

Sumo Construction and Engineering Private Limited

Ratings

Facilities	Amount (Rs. in Million)	Ratings ¹	Rating Action
Long Term Bank Facilities	689.59	CARE-NP BB [Double B]	Reaffirmed
Short Term Bank Facilities	1,556.65	CARE-NP A4 [A Four]	Reaffirmed
Total Facilities	2,246.24		

Details of instruments/facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has reaffirmed the rating of 'CARE-NP BB' assigned to the long-term bank facilities and 'CARE-NP A4' assigned to the short-term bank facilities of Sumo Construction and Engineering Private Limited (SCEPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of SCEPL continue to be constrained by its short track record of operations, leveraged capital structure with moderate debt service coverage indicators, modest and concentrated order book position, working capital intensive nature of business and exposure to volatile interest rates.

The ratings, however, derives strength from association with strong promoter group, experienced management team, ownership of sizeable equipment fleet, low counter party risk, escalation clause in majority of the contracts. The ratings also derive strength from the growing scale of operations of the company with moderate profitability margins during FY21 (Audited, refers to the twelve-month period ended mid-July 2021).

Going forward, the ability of the company to manage the growth and maintain profitability margins without deterioration in its financial risk profile along with successful execution of projects would be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Leveraged capital structure with moderate debt service indicators of the company

Capital structure of SCEPL stood leveraged with overall gearing ratio of 3.89x as on mid-July 2021, which deteriorated from 2.11x as on mid-July 2020 amid increased debt levels to support growth in operations. Total debt of the company, which mainly comprises of term loans, unsecured loans from promoters & working capital borrowings, increased in FY21 to Rs. 2,192 Mn from Rs. 1,094 Mn in FY20 on account of increased hire purchase loans for funding purchase of construction machineries and working capital loans for funding working capital needs of the company. Also, total outside liabilities to total net worth and total debt to gross cash accruals remained high at 7.93x and 5.31x respectively as on mid-July 2021 (9.55x and 2.64x, respectively, as on mid-July 2020). However, the interest coverage was moderate at 3.88x in FY21 which moderated from 5.36x in FY20, aided by increased interest expense amid higher bank borrowings of the company. Furthermore, with increased debt levels, Total debt/ GCA of the company deteriorated to 5.31x in FY21 from 2.64x in FY20. Though debt service coverage indicators moderated, it continues to remain at satisfactory levels.

Short track record of operations and concentrated order book

SCEPL has been involved in construction business since FY18 and has only four years of track record. However, the experience of the promoters in the diversified businesses partially offsets this risk. The promoters have ventured into construction industry due to favourable government policies towards capital expenditure of the GON to support the same

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

and to support the group requirements of civil works for the under construction hydropower projects. Furthermore, the management is supported by an experienced team having an experience of about a decade in energy sector.

As on April 20, 2022, the unexecuted orders in hand of the company stood at Rs. 3,921 Mn, which is 0.84x of the revenue from contract of FY21, providing near term revenue visibility. All the contracts entered by SCEPL are with its group companies which is entirely concentrated towards hydropower projects in the same region. This results in the order book being exposed to high geographical concentration risk, particularly amid any natural disasters or any other region-specific disruptions.

Working capital intensive nature of business

The operations of the company are working capital intensive in nature marked by high inventory holding period and moderate collection period. SCEPL's inventory holding period increased to 84 days in FY21 from 53 days in FY20 majorly due to piling up of construction materials as the company has to maintain inventory at various sites for smooth execution of project works. Furthermore, the funds are moved between the group companies on case-to-case basis. Consequently, average collection period of the company remained moderate at 45 days in FY21, which increased from 31 days in FY20. As a result, the fund based working capital requirement for the company remains on the higher side, which resulted in average utilization of around 91% of its sanctioned working capital borrowings during the twelve-month period ended mid-April 2022. Furthermore, the liquidity position of the company remains weak as reflected from stretched current ratio of less than unity in FY20 and FY21. Similarly, SCEPL's creditor days has increased to 97 days from 89 days in FY20, emanating from the challenges faced by the company to efficiently manage its working capital cycle.

