

Golden Good Sherpa Construction Private Limited

Ratings

Facilities	Amount (Rs. in Million)	Ratings ¹	Rating Action
Long Term Bank Facilities	57.67	CARE-NP BB- [Double B Minus]	Assigned
Short Term Bank Facilities	344.50	CARE-NP A4 [A Four]	Assigned
Long Term/ Short Term Bank Facilities	3,327.83	CARE-NP BB-/ A4 [Double B Minus/ A Four]	Assigned
Total Facilities	3,730.00 (Three Thousand Seven Hundred Thirty Million Only)		

Details of instruments/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 Golden Good Sherpa Construction Private Limited (GGPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of GGPL are constrained by its fluctuating scale of operations in last three FYs (FY20-FY22; FY refers to the twelve-month period ending mid-July) with leveraged capital structure and elongated operating cycle marked by high inventory period at the end of FY22. The ratings also factor in the tender based nature of operations in highly competitive construction industry, risk of delay in project execution and timely recovery of contract proceeds, particularly amid the ongoing slowdown in infrastructure spending by the government.

The ratings, however, derive strength from the established track record of operations of company along with experienced promoters and diversified, albeit moderate order book position providing near-term revenue visibility. The ratings also factor in moderate counter party risk over the medium-term and escalation clause in majority of contracts.

Going forward, the ability of the company to successfully execute projects and recover contract proceeds in a timely manner and healthy revenue growth and maintain profitability leading to improvement in its financial risk profile will be key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Fluctuating scale of operations and leveraged capital structure of the company

GGPL's scale of operations over the past three years (FY20-FY22) has been fluctuating mainly attributed to the lingering impact of the pandemic and also due to the slowdown in the construction activities in the country. GGPL's Total Operating Income (TOI) grew ~77% year-on-year to Rs. 518 Mn during FY21 boosted by lower base of FY20 when project execution was impacted by the covid19 led disruptions. However, GGPL's TOI declined ~5% year-on-year to Rs. 492 Mn during FY22 amid the slowdown in construction activities in the country mainly owing to lower government capital expenditures. Similarly, profitability margins have also been volatile as they are directly associated with the nature of contracts executed by the company. PBILDT margin of the company decreased by 71 bps to 26.72% in FY22. Consequently, PAT margin of GGPL decreased to 2.18% in FY22 from 2.75% in FY21 amid higher interest expenses with higher utilization of working capital limits by the company coupled with increased funding cost during the period. Gross Cash Accruals (GCA) of the company declined by around 16% to Rs. 76 Mn in FY22.

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

Capital structure of GGPL stood leveraged with overall gearing ratio (excluding mobilization advance) of 2.42x as on mid-July 2022, improved from 3.42x as on previous balance sheet date. Overall gearing ratio (including mobilization advance) stood at 2.42x as on mid-July 2022, improved from 4.10x as on previous balance sheet date. Gearing levels have improved at the end of FY22 supported by increased net worth base, which was on account of infusion of Rs. 50 Mn as equity and accretion of profits to reserves of the company at the end of FY22 coupled with decline in mobilization advance balance. Interest coverage ratio stood moderate at around 2.54 times in FY22 (FY21: 3.06x); however, total debt to GCA stood high at 6.09x at the end of FY22 (FY21: 5.89x) on account of decline in GCA during FY22. Furthermore, Total Outside Liabilities (TOL)/ TNW of the company also stood high at 4.32x at the end of FY22, although improving from 6.14x at the end of FY21 aided by increased net worth base at the end of FY22.

Elongated operating cycle with increasing trend in inventory period

The operations of the company are working capital intensive in nature marked by high inventory holding at the end of FY22. Average inventory holding period elongated to 480 days at the end of FY22 from 304 days at the end of FY21 mainly attributable to increased WIP. The funds are released only after the work certification process is completed and finalization of the bill is done. A substantially elongated inventory period owing mainly to unbilled WIP which is on account of slowdown in government capital expenditures and revenue collection over the last year or so coupled with the ongoing liquidity stress/credit crunch in the banking industry. Although counterparty risk remains low over the long-term, stretched operating cycle could put additional burden in the company's financial profile. The company's ability to timely turnaround projects under work-in-progress coupled with swifter debtor realization will be critical from credit perspective.

Tender based nature of operations in highly competitive construction industry

Majority of GGPL's projects are tender-based government contracts wherein the company has to quote a bid. With multiple players active in the industry, GGPL's business is vulnerable to under bidding at a relatively low cost in order to secure the projects, in the highly competitive construction industry. Furthermore, the business also remains dependent on sustained capital expenditure by the government towards construction projects, overall stability in government policies and fiscal position of the government. Government of Nepal (GoN) has put certain restrictions on the contractors to participate in tenders such as prohibiting foreign companies to participate in tenders having value less than Rs. 5,000 Mn, which augurs well for domestic players. Furthermore, the GoN has also placed a cap on total active projects of construction companies at five, which could limit growth prospects.

