

Kumar Shrestha Nirman Sewa Private Limited

Ratings

Facilities	Amount (Rs. in Million)	Ratings ¹	Rating Action
Long Term Bank Facilities	960.38	CARE-NP BB+ [Double B Plus]	Assigned
Short Term Bank Facilities	980.00	CARE-NP A4+ [A Four Plus]	Assigned
Long Term/ Short Term Bank Facilities	9,059.62	CARE-NP BB+ / A4+ [Double B Plus/ A Four Plus]	Assigned
Total Facilities	11,000.00 (Eleven Thousand 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 Kumar Shrestha Nirman Sewa Private Limited (KSNS).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of KSNS are constrained by its leveraged capital structure, working capital intensive nature of operations and declining profitability during FY20-FY22 (Audited; FY refers to the twelve-month period ending mid-July). The ratings also factor in the tender based nature of operations in the highly competitive construction industry, exposure to volatile interest rates and regulatory risk and risk of delay in project execution.

The ratings, however, derive strength from the established track record of operations of company along with experienced promoters and growing scale of operations with healthy, albeit concentrated, order book position providing mid-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 manage its working capital requirements to support growth will be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Declining profitability and leveraged capital structure of the company

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. PBILDT margin of the company had been on declining trend from around 15% in FY20 to around 8% in FY22 amid increasing fuel prices and prices of raw materials. PBILDT margin of company decreased by 314 bps year-on-year to 8.40% during FY22. Amid declining PBILDT margin and higher interest expenses with higher utilization of working capital limits by the company coupled with increased funding cost during the during FY22, net profitability margin declined by 337 bps to 3.22%.

Capital structure of KSNS stood leveraged with overall gearing ratio (including mobilization advance, normally interest free) of 3.21x as on mid-July 2022, deteriorating from 2.57x as on mid-July 2021. Overall gearing ratio (excluding mobilization advance) stood at 2.13x as on mid-July 2022, deteriorated from 2.03x as on mid-July 2021. Gearing levels have deteriorated in FY22 amid increasing term loans and advance mobilization received by the company. Interest coverage ratio stood moderate at around 2.91 times in FY22; however, total debt to GCA stood high at 14.95x in FY22 on account of higher balance of mobilization advances and term loans. Furthermore, Total Outside Liabilities (TOL)/ TNW of the company also stood high at 5.30x in FY22.

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

Working capital intensive nature of business

The operations of the company are working capital intensive in nature marked by higher collection period. KSNS's average collection period elongated to 69 days in FY22 from 35 days in FY21. KSNS's customer base includes majorly government departments/ bodies; therefore, the certification and realization of the bill generally takes the period of around 1-2 months. The funds are released only after the work certification process is completed and finalization of the bill is done. However, an elongated collection period is a concern, particularly amid the 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 over the near-term. Operating cycle of the company increased to 50 days in FY22 from 23 days in FY21. Amid increasing working capital intensity, the company's reliance on borrowings to meet its working capital requirements is only likely to increase further. The resultant working capital requirements are met largely through bank borrowings which normally results in average utilization of more than 50% of its sanctioned working capital limits. Hence, the company's ability to realize debtors swiftly will be critical from credit perspective.

Tender based nature of operations in highly competitive construction industry

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

KSNS had Rs. 105 Mn as finance cost in FY22, which increased from Rs. 84 Mn in FY21, thus squeezing its net profitability. KSNS's interest expenses 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. Thus, funding taken by the firm is exposed to volatile interest rate.

Risk of delay in project execution

Given the nature of projects awarded, KSNS 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.

Key Rating Strengths**Experienced promoters and established track record of operations**

KSNS has three directors in its Board of Directors led by Managing Director, Mr. Prem Kumar Shrestha, who has been leading the company since its inception in 1977. Mr. Shrestha has experience of more than four 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 around four decades in the construction of various infrastructure projects all over Nepal.

Growing scale of operations with healthy, albeit concentrated order book position

During FY20-FY22, Total Operating Income (TOI) of KSNS increased at a compounded annual growth rate of around 27% over FY20-FY22. TOI of KSNS grew 21.52% year-on-year to Rs. 3,632 Mn during FY22 with execution of large sized projects during FY22. The company has unexecuted order book of Rs. 8,576 Mn, which is 2.44x of the income from contract of FY22 as on March 31, 2023 providing moderate revenue visibility. The company's order book position is diversified among different sectors mostly from various government departments including provincial and local bodies. The diversification among different sectors hedges the company from the risk of sectoral concentration. However, 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. One of the total projects account for around 34% of the total order book. Having a concentrated order book on few projects links the company's performance to the same and any delays in execution of such projects can materially impact the company's financial health. Timely completion of the projects, including KSNS'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

Revenue of KSNS is generated majorly via contracts from government departments. The order book is primarily concentrated towards road and river training and building 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.

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 KSNS, remains challenging and will remain a key monitorable aspect.

About the Company

Kumar Shrestha Nirman Sewa Private Limited (KSNS) is Class "A" construction company of Nepal which was incorporated in the year 1977 and later on converted into private limited company in February 28, 1998 with registered office based in Kanchanpur, Nepal. The company is involved in construction of building, roads, bridges, airports etc. across Nepal. The company also enters into Joint Ventures (JVs) with other companies in order to meet the eligibility criteria for different construction projects for bidding and execution of contracts.

Analytical Approach

CRNL has analysed KSNS's credit profile by considering the consolidated financial statements comprising KSNS and its joint venture entities related to the construction projects.

Financial Performance

(Rs. Million)

For the Period	FY20 (A)	FY21 (A)	FY22 (A)
Income from Operations	2,265	2,988	3,632
PBILDT Margin (%)	15.44	11.54	8.40
Overall Gearing (times)	3.76	2.57	3.21
Total Outstanding Liabilities/Tangible Net worth (times)	5.51	5.52	5.30
Interest Coverage (times)	3.55	4.10	2.91
Current Ratio (times)	1.24	0.98	1.46
Total Debt/Gross Cash Accruals (times)	8.74	6.16	14.95

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	960.38	CARE-NP BB+ [Double B Plus]
Short Term Bank Facilities	Fund Based Limits	980.00	CARE-NP A4+ [A Four Plus]
Long Term/ Short Term Bank Facilities	Non Fund Based Limits	9,059.62	CARE-NP BB+ / A4+ [Double B Plus/ A Four Plus]
Total		11,000.00	

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