

Ramechhap Sherpa Construction Private Limited

Ratings

Facilities	Amount (Rs. in Million)	Ratings ¹	Rating Action
Long Term Bank Facilities	70.80 (Increased from Rs. 37.38 Mn)	CARE-NP BB [Double B]	Reaffirmed
Short Term Bank Facilities	71.20 (Increased from Rs. 61.20 Mn)	CARE-NP A4 [A Four]	Reaffirmed
Long Term/ Short Term Bank Facilities	1,098.00 (Increased from Rs. 893.00 Mn)	CARE-NP BB/ A4 [Double B/ A Four]	Reaffirmed
Total Facilities	1,240.00 (One Billion Two Hundred and Forty Million)		

Details of Facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has reaffirmed the rating of 'CARE-NP BB' for the long-term bank facilities and 'CARE-NP A4' for the short-term bank facilities of Ramechhap Sherpa Construction Private Limited (RSC).

Analytical approach:

CRNL has analysed RSC's credit profile by considering the combined 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 continue to be constrained by elongated operating cycle of the company on account of high inventory holding period, planned debt funded capital expenditure, leveraged capital structure, highly concentrated order book position of the company and high counterparty risk. The ratings are also constrained by tender based nature of operations in highly competitive construction industry, exposure to volatile interest rate and risk of delay in project execution.

The ratings, however, derive strength from long track record of operations and experienced promoters in the related fields, healthy order book position along with escalation clause in majority of the contracts. The ratings also factor in moderate profitability and debt service coverage indicators of the company.

Ability of the company to successfully execute projects in time & 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.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Elongated operating cycle of the company on account of high inventory holding period

The operations of the company are working capital intensive marked by high operating cycle of 264 days in FY21 mainly due to high inventory holding period for the company. RSC has high inventory holding period as it has to execute orders at different sites and billing for the same is done on the basis of work completion & the same is required to be approved by the respective employer. This leads to classifying completed work as work-in-progress till the same has been approved by the respective principal. Also, the company is primarily involved in construction of hydropower projects and has to deal with private parties for payments. In respect of government departments, payments are realized in 1-2 months. For FY21, the average collection and payable period stood at 77 days and 17 days respectively. Due to realization of retention deposit from few completed projects, the average collection shown improvement in FY21.

¹Complete definitions of the ratings assigned are available at www.careratingsnepal.com and in other CRNL publications

Leveraged capital structure of the company

Total debt of the company mainly comprises term loans, working capital borrowings and mobilization advances increased by Rs. 92 Mn in FY21 and stood at Rs. 377 Mn as on mid-July 2021. RSC has taken additional debt for purchase of equipment during FY21 as well as working capital loans to support the increased scale of operations. Overall gearing ratio (including mobilization advance) of the company stood leveraged at 2.10x as on mid-July 2021 which improved from 2.45x as on mid-July 2020 on account of additional equity infused by the promoters during FY21 as well as plough back of profit into the business.

Interest coverage ratio of the company stood satisfactory at to 5.12x in FY21. Also, TOL/ TNW and total debt to GCA of the company improved to 2.37x and 7.78x respectively in FY21 compared to 2.81x and 8.65x in FY20.

Planned debt funded capital expenditure

The company has been making regular investments in construction equipment / machineries to increase its assets base for the smooth execution of its projects. Furthermore, it is expected that the company will take additional loans for purchase of equipment/machineries for the new projects proposed to be undertaken in future. Attributed to same, the capital structure of the company is likely to remain leveraged due to capex term loans expected to be taken in future.

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 couple of 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 maintaining the liquidity of the company.

Tender based nature of operations in highly competitive construction industry with risk of delay in project execution

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. 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.

RSC'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, RSC 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 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.

Below Average financial profile

Company's total operating income has been fluctuating over the past three years (FY19-FY21). TOI has registered a decline on y-o-y basis in FY20 and registers a growth in FY21. The operations of the company were significantly impacted

due to Covid-19 during FY20 halting construction activities in most of the sites coupled with delay in billing process for work done in various projects during the period leading to decline in total operating income.

With improvement in revenue in FY21 over previous year, PBILDT margin also improved to 14.91% in FY21 compared to 13.77% in FY20. Improvement in margin was also due to completion of few of the projects which were at final stage of construction. Improvement in PBILDT has led to improvement in the net profit as well as net profit margin.

Healthy order book position though concentrated

The unexecuted orders in hand of the company stood healthy at Rs. 2,995 Mn as on October 24, 2021 which is approximately 6.30x of its total operating income for FY21 (on consolidated basis) providing medium term revenue visibility. The order book of the company is mainly concentrated in works related to hydropower projects (i.e. ~83%) from various private parties coupled with other various projects such as road works, water supply & irrigation project and bridge works 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 FY21 are given below:

(Rs. Million)

For the year ended Mid July	FY19	FY20	FY21
	(Audited)	(Audited)	(Provisional)
Total Operating Income	536	373	462
PBILDT Margin (%)	12.23	13.77	14.91
Overall Gearing (times)	2.72	2.45	2.10
Total Outstanding Liabilities/Tangible Net worth (times)	3.44	2.81	2.37
Interest Coverage (times)	3.80	3.85	5.12
Current ratio (times)	2.78	3.36	3.14
Total Debt/Gross Cash Accruals (times)	6.66	8.65	7.78

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	66.18	CARE-NP BB
Long Term Bank Facilities (Proposed)	Term Loan	4.62	CARE-NP BB
Short Term Bank Facilities	Fund Based Limits	71.20	CARE-NP A4
Long Term/ Short Term Bank Facilities	Non-Fund Based Limits	1,098.00	CARE-NP BB/ A4
Total		1,240.00	

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