M.A. Construction Private Limited

Ratings

Facilities	Amount (Rs. Million)	Rating[1]	Rating Action
Long Term Bank Facilities	44.48	**CARE-NP BB [Double B]**	Reaffirmed
Short Term Bank Facilities	2,435.52	**CARE-NP A4 [A Four]**	Reaffirmed
Long Term/Short Term Bank Facilities	1,346.69	**CARE-NP BB/ A4 [Double B/ A Four]**	Reaffirmed
Total	**3,826.69 (Three Billion Eight Hundred Twenty-Six Million and Six Hundred Ninety Thousand)**		

Details of Facilities/Instruments to be rated in Annexure 1

CARE Ratings Nepal Limited (CRNL) has reaffirmed the rating of 'CARE-NP BB' assigned to the long-term bank facilities and 'CARE-NP A4' to the short-term bank facilities of M. A. Construction Private Limited (MAC).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of MAC continues to be constrained by highly leveraged capital structure with modest debt service coverage indicators, elongated operating cycle marked by high inventory holding and high collection 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 experienced promoters and established track record of operations, moderate order book position albeit concentrated towards energy sector 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. The ratings also take cognizance of sequential improvement in total operating income and profitability of the company in FY22 (Audited, FY refers to the twelve-month period ending mid-July) from the largely covid19 impacted FY21.

Going forward, the ability of the company to profitably scale up its operations amidst high level of competition and manage its working capital effectively considering high funding requirement to support growth will be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Highly leveraged capital structure with modest debt service coverage indicators

The company's capital structure remains highly leveraged with gearing ratio of 6.28x at the end of FY22, although improved from 8.86x at the end of FY21. The improvement was primarily on account of infusion of additional equity of Rs. 100 Mn in FY22. Despite the additional equity during FY22, overall net worth of the company remains lower in comparison to its relatively high debt levels. Interest coverage ratio was modest at 1.30x, although improving from 0.96x in FY21 supported by improving operations in FY22. The company continues to have low gearing headroom, which could limit its financial flexibility. Rationalisation of debt, in commensurate with its scale of operations, will remain key from credit perspective.

Elongated operating cycle marked by high inventory and collection period

The operations of the company are working capital intensive in nature marked by substantially high average collection period and inventory period at the end of FY22. MAC's average collection period elongated to 182 days in FY22 from 104 days in FY21. MAC's

[1]Complete definition of the ratings assigned are available at www.careratingsnepal.com and other CARE publications

customer base includes government departments / bodies and also private sector. With respect to government department, certification and realization of bills generally taking a period of around 2-3 months. However, a substantially 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 in the banking industry. MAC's inventory period also stood high at 158 days in FY22 (FY21: 246 days), partly due to substantial work in progress, albeit in a decreasing trend from previous fiscal. The company's creditors period had remain highly stretched to 428 days in FY22 (FY21:150 days). As per banker, working capital facilities has been fully utilized over the last 12 months.

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. Amid increasing working capital intensity, the company's reliance on borrowings to meet its working capital requirements is only likely to increase further. However, a major ongoing project of the company is a hydropower project where promoters of MAC have major shareholding. Cash conversion cycle is expected to improve in coming periods, which will be critical from credit perspective.

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 MAC 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. MAC 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 MAC 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.

Exposure to volatile interest rate

Sustained requirement for short-term working capital borrowings results in a high interest expense for MAC. 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. Hence, funding taken by the company remains exposed to volatile interest rate. Sustained high interest rates, as seen over the last year or so, have added to the interest burden of the company, squeezing its profitability and impacting its liquidity position.

Risk of delay in project execution

Given the nature of projects awarded, MAC 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 established track record of operations

The company has long track record of operations of more than 35 years in the construction of various infrastructure projects all over Nepal. MAC has two directors in its board. Mr. Anup Acharya, managing director, has more than 30 years of experience in the construction and energy sector. He looks after the overall operations of the company. Mr. Deepak Baral, civil engineer, is the other director of MAC and has 20 years of experience in the construction business. The management is further supported by an experienced team across various departments.

