Rating Rationale

M.A. Construction Private Limited

Rating

Facility	Amount (Rs. In Million)	Rating[1]	Rating Action
Long Term Bank Facilities	51.85	**CARE-NP BB [Double B]**	Assigned
Short Term Bank Facilities	665.80	**CARE-NP A4 [A Four]**	Assigned
Long Term/Short Term Bank Facilities	932.35	**CARE-NP BB/ A4 [Double B / A Four]**	Assigned
Total Facilities	**1,650.00**		

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 M.A. Construction Private Limited (MAC).

Analytical approach:

CRNL has analyzed MAC's credit profile by considering the consolidated financial statements.

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of MAC are constrained by leveraged capital structure and weak debt service coverage indicators, working capital intensive nature of business, concentrated order book position. The ratings are also constrained by MAC's presence in highly competitive construction industry coupled with tender based nature of operations, risk of delay in project execution and exposure to volatile interest rates.

The ratings, however, derive strength from experienced promoters and long track record of more than 35 years, growing scale of operations with moderate profitability margins. The ratings also factor in healthy order book position and escalation clause in majority of the contracts.

Going forward, the ability of the company to profitably scale up its operations amidst high level of competition and manage its working capital effectively considering high funding requirement to support growth will be crucial and act as the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Highly Leveraged capital structure and weak debt service coverage indicators of the company

At the end of FY20, the overall gearing ratio of the company stood high at above 24x (including mobilization advance) and has shown improvement on account of increase in net-worth due to plough back of profit into business and decline in mobilization advance. Though improved it continued to remain high. The company had leveraged capital structure due to low networth base. Apart from overall gearing, other

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

coverage indicators of the company stood weak marked by high total debt debt to GCA at 24.37x and low interest coverage ratios of 1.56x for FY20.

The promoters of the company have infused additional funds in the form of equity capital of Rs. 95 Mn in the 9 months current financial year (9MFY21) and it is expected that the capital structure is likely to improve going forward, despite increase in debt levels. The company has plans to take additional borrowings for purchase of equipment/machineries to support the growing scale of operations.

Working capital intensive nature of business

The company has working capital intensive nature of operations as reflected by high working capital utilization of more than 95% for the last 12 months ended mid-January, 2021. Moreover, the company had a modest current ratio of 1.13x as at the end of FY20 which declined from 1.35x as at the end of FY19 on account of increase in working capital borrowings. The company has high inventory holding as it has to execute orders at different sites and has to maintain minimum inventory at different sites for smooth execution of contracts. The company works with government departments either directly or through subcontract basis, the payments for which are received in a timely manner in around 60 days after presenting the bill. The company purchases raw materials from domestic market and average payable period stood at 45 days in FY20. Entailing all, MAC had high average operating cycle of 108 days in FY20 resulting reliance on bank finance to meet its working capital requirements.

Moderate Order book position though concentrated

As on March 19, 2021, the unexecuted orders in hand of the company stood at Rs. 4,524 Mn, which is approximately 4.20x of its total operating income for FY20 providing short to moderate revenue visibility. However, current order book of the company is mainly concentrated towards two hydropower projects which accounts for 79% of the total order book. Hence, timely completion of the projects and thereby increasing its scale of operations would be critical from the credit perspective.

Tender based nature of operations in highly competitive construction industry

The company mainly caters to orders received from various Government entities and other private parties either directly or on sub-contract basis. The concentration on government contracts also makes the company susceptible to any changes pertaining to government policy in regard to awarding tenders to contractors. The tender-based business is characterized by intense competition and the growth of the business depends on its ability to successfully bid for the tenders and emerge as the lowest bidder. Furthermore, the business also remains dependent on stability in government policies and fiscal position of the government.

Risk of delay in project execution

MAC’s business is susceptible to the financial loss arising out of delay in project execution, as generally, there is a penalty clause for delay in contract execution. However, MAC has relied on the experience of its management team with strong project execution skills which has enabled the company to build satisfactory standing in the industry as indicated by the repeat orders awarded by its clients.

Key Rating Strengths

Long track record of operations and experienced promoters in the related fields

The company has long track record of operations of more than 35 years in the construction of various infrastructure and civil constructions projects all over Nepal. The company is currently managed by Mr. Anup Acharya and Mr. Deepak Baral. Mr. Anup Acharya has more than 30 years of experience in the construction and power generation business though its association with operational and under-construction hydro power projects. He looks after overall operations of the company. The management is further supported by an experienced team across various functions/ departments.

Growing scale of operations and moderate profitability

For the period FY18-FY20 (Audited, refers to 12 months' period ended mid-July 2020), MAC's total operating income grew from Rs. 365 Mn in FY18 to Rs. 1,138 Mn in FY20 reflecting a compounded annual growth rate of around 76%. The growth in revenue of the company was mainly in FY20, due to execution of one high valued order that contributed 80% of the total revenue. Furthermore, the company has achieved total operating income of Rs. 108 Mn in 8MFY21 ended mid-March, 2021.

Profitability margins of the company are directly associated with technical aspect of the contract executed. The contracts which are generally technical and complex in nature fetched better profitability margins. The PBIDLT margin of the company has remained range bound and PAT margin has improved over the years. Despite decline in PBIDLT margin, the company has reported net profit in FY20 as against net losses in FY19 on account of significant increase in the scale of operations which led to proportionate decline in various fixed & variable overhead costs in FY20.

Moderate counter party risk

Revenue of MAC is generated via contracts from both government departments and private parties. In the past, MAC generated around 76% of its total revenue from government departments and balance from projects belonging to private parties where promoters of MAC have major shareholding. However, the counter party risk is moderated by the fact that majority of the construction contracts are obtained from government departments. Also, contract in respect of private parties are majorly from hydropower projects where promoters of MAC have major shareholding resulting moderate counter party risk.

Escalation clause in majority of the contracts

The company has inbuilt price escalation clauses in majority of contracts (both government and private 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

M.A. Construction Private Limited was incorporated on April 10, 1983 in the name of Munna and Acharya Construction Company Private Limited which later on March 5, 2017 was changed into M.A. Construction Private Limited. It is a Class-A construction company of Nepal with registered office based in Dharan, Nepal. MAC undertakes projects independently as well as through Joint Ventures (JVs) with other companies in order to meet the eligibility criteria for different construction projects.

Brief financials of MAC (Consolidated) for last three years ending FY20 are given below:

(Rs. Million)

For the year ended Mid July	FY18 (Audited)	FY19 (Audited)	FY20 (Audited)
Income from Operations	365	356	1,138
PBILDT Margin (%)	16.42	19.12	13.29
Overall Gearing (times)	20.44	51.16	24.03
Total Outstanding Liabilities/Tangible Net worth (times)	30.54	77.03	39.85
Interest Coverage (times)	1.33	1.10	1.56
Current Ratio (times)	1.23	1.35	1.13
Total Debt/ Gross Cash Accruals (times)	68.17	4,262.28	24.37

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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 Loans	51.85	CARE-NP BB
Short Term Bank Facilities	Working Capital Loans	665.80	CARE-NP A4
Long Term/ Short Term Bank Facilities	Non-Funded Loans	932.35	CARE-NP BB/ A4
Total		**1,650.00**	