

Mahesh Engineering & Builders Private Limited

Ratings

Facilities	Amount (Rs. in Million)	Ratings ¹	Rating Action
Long Term Bank Facilities	13.17	CARE-NP B [Single B]	Assigned
Short Term Bank Facilities	10.00	CARE-NP A4 [A Four]	Assigned
Long Term/ Short Term Bank Facilities	576.83	CARE-NP B/A4 [Single B/ A Four]	Assigned
Total Facilities	600.00 (Six Hundred Million Only)		

Details of 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 Mahesh Engineering & Builders Private Limited (MEBPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of MEBPL are constrained by its small and fluctuating scale of operations and stressed liquidity profile owing to highly elongated collection period in FY22 (Audited; FY refers to the twelve-month period ending mid-July). 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 a slowing economy.

The ratings, however, derive strengths from experienced promoter in the related field with long track record in execution of various construction works, moderate order book position with mid-term revenue visibility albeit concentrated order book, 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 timely manner, profitably scale up the operations of the company leading to sustained revenue growth while improving its overall financial risk profile will be key sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Small and fluctuating scale of operations

MEBPL has a modest scale of operations with Total Operating Income (TOI) of Rs. 27 Mn during FY22, which declined by ~74% year-on-year amid lower execution of projects during the FY22. Amid low TOI, the profitability of the company also remained minimal during FY22 resulting in a weak financial risk profile. 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. 30 Mn as on mid-July 2022. The small scale of operations in a competitive industry limits the pricing power and benefits of economies of scale.

Elongated operating cycle with increasing trend in collection period

The operations of MEBPL is working capital intensive marked by substantially high average collection period. MEBPL's average collection period stood at 373 days in FY22, mainly due to spill over of some receivables from FY21 into FY22. Although counterparty risk over the long term is moderate as MEBPL's customer base majorly includes of government departments / bodies, a substantially elongated collection period adversely impacts the company's liquidity position and is a major concern. A stretched operating cycle could put additional burden in the company's financial profile over the near-term leading to increased reliance on borrowings to meet its working capital needs.

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 its majority work orders from government departments and local authorities. All contracts are tender-based for which MEBPL has to participate in the tenders, 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 at low price through e-bidding to sustain the competition. MEBPL enters into construction contracts either individually or through JV entities in order to meet eligibility criteria for these contracts.

There are numerous fragmented and unorganized players operating in this industry which makes the industry highly competitive and the ability of MEBPL to sustain its profitability margins and growth in future remain 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 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.

Risk of delay in project execution

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

Key Rating Strengths**Experienced promoter in the related field with long track record in operations**

MEBPL was incorporated as a sole proprietorship in 1985 owned by Mr. Dhurva Prasad Upadhayay. Later on, it was converted into private limited in 2019 and promoted by Mr. Manoj Kumar Khanal and Mr. Dhurva Prasad Upadhayay. Mr. Khanal, Managing Director, has experience of more than two decades in the field of construction. He is also the sole owner of another construction company, M K Construction Private Limited and is involved in trading of construction material named as Moonsoon Suppliers. Mr. Dhurva Prasad Upadhayay, Director, has experience of over three decades in the field of construction.

MEBPL has long track record of almost four decades in the construction of roads (majorly), bridge projects, and irrigation projects from small to mid-size projects and have executed several projects across the country in different terrains either individually or through its JV entities.

Moderate order book position with mid-term revenue visibility albeit concentrated order book.

The unexecuted order in hand of the company as on February 27, 2023 was Rs. 331 Mn (share of MEBPL only), which is 12.25x of the income from contract in FY22. The tenure of the orders undertaken by the company is up to 12-36 months. The order book is primarily concentrated towards road projects (~78%) and others include bridge works, river training and other infrastructure development projects received from various government authorities. Timely execution of the orders would be critical for the business prospects of the company and has a direct bearing on its margins.

Moderate counter party risk and escalation clause in majority of contracts

Revenue of MEBPL is majorly generated via contracts from government departments including provincial and local bodies. The order book is primarily concentrated towards road projects from government departments. Counter party risk remains moderate 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 burden to the customer 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 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 RCPL, remains challenging and will remain a key monitorable aspect.

About the Company

Mahesh Engineering & Builders Private Limited (MEBPL) is a 'C' class construction company in Nepal, established in 1985 as a sole proprietorship firm. It was later changed to a limited liability company based in Bardagat, Nawalparasi, Nepal on 21st August 2019. MEBPL is mainly involved in road projects and a few bridge construction projects. In addition to doing projects independently, MEBPL also enters into Joint Ventures (JVs) with other companies in order to meet the eligibility criteria for different construction projects.

Financial Performance

For the period ended/ as at mid-July	FY20 (A)	FY21 (A)	FY22 (A)
Income from operations	84	105	27
PBILDT Margin (%)	11.09	8.05	19.85
Overall Gearing (times)	0.27	0.30	0.33
Interest Coverage (times)	6.06	7.09	4.97
Current Ratio (times)	17.43	6.99	4.18
Total Debt/ GCA	1.40	1.83	3.17

A: Audited;

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	13.17	CARE-NP B [Single B]
Short Term Bank Facilities	Fund Based Limit	10.00	CARE-NP A4 [A Four]
Long Term/ Short Term Bank Facilities	NonFund Based Limit	576.83	CARE-NP B/A4 [Single B/ A Four]
Total		600.00	

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