

M.K. Builders & Construction Company Private Limited

Ratings

Facilities	Amount (Rs. in Million)	Ratings ¹	Rating Action
Long Term Bank Facilities	41.50	CARE-NP B+ [Single B Plus]	Assigned
Short Term Bank Facilities	618.50	CARE-NP A4 [A Four]	Assigned
Total Facilities	660.00 (Six Hundred and Sixty Million Only)		

Details of instruments/facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has assigned the rating of 'CARE-NP B+' to the long term bank facilities and the rating of 'CARE-NP A4' to the short term bank facilities of M.K. Builders & Construction Company Private Limited (MKPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of MKPL are constrained by the small scale of operations of the company along with limited track record in executing construction works and modest order book position. The ratings also factor in the tender based nature of operations in the highly competitive construction industry and risk of delay in project execution. The ratings, however, derive strengths from experienced promoter in the related field, decent debt service coverage indicators, moderate counter party risk 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 leading to a sustained profitable growth in the operations of the company along with improved overall financial risk profile will be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Limited track record of operations with small scale of operations and declining profitability

MKPL started operations from 2018 and has only four years of track record with small scale of operations; however, the experience of the promoters in the construction business partially offsets this risk. The company is a regional player and mainly engaged in building and road works ranging from small-sized to mid-sized projects either individually or through its JV entities.

MKPL's scale of operations has remained small with total operating income (TOI) and gross cash accruals (GCA) Rs. 135 Mn and Rs. 8 Mn, respectively, during FY22 (Audited, FY refers to the twelve-month period ending mid-July). The ability of the company to scale up to larger-sized contracts having better operating margins is constrained by its comparatively low capital base of Rs 50 Mn as on FY22. The small scale of operations in a competitive industry limits the pricing power and benefits of economies of scale.

For the period FY19-FY22, company's total operating income grew from Rs. 29 Mn to Rs. 135 Mn reflecting a compounded annual growth rate of around 67%. Despite the growth in total operating income, PBILDT margin declined from 16% in FY21 to 10% in FY22 on account of execution of low margin contracts. As on April 01, 2023 total unexecuted order book size of the company was modest at Rs. 163 Mn (share of MKPL in JV's). The company's ability to scale up to larger projects with better margins will remain critical from analytical perspective.

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

Tender based nature of operations in highly competitive construction industry

The company receives majority of its work orders from government departments and local authorities. All contracts are tender-based for which MKPL has to participate in the tenders, wherein the company has to quote the bid and hence it has to face the risk of quoting at low prices in order to secure the tender and sustain in an increasingly competitive industry.

There are numerous fragmented and unorganized players operating in this industry which makes the industry highly competitive and the ability of MKPL to sustain its profitability margins and growth in future remains crucial. Furthermore, the business also remains dependent on 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 from participating 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.

Risk of delay in project execution

Given the nature of projects awarded, MKPL 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, resulting in delay in the realization of revenue. Furthermore, the company's ability to execute a project in timely manner would be led by its own operational efficiency and timely stage payments received from clients.

Key Rating Strengths**Experienced promoters in the related field**

MKPL is promoted by four individuals who are also in the board of directors of the company. Mr. Chakra Bahadur Shah, Chairman, has been leading the company since its inception from 2018 and has experience of around two decades in the construction sector. Mr. Chandra Bahadur Shah, Director, has more than a decade's experience and manages overall projects executed by the company. Board of Directors is further supported by an experienced team across various functions/ departments.

Moderate debt service coverage indicators of the company

The overall gearing ratio (excluding mobilization advance) of the company stood relatively low at 0.42x as on mid-July 2022 as fund-based limits utilization has remained on the lower side. Interest coverage ratio of the company was moderate at 3.25x in FY22 which improved from 2.10x in FY21 on account of lower interest outgo. Total Outside Liabilities/Tangible Net Worth of the company also improved to 0.51x in FY22 from 0.73x in FY21 on account of increase in net worth of the company. Total debt/ GCA of the company improved to 4.25x in FY22 from 5.15x in FY21.

Industry Outlook

The construction sector in Nepal has been impacted by lower execution in the aftermath of the Covid-19 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 MKPL, remains challenging and will remain a key monitorable aspect.

About the Company

M.K. Builders & Construction Company Private Limited (MKPL) is a class "A" construction company of Nepal incorporated in year 2018 with its registered office based in Dhangadi, Nepal. The company is involved in construction of buildings, bridges, roads etc. across Nepal. In addition to doing projects independently, MKPL 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 year ended mid-July	FY20 (A)	FY21 (A)	FY22 (A)
Income from Operations	52	99	135
PBILDT Margin (%)	27.31	16.19	10.01
Overall Gearing (times)	0.42	0.51	0.42
Total Outstanding Liabilities/Tangible Net worth (times)	0.45	0.73	0.51
Interest Coverage (times)	2.00	2.10	3.25
Current Ratio (times)	0.22	0.21	0.29
Total Debt/Gross Cash Accruals (times)	4.62	5.15	4.25

A: Audited

Annexure 1: Details of the Facilities Rated

Name of the Bank Facilities	Type of facility	Amount (Rs. In Million)	Ratings
Long Term Bank Facilities	Term Loan	41.50	CARE-NP B+ [Single B Plus]
Short Term Bank Facilities	Fund Based Limits	18.50	CARE-NP A4 [A Four]
Short Term Bank Facilities	Non-Fund Based Limits	600.00	CARE-NP A4 [A Four]
Total		660.00	

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About CARE Ratings Nepal Limited:

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