

Rating Rationale

Diwa Nirman Sewa Private Limited

Rating

Facility/ Instrument	Amount (Rs. In Million)	Rating ¹	Rating Action
Long Term Bank Facilities –Term Loan	58.48	CARE-NP BB [Double B]	Assigned
Short Term Bank Facilities- Fund Based Limits	232.50	CARE-NP A4 [A Four]	Assigned
Long Term/Short Term Bank Facilities- Non-Fund Based Limits	1,959.02	CARE-NP BB/A4 [Double B/A Four]	Assigned
Total Bank Facilities	2,250.00		

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 Diwa Nirman Sewa Private Limited (DNSP).

Analytical approach:

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

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of DNSP are constrained by substantial decline in revenue and profitability, however with growth in PBILDT margins during FY20 (Audited, refers to 12 months’ period ended mid-July 2020) and low order book position on standalone basis. The rating is also constrained by tender based nature of operations in highly competitive construction industry, working capital intensive nature of business and exposure to volatile interest rates. The ratings, however, derive strength from comfortable capital structure and debt service coverage indicators of the company at the end of FY20, coupled with comfortable order book position in Joint Ventures (JVs) and experienced promoter in construction field with established track record of over 4 decades in executing various construction works. The rating also derive strength from moderate counter party risk and escalation clause in majority of the contracts. Ability of the company to increase its order book and successfully execute projects in time and ability to maintain profitability margins and growth in gross cash accruals will be key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Deteriorated financial performance in FY20, however with the improvement in PBILDT margins

The revenue of the company declined substantially by ~80% in FY20 to Rs. 385 Mn from Rs. 1,938 Mn in FY19 mainly due to few projects with the company for execution on standalone basis coupled with

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

execution of work in hand being impacted in the lockdown period due to Covid-19. However, the PBILDT margins of the company improved during FY20 due to decline in direct cost. With lower revenue being booked, profitability and Gross Cash Accruals of the company declined in FY20.

Low order book position at standalone level, however comfortable order book position in JVs

As on March 08, 2021, the unexecuted orders in hand of the company stood at Rs. 292 Mn. (standalone) and unexecuted orders in hand with the JVs stood at Rs. 5,290 Mn. (share of DNSP). The order book of the company (standalone) reflects low term revenue visibility for less than a year which is expected to be completed by the end of FY21. Timely completion of the projects and thereby increasing its scale of operations with building up new order books would be critical from the credit perspective for DNSP.

Tender based nature of operations in highly competitive construction industry

The company receives its entire 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.

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 at 33 days at the end of FY20 which increased from 22 days at the end of FY19 due to base impact. Average inventory holding period of the company was around 20 days at the end of FY20. Retention money is deducted by the client from running bills which gets refunded to the contractor after some period, usually 1 year, on successful execution of the contracted work. These factors lead to reliance of the company on bank finance to meet its working capital requirements.

Key Rating Strengths

Experienced promoters in the related fields and moderate track record of operations

DNSP is being promoted by Mr. Uttam Basnet, Chairman, has been leading the company since its inception from July 1978. He manages overall projects executed by the company since 1978. Further, the board is supported by an experienced team across various functions.

Established track record in executing various construction works

DNSP has an established track record of above 4 decades in construction of roads, bridge, buildings and irrigation works ranging from small sized to large sized projects. The company has executed several projects (majority of which are road projects) across the country in different terrains either individually or

through its JV entities. The long operational track record has enabled the company to establish relations with its customers thereby resulting into repetitive orders/ tenders from the government departments.

Comfortable capital structure and debt service coverage indicators of the company

The capital structure of the company is comfortable marked with debt equity ratio of 0.71x and overall gearing ratio of 0.76x at the end of FY20. The gearing ratio improved at the end of FY20 mainly on account of decrease in mobilization advance which was partially offset by decline in Tangible Networth (TNW). Interest coverage ratio of the company was comfortable at 3.41x in FY20. Total Outside Liabilities/ Tangible Net-worth (TOL/TNW) and Total debt/ GCA of the company was moderate at 2.18x and 4.43x respectively during FY20.

Moderate counter party risk

Revenue of DNSP is generated via construction contracts entirely from government departments. Average collection period of the company was at 33 days at the end of FY20 (vis-à-vis 22 days at the end of FY19) which primarily includes the amount receivable from the government parties. Despite 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

Diwa Nirman Sewa was incorporated on July 30, 1978 as a sole proprietorship which was later converted into private limited company as Diwa Nirman Sewa Private Limited (DNSP) on November 21, 2012. It is a Class-A construction company of Nepal with registered office based in Satdobato, Lalitpur, Nepal. The company is mainly involved in construction of various projects such as road works, building works, bridge works, irrigation works etc. across Nepal. In addition to doing projects independently, DNSP also enters into JVs with other companies in order to meet the eligibility criteria for different construction projects.

Brief financials of DNSP (standalone) for last three years ending FY20 are given below:

(Rs. Million)

For the year ended Mid July	FY18	FY19	FY20
	(Audited)	(Audited)	(Audited)
Income from Operations	1,255	1,938	385
PBILDT Margin (%)	8.10	7.91	14.89

For the year ended Mid July	FY18	FY19	FY20
	(Audited)	(Audited)	(Audited)
Overall Gearing (times)	4.27	0.92	0.76
Total Outstanding Liabilities/Tangible Net worth (times)	6.84	3.03	2.18
Interest Coverage (times)	9.69	10.90	3.41
Current Ratio (times)	1.85	1.01	0.93
Total Debt/ Gross Cash Accruals (times)	5.85	1.19	4.43

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Annexure 1: Details of the Facilities Rated

Nature of the Facility	Type of the Facility	Amount (Rs. Million)	Rating
Long Term Bank Facilities	Term Loans	58.48	CARE-NP BB
Short Term Bank Facilities	Working Capital Loans	132.50	CARE-NP A4
Short Term Bank Facilities (Proposed)	Working Capital Loans	100.00	CARE-NP A4
Long Term/ Short Term Bank Facilities	Non-Funded Loans	1,575.00	CARE-NP BB/A4
Long Term/ Short Term Bank Facilities (Proposed)	Non-Funded Loans	384.02	CARE-NP BB/A4
Total		2,250.00	