

## Aarogya Construction Private Limited

### Ratings

Facilities	Amount (Rs. in Million)	Ratings <sup>1</sup>	Rating Action
Long Term Bank Facilities	66.00	CARE-NP B+ [Single B Plus]	Revised from CARE-NP BB-
Short Term Bank Facilities	318.70	CARE-NP A4 [A Four]	Reaffirmed
Long Term/ Short Term Bank Facilities	2,350.00	CARE-NP B+ / A4 [Single B/ A Four]	Revised from CARE-NP BB- / A4
<b>Total Facilities</b>	<b>2,734.70</b> <b>(Two Billion Seven Hundred Thirty Four Million and Seven Hundred Thousand Only)</b>		

*Details of instruments/facilities in Annexure 1*

CARE Ratings Nepal Limited (CRNL) has revised the rating to 'CARE-NP B+' for the long term bank facilities and reaffirmed the rating of 'CARE-NP A4' assigned to the short term bank facilities of Aarogya Construction Private Limited (ACPL).

### Detailed Rationale & Key Rating Drivers

The revision in the ratings assigned to the bank facilities of ACPL takes into account its elongated operating cycle resulting to working capital intensive nature of business and stretched liquidity position. The ratings also factor in ACPL's leveraged capital structure, fluctuating profitability margins and its presence in highly competitive construction industry coupled with tender based nature of operations, exposure to volatile interest rates and government regulations and risk of delay in project execution.

The ratings, however, derive strengths from experienced promoters and moderate track record of operations, moderate order book with mid-term revenue visibility, moderate counter party risk and escalation clause in majority of the contracts. The ratings also take cognizance of growth in total operating income (TOI) in FY22 (Audited; FY refers to the twelve-month period ending mid-July), albeit timely realisation of debtors remain a key concern.

*Going forward, the ability of the company to successfully execute projects and recover contract proceeds in a timely manner, profitably scale up the operations of the company leading to sustained revenue growth and rationalization of its debt through efficient working capital management would be the key rating sensitivities.*

### Detailed Description of the Key Rating Drivers

#### Key Rating Weaknesses

#### Highly elongated operating cycle resulting in stretched liquidity position

The operations of the company are working capital intensive in nature. Net Operating cycle of the company remained very high at 985 days in FY22, which increased from 719 days in FY21. ACPL's operating cycle is in increasing trend from the past 4 financial years (FY19-FY22). This is on account of increase in average collection period to 564 days in FY22 from 487 days in FY21 (244 days in FY19) coupled with high inventory holding period of 564 days in FY22 which however improved from 622 days in FY21 (322 days in FY19).

The major factor that resulted in high inventory was accumulation of inventory on account of unexecuted projects due to delay in clearance from the government authorities for laying of fibre optic cables. The funds are released only after the work certification process is completed and finalization of the bill is done. Customer base includes government departments and private entities. The certification and realization of the bill generally takes a period of around three months. There

<sup>1</sup>Complete definitions of the ratings assigned are available at [www.careratingsnepal.com](http://www.careratingsnepal.com) and in other CRNL publications

have been procedural delays in the recovery of debtors, and at times, the same have exceeded a year. Furthermore, there is spill over of some receivables from FY21 into FY22. Consequently, average collection period of the company was high at around 564 days in FY22. An elongated operating cycle resulted in a stretched liquidity position of the company, increasing its reliance on the bank finance for meeting its working capital needs, resulting in increased debt levels. Accordingly, ACPL has been fully utilizing its working capital loans with average utilization of more than 90% against sanctioned limits.

Interest coverage ratio of the company was moderate at 1.77x in FY22 which deteriorated from 2.20x in FY21 on account of increased interest expenses due to increased working capital loans availed by the company. Furthermore, Total debt/GCA of the company deteriorated substantially to 20.97x in FY22 from 14.11x in FY21, with impact of increased working capital borrowings of the company. Timely receipt of contract proceeds as envisaged will be a key monitorable aspect.

