to 12 months’ period ended mid-July 2020) mainly due to impact of Covid-19 on the business of the company, working capital intensive nature of business and planned debt funded capital expenditure. The rating is also constrained by highly concentrated order book position of the company, high counterparty risk, exposure to volatile interest rates and tender based nature of operations in highly competitive construction industry. The ratings, however, derive strength from long track record of operations and experienced promoters in the related fields, improvement in PBILD margin during FY20 and moderate capital structure and debt service coverage indicators of the company. The ratings also factor in RSC’s established track record in executing various construction works, healthy order book position with mid-term revenue visibility along with 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. Further, ability to manage the impact of Covid-19 on the operations and financials of the company will be the key rating sensitivity.

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 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

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

were also subdued on account of the lockdown. Also, since construction activities in Nepal usually takes momentum on second half of the financial year and with country's economy and construction sector being significantly impacted since March 2020, it had a negative impact on the revenue and profitability of the company in comparison to the normal operations. The company's ability to achieve its projected revenue for FY21 and maintain profitability margins will be key rating consideration.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Deteriorated financial performance in FY20, however with improvement in PBILDT margin

Total revenue of RSC declined by ~31% in FY20 mainly on account of lower execution of the contracts in hand due to impact of COVID-19. With decline in total revenue of the company, PBILDT of the company also declined however the PBILDT margin improved in FY20 mainly due to lower direct cost incurred on projects which were at final phase of construction. On back of decline in PBILDT, PAT and Gross Cash Accruals (GCA) of the company also declined in FY20.

Working capital intensive nature of business

The operations of the company are working capital intensive in nature as the company is primarily involved in construction of hydropower projects and has to deal with private parties for payments. With majority of revenue coming from private parties, RSC remains at risk of slow realization from debtors. Average debtor days stood at 126 days in FY20 which increased from 82 days in FY19 majorly due to higher retention deposits coupled with slow realization from its debtors majorly being hydropower projects which are too affected by the COVID-19. Average inventory holding period of the company was high at 231 days in FY20. These factors lead to high reliance of the company on bank finance to meet its working capital requirements. The maximum working capital limit utilization of the company against drawing power for 12 months ending mid-August, 2020 was 77.24%.

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. RSC is expected to take additional loans for purchase of equipment/machineries for the new projects proposed to be undertaken in future. Company is expected to make capital expenditure of Rs. 128 Mn in FY21 which is expected to be funded through bank loan and equity in the ratio of 80:20.

Order book position of the company highly concentrated

Out of total order book of the company, around 84% is concentrated towards two hydropower projects. This exposes company to order book concentration risk as failure or delay in successful execution of these projects is likely to impact operations, revenue and profitability as well as debt servicing capability of the company.

High Counterparty risk

Order book concentration of RSC is majorly from private parties which exposes the company to delayed payments without any recourse. In past 10 years, RSC generated around 73% of its total revenue from various hydropower projects belonging to private parties. Revenue billing and payment recovery of RSC is dependent on availability of funds and liquidity of the private parties which may significantly impact RSC's financials. Since, RSC majorly deals with private parties, it classifies completed works in respect of which billing is pending as work in progress. Timely realization of funds blocked in work-in-progress is crucial for better performance of the company.

Tender based nature of operations in highly competitive construction industry

The company receives its work orders from government departments as well as private entities. However, majority of the work order comes from private entities mainly being hydropower projects. All these 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.

Key Rating Strengths***Long track record of operations and experienced promoters in the related fields***

The company has long track record of operations of over 20 years in the construction of various infrastructure projects all over Nepal. RSC is promoted by Mr. Gelje Lama and his family who currently hold majority shares in the company. Mr. Gelje Lama, Managing Director, has been leading the company since its inception in 1997 and has extensive experience of more than 35 years in the field of construction contract business. He is responsible for day to day operations and overall management of the projects. Board of directors are further supported by an experienced team across various functions/ departments.

Moderate capital structure and debt service coverage indicators of the company

The capital structure of the company is marked with debt equity ratio of 0.33x and overall gearing ratio of 2.61x at the end of FY20 (vis-à-vis 0.48x and 2.72x respectively at the end of FY19). The gearing ratio improved in FY20 compared to FY19 mainly on account of increase in networth and scheduled repayment of term loans of the company which was partially offset by increase in mobilization advance money received and working capital loans availed by the company. Interest coverage ratio of the company was moderate at 3.55x in FY20. Also, Total Outside Liabilities/ Tangible Networth (TOL/TNW) and Total debt/ Gross Cash Accruals of the company was at 3.14x and 9.56x in FY20.

Established track record in executing various construction works

RSC has an established track record of over 20 years in the construction of hydropower projects, road works, bridge works, irrigation works, building works etc. ranging from small sized to large sized projects

across the country in different terrains either individually or through its JV entities. The long track record has enabled the company to establish strong relations with its customers thereby resulting allotment of new projects.

Healthy order book position with mid-term revenue visibility

Till August, 2020, the unexecuted orders in hand of the company stood at Rs. 1,919 Mn. Also, the present order book to FY20 revenue is around 5.21x which provides healthy revenue visibility. The order book of the company is mainly concentrated in works related to hydropower projects (i.e. ~84%) coupled with other various projects such as road works, water supply & sanitation project, building works, bridge works, etc. received from various government authorities and private entities. Timely completion of the projects and thereby increasing its scale of operations would be critical from the credit perspective for RSC.

Escalation clause in majority of the contracts

RSC procures its construction materials mainly from the local vendors which has risk of volatility in raw material prices. 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.

About the Company

Ramechhap Sherpa Construction Private Limited (RSC) is Class “A” construction company of Nepal which was incorporated in the year 1997 with registered office based in Mahankal, Kathmandu, Nepal. The company is mainly involved in construction of hydropower projects, roads, bridges, buildings, irrigation, etc. In addition to doing projects independently, RSC also enters into Joint Ventures (JV) with other companies in order to meet the eligibility criteria for different construction projects.

Brief financials of RSC for last three years ending FY20 are given below:

(Rs. Million)

For the year ended Mid July	FY18	FY19	FY20
	(Audited)	(Audited)	(Provisional)
Income from Operations	532	536	368
PBILDT	61	65	50
PAT	21	22	15
Overall Gearing (times)	2.66	2.72	2.61
TOL/ TNW (times)	3.52	3.44	3.14
Interest Coverage (times)	4.56	3.80	3.55

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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	37.38	CARE-NP BB
Short Term Bank Facilities	Working Capital Loan	61.20	CARE-NP A4
Long Term/ Short Term Bank Facilities	Non-Funded Loan	893.00	CARE-NP BB/ A4
Total		991.58	