Exposure to volatile interest rate

Nepalese banking sector has a floating interest rate regime, where a certain premium is added to the quarterly base rate and interest rate is changed accordingly on quarterly basis. The base rates of the banks and financial institutions (BFIs) in Nepal remain quite volatile as they are impacted by available liquidity in the system which leads to change in interest rates. The volatility in interest rate is more evident currently on account of the ongoing liquidity stress in the economy. Furthermore, increased bank rates announced in the Monetary Policy for FY23 is likely to add to the upward pressure on interest rates going forward. Any significant rate hikes could put increased interest burden on the company, squeezing its profitability and impacting its liquidity position. Therefore, funding taken by the company from BFIs is subject to volatile interest rate.

Key Rating Strengths

Association with strong promoter group and experienced management team

SCEPL derives strength from its strong promoter group belonging to MV Dugar Group. MV Dugar Group is involved in diversified businesses like Construction, Automobiles trading, Insurance and Banking. MV Dugar Group has four hydropower projects including three under construction projects and one operational project. MV Dugar group is also the sole distributor in Nepal for world renowned brands like Mahindra (Commercial Vehicles and construction Equipment), John-Deere tractors, Royal Enfield, Piaggio etc.

SCEPL is promoted by Mr. Vivek Dugar, who is also the chairperson of the company. Mr. Dugar has more than two decades of business experience in various sectors. He is chairperson of Gurans Life Insurance Company Ltd. Day to day operations of the company is looked by Mr. Deepak Paudyal, CEO, who has considerable work experience in Energy sector. Furthermore, he has been supported by an experienced team across various functions.

Growing scale of operations and moderate profitability margins

Total operating income (TOI) of the company increased by ~12% year-on-year to Rs. 4,674 Mn during FY21 backed by execution of civil works of the exiting projects and the new project from Nasa Hydropower Limited (CARE-NP BB). PBILDT margin, however, reduced by 123 bps to 12.58% during FY21 due to increase in cost of raw materials such as cement and rods. Furthermore, with decline in PBILDT margin, PAT margin of the company deteriorated to 3.65% in FY21 from 4.39% in FY20 due to higher interest expenses on account of increased hire purchase and working capital loans availed by the company.

Low counter party risk

Majority of the revenue of SCEPL is generated via contracts related to civil works of hydropower projects from its group entities. Furthermore, the financial closure for all the three hydropower projects has already been completed. Accordingly, the counter party risk is low by the fact that all of the construction contracts are obtained from group companies where the debt and equity portion is already tied up for the construction of the projects and it has been making timely payment to the company in the past.

About the Company

SCEPL is a private limited company, incorporated as Sumo Engineering Consultant Private Limited on June 7, 2009; later on, on November 28, 2017 its name was changed to Sumo Construction and Engineering Private Limited (SCEPL). The company is involved in construction of hydropower projects with all the projects currently under construction belonging to Group Companies.

Financial Performance

(Rs. Million)

For the Period	FY19 (A)	FY20 (A)	FY21 (A)
Income from Operations	1,476	4,158	4,674
PBILDT Margin (%)	18.13	13.81	12.58
Overall Gearing (times)	Negative	2.84	3.89
Total Outstanding Liabilities/Tangible Net worth (times)	Negative	9.55	7.93
Interest Coverage (times)	4.72	5.36	3.88
Current Ratio (times)	0.40	0.85	0.99
Total Debt/Gross Cash Accruals (times)	0.24	2.64	5.31

A: Audited

Annexure 1: Details of the Facilities Rated

Name of the Bank Facilities	Type of the Facility	Amount (Rs. In Million)	Ratings
Long Term Bank Facilities	Term Loan	689.59	CARE-NP BB [Double B]
Short Term Bank Facilities	Fund Based Limits	1,390.00	CARE-NP A4 [A Four]
Short Term Bank Facilities	Non-Fund Based Limits	166.65	CARE-NP A4 [A Four]
Total		2,246.24	

Contact Us

Analyst Contact

Mr. Girish Bhatta

+977-01-4012630

girish.bhatta@careratingsnepal.com

Mr. Santosh Pudasaini

+977-01-4012629

pudasaini.santosh@careratingsnepal.com

Relationship Contact

Mr. Achin Nirwani

+977-9818832909

achin.nirwani@careratingsnepal.com

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