Increasing operating income and profitability in FY22

Company's total operating income (TOI) increased by ~52.54% year-on-year in FY22 to Rs.804 Mn supported by execution of major projects on timely basis. PBILDT margin of the company also increased 18.27% in FY22 from 15.99%, aided by favorable cost of production, which decreased to 74.33% of TOI in FY22 from 76.85% in FY21. Consequently, the company reported net profit of Rs. 5 Mn in FY22 from losses of Rs. 17 Mn in FY21. Net profitability has remained quite volatile in the last three years on account of fluctuating scale of operations amid the pandemic. The ability of the company to stabilize operations leading to a more stable net profitability profile will be crucial from credit perspective.

Moderate order book position albeit concentrated towards energy sector

As on March 20, 2023, the unexecuted orders in hand of the company were Rs. 3,917 Mn, which is ~5x of its income from contract of FY22, providing moderate revenue visibility. The order book is primarily concentrated towards hydropower works (~59.87%) and others include construction works such as construction of stadium and building works by entering into JVs. Timely completion of the projects would be critical for the business prospects of the company and has a direct bearing on the margins to be attained.

Moderate counter party risk and escalation clause in majority of contracts

Revenue of MAC 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

M.A. Construction Private Limited was incorporated on April 10, 1983 in the name of Munna and Acharya Construction Company Private Limited which later on March 5, 2017 was changed into M.A. Construction Private Limited. It is a Class-A construction company of Nepal with registered office based in Dharan, Nepal. MAC undertakes projects independently as well as through Joint Ventures (JVs) with other companies in order to meet the eligibility criteria for different construction projects. Brief financials of

MAC (Consolidated) for last three years ending FY22 are given below:

(Rs. in Million)

Particulars	FY20 Audited	FY21 Audited	FY22 Audited
Income from Operations	1,086	531	809
PBILDT / Total Income	13.83	15.99	18.27
Overall Gearing	13.08	8.81	6.28
Total Outside Liabilities/ Tangible Net-Worth (times)	19.92	12.35	12.36
Interest coverage (times)	1.55	0.96	1.30
Total Debt/GCA	24.21	Negative	56.23

Annexure-1 Details of Facilities/Instruments to be rated

Name of Instrument	Type of Facility	Amount (Rs in Million)	Rating
Long Term Bank Facilities	Term Loan	**44.48**	CARE-NP BB
Short Term Bank Facilities	Working Capital Loan	**2,435.52**	CARE-NP A4
Long Term/Short Term Bank Facilities	Non-Fund Based Loans	**1,346.69**	CARE-NP BB/A4
Total		**3,826.69**	

Contact us

Analyst Contact

Ms. Sujana Chaulagain
Contact No.: +977-01-4012628
Email: Sujana.chaulagain@careratingsnepal.com

Mr. Santosh Pudasaini
Contact no: +977-01-4012628
Email: santosh.pudasaini@careratingsnepal.com

Relationship Contact

Name: Achin Nirwani
Contact No.: +977 9818832909
Email: achin.nirwani@careratingsnepal.com

About CARE Ratings:

CARE Ratings Nepal Limited (CRNL) is licensed by the Securities Board of Nepal w.e.f. November 16, 2017. CRNL is supported by CARE Ratings Limited through a technical services agreement to provide technical support in the areas such as rating systems and procedures, methodologies, etc. from CARE Ratings on an ongoing basis. The technical support shall ensure that CRNL has adequate resources to provide high quality credit opinions in Nepal.
Our parent company, CARE Ratings Limited commenced operations in April 1993 and over two decades, it has established itself as one of the leading credit rating agencies in India. CARE is registered with the Securities and Exchange Board of India (SEBI) and also recognized as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI).