

Rating Rationale
Aarogya Construction Private Limited

Rating

Facility	Amount (Rs. In Million)	Rating ¹	Rating Action
Long Term Bank Facilities	35.50	CARE-NP BB [Double B]	Assigned
Short Term Bank Facilities	190.65	CARE-NP A4 [A Four]	Assigned
Long Term/Short Term Bank Facilities	1,273.85	CARE-NP BB/ A4 [Double B/ A Four]	Assigned
Total Facilities	1,500.00		

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 Aarogya Construction Private Limited (ACPL).

Analytical approach:

CRNL has analyzed ACPL’s credit profile by considering the standalone financial statements.

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of ACPL are constrained by deteriorated financial performance during FY20 (Unaudited, refers to 12 months’ period ended mid-July 2020) mainly due to negative impact of Covid-19 pandemic on the business operations of the company, small scale of operations with highly concentrated order book position and working capital intensive nature of business leading to high average collection and inventory period. The rating is also constrained by exposure to volatile interest rates and tender based nature of operations in highly competitive construction industry. The ratings, however, derive strength from comfortable capital structure and moderate debt service coverage indicators of the company with improvement in PBILDT margin during FY20, experienced promoters in the related fields and moderate track record of operations in executing various construction works. The ratings also factor in ACPL’s moderate order book position with mid-term revenue visibility along with escalation clause in majority of the contracts along with moderate counterparty risk. 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

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

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 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 the improvement in PBILDT margins

Total revenue of ACPL declined by ~43% 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 with improvement in PBILDT margin in FY20 mainly due to lower cost incurred in some of the major projects of the company which were at completion phase.

Working capital intensive nature of business

The operations of the company are generally working capital intensive in nature as the company primarily works with government departments and funds are released only after the work certification process is completed and finalization of the bills. Average debtor days stood high at 292 days in FY20 which increased from 244 days in FY19 majorly due to billing raised at year end mainly to the government parties. Average inventory holding period of the company was high at 691 days in FY20 due to stock of optical fiber which were imported in huge quantity for the work in hand and upcoming projects. These factors lead to high reliance of the company on bank finance to meet its working capital requirements.

Small scale of operations with highly concentrated order book position

The operations of the company are relatively smaller in scale coupled with highly concentrated order book position. Out of total order book of the company, around 53% is concentrated towards one single building project of Government contracts. This exposes company to order book concentration risk as failure or delay in successful execution of these projects is likely to impact operations and cashflows as well as debt servicing capability of the company.

Tender based nature of operations in highly competitive construction industry

The company receives its work orders from private entities, subcontract and government departments. However, majority of the work order comes from government contracts. 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.

Exposure to volatile interest rates

Nepalese banking sectors are fixing lending interest rate based on quarterly base rate and interest rate can 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 and moderate track record of operations***

ACPL is being promoted by Mr. Amod Jung Thapa, Managing Director, has been leading the company from November 2012 and has experience of more than two decades in the field of construction contract business. He is responsible for planning business strategies, policy making, recruitment of human resources and decision making. Further, the board is supported by an experienced team across various functions. The company has moderate track record of operations of over 9 years in various infrastructure projects all over Nepal.

Comfortable capital structure and moderate debt service coverage indicators of the company

The capital structure of the company is marked with debt equity ratio of 0.52x and moderate overall gearing ratio of 1.19x at the end of FY20 (vis-à-vis 0.67x and 1.33x respectively at the end of FY19). The gearing ratio slightly improved at the end of FY20 mainly on account of scheduled repayment of term loans of the company. Interest coverage ratio of the company was moderate at 2.96x in FY20. Also, Total Outside Liabilities/ Tangible Net-worth (TOL/TNW) and Total debt/ Gross Cash Accruals of the company was at 1.58x and 4.50x at the end of FY20 respectively.

Moderate order book position with mid-term revenue visibility

As on October 13, 2020, the unexecuted orders in hand of the company stood at Rs. 945 Mn. Also, the present order book to FY20 revenue is around 11.67x which provides healthy revenue visibility. The order book of the company is mainly concentrated in building works from government departments on subcontract basis (i.e. ~53%) coupled with other various projects such as laying/ installation of underground optical fiber cable works, road works, bridge works, hydropower 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 ACPL.

Moderate counter party risk

Revenue of ACPL is generated via construction contracts from government departments, subcontract and private sector players. In absolute terms, total debtor which primarily includes amount receivable from government parties decreased due to decline in income from construction contracts in FY20. Despite delays the counter party risk is moderated by the fact that contracts are obtained from government departments and it has been making payments 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

Aarogya Construction Private Limited (ACPL), is a Class “D” construction company in Nepal incorporated on November 17, 2011 with registered office based in Kathmandu, Bagmati, Nepal. The company is mainly involved in constructing various type of projects which includes building construction, optical Fiber- installation and maintenance, road construction, civil works of hydropower, bridges, etc. across Nepal. In addition to doing projects independently, ACPL also enters into Joint Ventures (JV) with other companies in order to meet the eligibility criteria for different construction projects.

Brief financials of ACPL (Standalone) 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	221	143	81
PBILDT	55	46	37
PAT	8	31	1
Overall Gearing (times)	2.87	1.33	1.19
TOL/ TNW (times)	4.46	2.51	1.58
Interest Coverage (times)	2.76	2.32	2.96

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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	35.50	CARE-NP BB
Short Term Bank Facilities	Working Capital Loan	190.65	CARE-NP A4
Long Term/ Short Term Bank Facilities	Non-Funded Loan	1,273.85	CARE-NP BB/ A4
Total		1,500.00	