M.A. Construction Private Limited

Ratings

Facilities	Amount (Rs. Million)	Rating[1]	Rating Action
Long Term Bank Facilities	44.48	CARE-NP BB [Double B]	Reaffirmed
Short Term Bank Facilities	1,955.52 (Increased from 665.80)	CARE-NP A4 [A Four]	Reaffirmed
Long Term/Short Term Bank Facilities	1,000.00 (Increased from 932.35)	CARE-NP BB/ A4 [Double B/ A Four]	Reaffirmed
Total	**3,000.00**		

CARE Ratings Nepal Limited (CRNL) has reaffirmed the rating of 'CARE-NP BB' assigned 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 its consolidated financial statements.

Detailed Rationale & Key Rating Drivers

The reaffirmation of the ratings assigned to the bank facilities of MAC continues to be constrained by highly leveraged capital structure, weak debt service coverage indicators, working capital intensive nature of operations and 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 also took cognizance of fluctuations in total operating income and net profitability of the company in last 3 FY's (FY19-21; audited, refers to the twelve-month period ended mid-July 2021).

The ratings, however, derive strength from experienced promoters and established track record of operations of more than 35 years, moderate order book position with mid-term revenue visibility. The ratings also factor in moderate counter party risk and escalation clause in majority of 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 the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Highly Leveraged capital structure with weak debt service coverage indicators

The company has a low net worth base resulting in a high gearing ratio, which stood high at 8.81x at the end of FY21, although improved from 13.08x at the end of FY20. The improvement was primarily on account of infusion of additional equity of Rs. 95 Mn FY21. Despite the added equity during FY21, overall net worth of the company remains lower in comparison to its relatively high debt levels. Interest coverage ratio of the company was weak at just below unity in FY21 amid declining financial performance which has resulted negative cash accruals during FY21. The promoters of the company have infused additional funds in the form of equity capital of Rs. 100 Mn during 9MFY22 (Unaudited, refers to the nine-month period ended mid-April 2022), which will help improve the capital structure, although offset to some extent by the increasing debt levels. Debts level are increasing in order to execute the new contracts secured during the year. Furthermore, it is expected that the company will take additional loan for purchase of equipment/machineries and execution of new contracts. Increased debt funded project is expected to put upward pressure in the gearing levels in the medium term.

[1]Complete definition of the ratings assigned are available at www.careratingsnepal.com and other CARE publications

Financial risk profile marked by fluctuations in revenue and net profitability

Company's total operating income has been fluctuating over the past three years (FY19-FY21). TOI has registered a growth on year on year (yoy) in FY20 and again decline in FY21. Total revenue of the company decreased by around 51% year on year (yoy) to Rs. 531 Mn in FY21, impacted mainly by unbilled revenue of around Rs. 320 Mn. Also, revenue in FY20 was relatively higher on account of the Pokhara Football Stadium project, which had accounted for around 80% of total revenue during FY20. Despite lower revenues, PBILDT margin of the company improved to 15.99% during FY21 from 13.83% during FY20. The operating margins are directly associated with technical aspect and nature of the contract executed. However, amid lower revenues, absolute PBILDT decreased by 43.50% yoy to Rs. 85 Mn. Consequently, the company reported net loss of Rs. 17 Mn during FY21. Net profitability has remained quite volatile in the last three years on account of fluctuating scale of operations. The ability of the company to stabilize operations leading to a more stable net profitability profile will be crucial from credit perspective.

Working capital intensive nature of business

The operations of the company are working capital intensive in nature. The company has high inventory holding period 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, payments for which are received only after presenting the bill. Total operating cycle of the company was substantially high at 306 days in FY21, majorly on account of relatively higher levels of receivable and inventory during the year end. An elongated operating cycle generally lead to increased reliance of the company on bank finance to meet its working capital requirements, resulting in increased debt levels and decreased net profitability.

Highly competitive construction industry coupled with tender based nature of operations

The company receives its work orders from government departments and also from private parties. 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. Furthermore, the company is also susceptible to any changes pertaining to government policy in regard to awarding tenders to contractors. Also, there are numerous fragmented and unorganized players operating in this industry which makes the civil construction space highly competitive and the ability of MAC to sustain its profitability margins and growth in future remain crucial.

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

Experienced promoters and established track record of operations

The company has long track record of operations of more than 35 years in the construction of various infrastructure projects all over Nepal. MAC has two directors in its board. Mr. Anup Acharya, managing director, has more than 30 years of experience in the construction and energy sector. He looks after the overall operations of the company. Mr. Deepak Baral, civil engineer, is the other director of MAC and has 20 years of experience in the construction business. The management is further supported by an experienced team across various departments.

Moderate order book position though concentrated towards energy sector

As on March 19, 2022, the unexecuted orders in hand of the company was Rs. 3,618.50 Mn, which is 6.81x and 3.33x of income from contract of FY21 and FY20, respectively providing moderate revenue visibility. The order book is primarily concentrated towards hydropower works (~86.06%) and others include construction works such as construction of stadium and building works by entering into JVs. Timely completion of the projects would be critical for the business prospects of the company and has a direct bearing on the margins to be attained.

Moderate counter party risk

Revenue of MAC is generated via contracts from both government departments and private parties. The order book is primarily concentrated towards hydropower projects, where promoters of MAC have major shareholding, resulting moderate counterparty risk. With respect to government department, the company has a long experience of working in the government projects and it has been receiving timely payments.

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 is critical for maintaining a stable profitability profile.

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 FY21 are given below:

(Rs. in Million)

Particulars	**FY19**	**FY20**	**FY21**
	Audited	**Audited**	**Audited**
Income from Operations	356	1,086	531
PBILDT / Total Income	19.12	13.83	15.99
Overall Gearing	51.16	13.08	8.81
Total Outside Liabilities/ Tangible Net-Worth (times)	77.03	19.92	12.35
Interest coverage (times)	1.10	1.55	0.96
Total Debt/GCA	4,262.28	24.21	Negative

Annexure-1 Details of Facilities/Instruments to be rated

Name of Instrument	**Type of Facility**	**Amount (Rs in Million)**	**Rating**
Long Term Bank Facilities	Term Loan	44.48	CARE-NP BB
Short Term Bank Facilities	Working Capital Loan	1955.52	CARE-NP A4
Long Term/Short Term Bank Facilities	Non-Fund Based Loans	1000.00	CARE-NP BB/A4
Total		**3000.00**	

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