Exposure to volatile interest rate

Sustained requirement for short-term working capital borrowings results in a high interest expense for GGPL. The company's interest rates are based on 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. Sustained high interest rates, as seen over the last year or so, add to the interest burden of the company, squeezing its profitability and impacting its liquidity position. However, Nepal Bankers Association's decision to lower premium on loans by 1% from March 2023 could provide some relief. Nevertheless, funding taken by the company remains exposed to volatile interest rate.

Risk of delay in project execution and timely realization of proceed of contracts

Given the nature of projects awarded, GGPL is exposed to inherent risk in terms of delays in certain projects undertaken by the company due to delay in procedural approvals and clearance of project sites, etc, thus exposing the company

towards the risk of delay in projects resulting in a delay in the realization of revenue growth. Furthermore, the company ability to execute a project in timely manner would be led by its own operational efficiency and timely stage payments received from clients. Although counter party risk over the medium term remains moderate given the projects are from government departments, which have been making timely payment to the company in the past, timely debtor realization, particularly at times of economic downturn, remain key challenge for the construction sector.

Key Rating Strengths

Experienced promoters and established record of operations

GGPL has four directors in its Board of Directors chaired by Mr. Gelje Lama, who has been leading the company since its inception in 1993. Mr. Lama has experience of around three decades in the construction sector which bodes well for the overall business prospects of the company in an increasingly competitive industry. Furthermore, the board is supported by an experienced team across various functions. The company has established track record of operations of over three decades in the construction of various infrastructure projects all over Nepal.

Diversified order book position; albeit near term revenue visibility

The company has unexecuted order book of Rs. 956 Mn, which is 1.97x of the income from contract of FY22 as on March 26, 2023 providing near term revenue visibility. The company's order book position remains diversified with projects distribution towards road projects (~40% of total order book) and other segments as sewerage, railway and bridge projects mostly from various government departments including provincial and local bodies. Diversification over various segments could assist the company to hedge revenue concentration risk to some extent. Concentration of government orders exposes the company with risk related to allocation of fund or regulatory changes mainly in the Public Procurement Act and other related regulations. Timely completion of the projects, including GGPL's ability to regularly bill and realize projects under progress, would be critical for the business prospects of the company and also has a direct bearing on its margins.

Moderate counter party risk and escalation clause in majority of contracts

Revenue of GGPL is generated majorly via contracts from government departments. The order book is primarily concentrated towards road and sewerage projects from government departments. Counter party risk remains moderate over the long term given the projects are from government departments, which have been making timely payment to the company in the past. Presence of escalation clause in majority of the contracts enable the company to pass increase in raw material prices to its customers. Ability of the company to pass increased cost burden to its customers in a timely manner and maintain profitability margins is critical from credit perspective.

Industry Outlook

The construction sector in Nepal has been impacted by lower execution in the aftermath of the covid19 pandemic with slower pace of economic growth coupled with relatively lower infrastructure spending by the government. Furthermore, contractors' cash flows have also come under pressure as a result of highly inflated construction costs leading to shrinking margins over FY22-H1FY23. Increasing trend in fuel price, which is a key input for road construction, building materials and other construction equipment, has added to the margin pressure. Furthermore, as government capital expenditure continues to remain substantially lower than budgeted amount, income prospects remain subdued over the near-term, which coupled with delays in payments to contractors has led to some stress in the construction sector in H1FY23 leading to the slippages in the construction portfolio of BFIs. Near term operating environment for construction companies, including GGPL, remains challenging and will remain a key monitorable aspect.

About the Company

Golden Good Sherpa Construction Private Limited (GGPL) is a class "A" construction company of Nepal incorporated on November 02, 1993 with its registered office based in Kathmandu, Nepal. The company is involved in construction of roads, building, canals etc. across Nepal. In addition to doing projects independently, GGPL also enters into Joint Ventures (JVs) with other companies in order to meet the eligibility criteria for different construction projects.

Financial Performance

(Rs. Million)

For the Period	FY20 (A)	FY21 (A)	FY22 (A)
Income from Operations	292	518	492
PBILDT Margin (%)	59.69	27.43	26.72
Overall Gearing (times)	4.95	4.10	2.42
Total Outstanding Liabilities/Tangible Net worth (times)	6.25	6.14	4.32
Interest Coverage (times)	2.36	3.06	2.54
Current Ratio (times)	1.09	0.98	0.96
Total Debt/Gross Cash Accruals (times)	5.89	5.89	6.09

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	57.67	CARE-NP BB- [Double B Minus]
Short Term Bank Facilities	Fund Based Limits	344.50	CARE-NP A4 [A Four]
Long Term/ Short Term Bank Facilities	Non Fund Based Limits	3,327.83	CARE-NP BB-/ A4 [Double B Minus/ A Four]
Total		3,730.00	

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About CARE Ratings Nepal Limited:

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