### **Below average financial risk profile marked by fluctuating profitability margins and leveraged capital structure**

The business generation of the company is through bidding and tendering process and profitability margins are directly associated with the nature of contracts executed by the company. PBILD margin has also remained highly volatile and fluctuated between 32% - 45% during the last 4 financial years (FY19-FY22). With increase in interest expenses, PAT margin of ACPL declined to 1.76% in FY22 from 3.79% in FY21.

Capital structure of the company stood leveraged on account of higher short-term debts availed by ACPL for funding the working capital needs of the company and the same has been reflected from high overall gearing of 3.43x as on mid-July 2022, deteriorating from 3.18x as on mid-July 2021. Furthermore, Total Outside Liabilities (TOL)/ TNW of the company deteriorated to 3.68x in FY22 from 3.53x in FY21.

### **Tender based nature of operations in highly competitive construction industry**

Majority of the ACPL's projects are tender-based government contracts wherein the company has to quote a bid. With multiple players active in the industry, ACPL'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**

The company's interest rates are based on 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. Therefore, funding taken by the company from BFIs is subject to volatile interest rate.

### **Risk of delay in project execution**

Given the nature of projects awarded, ACPL 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 promoters and moderate track record of operations**

ACPL is promoted by Mr. Amod Jung Thapa, Managing Director, who has been leading the company since November 2012. Mr. Thapa has experience of more than two decades in the construction sector which bodes well for the overall business prospects of the company in an increasingly competitive industry. He is responsible for planning business strategies of the company. Furthermore, the board is supported by an experienced team across various functions. The company has moderate track record of operations of around a decade in the construction of various infrastructure projects all over Nepal.

#### **Moderate order book position with diversified projects**

As on mid-April, 2023, the unexecuted orders in hand of the company stood at Rs. 1,125 Mn, which is 9x of the income from contract of FY22, providing moderate revenue visibility. ACPL's TOI grew ~33% year-on-year to Rs. 125 Mn during FY22 boosted by execution of outstanding projects. The order book is moderately diversified and consists of various construction projects but remain primarily concentrated towards laying/installation of underground optical fibre cable (~51%) and others include, building, road, bridge and hydropower projects by entering into JVs. Timely completion of the projects would be critical for the business prospects of the company and also has a direct bearing on its margins.

#### **Moderate counter party risk**

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, remains a key challenge for the construction sector. 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 a 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 FY22-9MFY23. 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 9MFY23 leading to the slippages in the construction portfolio of BFIs. Near term operating environment for construction companies, including ACPL, remains challenging and will remain a key monitorable aspect.

### **About the Company**

ACPL is a Class "D" construction company of Nepal incorporated on November 17, 2011 with its registered office based in Kathmandu, Nepal. The company is involved in building construction, optical fibre installation and maintenance, road construction. In addition to doing projects independently, ACPL 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	81	94	125
PBILDT Margin (%)	44.02	44.73	38.71
Overall Gearing (times)	1.16	3.18	3.43
Total Outstanding Liabilities/Tangible Net worth (times)	2.01	3.53	3.68
Interest Coverage (times)	2.93	2.20	1.77
Current Ratio (times)	1.07	1.04	1.01
Total Debt/Gross Cash Accruals (times)	4.81	14.11	20.97

A: Audited

## Annexure 1: Details of the Facilities Rated

Nature of the Facility	Type of the facility	Amount (Rs. In Million)	Ratings
Long Term Bank Facilities	Term Loan	66.00	CARE-NP B+ [Single B Plus]
Short Term Bank Facilities	Fund Based Limits	318.70	CARE-NP A4 [A Four]
Long Term /Short Term Bank Facilities	Non-Fund Based Limits	2,350.00	CARE-NP B+ / A4 [Single B Plus /A Four]
<b>Total</b>		<b>2,734.70</b>	

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### About CARE Ratings Nepal Limited:

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