

Aashirbad Nirman Sewa Private Limited

Ratings

| Facility | Amount (Rs. in Million) | Rating ¹ | Rating Action |
|--------------------------------------|--|--|-------------------------------|
| Long Term Bank Facilities | 70.78 (Decreased from 117.18) | CARE-NP BB- [Double B Minus] | Revised from CARE-NP BB |
| Short Term Bank Facilities | 57.18 (Increased from 29.82) | CARE-NP A4 [A Four] | Reaffirmed |
| Long Term/Short Term Bank Facilities | 1,672.05 (Increased from 1,653.00) | CARE-NP BB-/A4 [Double B Minus/ A Four] | Revised from CARE-NP BB/A4 |
| Total Facilities | 1,800.00 One Thousand Eight Hundred Million Rupees Only | | |

Details of Facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has revised the ratings assigned to the long term bank facilities of Aashirbad Nirman Sewa Private Limited (ANS) to 'CARE-NP BB-' from 'CARE-NP BB' and reaffirmed the rating of 'CARE-NP A4' assigned to its short term bank facilities.

Detailed Rationale & Key Rating Drivers

The revision in ratings assigned to the bank facilities of ANS takes into account the stretched liquidity position reflected from the few instances of overdrawn in working capital borrowings owing to delays in realization of contract proceeds. The company's average collection period was on an increasing trend in FY22 (Audited, FY refers to the twelve-month period ending mid-July). Moreover, slower debtors' realization trend in the construction sector is likely to have spilled over into FY23, particularly given the lower-than-expected government capital expenditure in FY23. A sustained high collection period could add to the financial burden of the company over the near-term, which remains a concern from credit perspective. The ratings also factor by its small scale of operations with geographically concentrated order book position, tender based nature of operations, planned debt funded capital expenditure, exposure to volatile interest rates, risk of delay in project execution and working capital intensive nature of business.

The ratings, however, continue to derive strength from ANS's experienced promoters and moderate track record of operations, moderate order book position and counter party risk, and escalation clause in majority of the contracts.

Going forward, the ability of the company to profitably scale up its operations while successfully executing the projects on time and managing its working capital requirements to support growth will be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Small scale of operations with geographically concentrated order book position

The total operating income of ANS stood relatively smaller at Rs. 217 Mn in FY22, albeit growing at 7% over FY21. 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. Small scale of operations in a competitive industry limits the pricing power and benefits derived from economies of scale. Furthermore, the entire operations of the company and its order book are concentrated mainly in the eastern region of Nepal. Attributed to same, the company is also exposed to geographical concentration risk such as natural disasters, regional execution challenges related to local disturbances towards execution of contract etc.

Delay in relation leading to stretched liquidity position

The operations of the company are working capital intensive in nature, marked by moderate average collection period. ANS's average collection period during FY22 was 79 days compared to 50 days in FY21. Consequently, there have been instances of delays in debt servicing in the past. Although counterparty risk remains low over the long-term, transient delays in debtor realization resulting in stretched operating cycle could put additional burden in the company's financial profile over the near-term. The company primarily works with the government departments and payments for the contracts are received after completion of work certification process, generally within two months. The credit period is normally around two months, which can be extended by suppliers of raw materials on the basis of negotiation power. Retention money is deducted by the client from running bills which will get refunded to the contractor after certain period, usually 1 year, on successful execution of contracted work. These factors lead to reliance of the company on external finance to meet its working capital requirements.

Planned debt funded capital expenditure

The company has been making regular investments to expand its infrastructure facilities in the past and expected to continue in future. The investment in equipment/ machineries was approx. Rs. 100 Mn in last 3 FYs (FY20-FY22).. The purchase of fixed assets was mainly funded through internal accruals, equipment loan and also infusion from promoters. The company has planned the purchase of equipment/machineries in the upcoming financial year as well. Any un-envisaged debt funded capital expenditure would impact the capital structure adversely and also deteriorate the debt coverage indicators of the company. Hence, the increase in debt levels, going forward, would remain a key rating monitorable.

Tender based nature of operations in highly competitive construction industry

Majority of the ANS's projects are tender-based government contracts wherein the company has to quote a bid. With multiple players active in the industry, the company's business is vulnerable to underbidding 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. 3,000 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, ANS 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. Although counter party risk over the medium term remains low given the projects are majorly from NEA and Government departments, which have been making timely payment to the company in the past, timely debtor realization, particularly at times of economic downturn, remain key challenge for the construction sector.

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

ANS is promoted by Mr. Keshar Kumar Budhathoki who has been leading the company since its inception in 2015 and has long experience of two decades in the field of construction business. Similarly, other directors of the company have reasonable experience in construction contract business. The board is aptly supported by an experienced team across various

functions. The company has a moderate track record of operations of more than seven years in the construction of various small- and large-scale infrastructure projects across Nepal.

Growing scale of operations with moderate profitability margins

Total operating income of the ANS increased to Rs. 217 Mn in FY22 compared to Rs. 202 Mn in FY21 on account of improved execution of major contracts during the period. Despite higher income, PBILDT margin declined to ~16.04% in FY22 from ~17.91% owing to increase in cost of raw material. Consequently, PAT margin of the company slightly deteriorated to 3.64% in FY22 from 4.78% in FY21. Though profitability margins moderated, it continued to remain at moderate levels. Also, debt coverage indicators of the company were moderate marked by total debt to gross cash accruals (GCA) and interest coverage of 4.88x and 4.39x, respectively, in FY22. The ability of ANS to sustain its profitability margin while managing working capital requirements and maintaining debt service coverage indicators will remain key monitorable.

Moderate order book position with mid-term revenue visibility and escalation clause in majority of the contracts

The unexecuted order book of the company as on mid- July 2022 was Rs. 1,405 Mn (share of ANS in joint ventures), which is 6.85x of the income from contract in FY22, providing moderate revenue visibility. The tenure of the orders undertaken by the company is up to 42 months. The order book is primarily concentrated towards building projects (~65%) and others include bridge works, road works, irrigation/water supply/ related works, sewage works and airport works received from various government authorities. Timely execution of the orders, however, would be critical for the business prospects of the company and has a direct bearing on its margins.

Revenue of ANS is generated via contracts majorly from government departments. The order book is primarily concentrated towards 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. Furthermore, the company has inbuilt price escalation clauses in majority of contracts in order to insulate the company from any adverse fluctuation in construction material prices and labor expenses. This enables the company to pass on increase in raw material prices to its customers (employers). Ability of the company to pass on increased price burden to the customers 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 FY22-9MFY23. Increasing trend in fuel price, which is a key input for construction projects, 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 RCCPL, remains challenging and will remain a key monitorable aspect.

About the Company

Aashirbad Nirman Sewa Private Limited (ANS) was incorporated on March 3, 2015 as a Class-D construction company of Nepal with registered office based in Biratnagar, Morang, Nepal. The company is involved in construction of both small- and large-scale projects mainly relating to road works, building works, bridge works, irrigation works, etc. in various parts of

Nepal. In addition to doing projects independently, ANS also enters into Joint Ventures (JVs) with other companies in order to meet the eligibility criteria for different construction projects.

Brief financials of ANS for the past three years ended FY22 are given below:

(Rs. Million)

| For the year ended Mid-July | FY20 (Audited) | FY21 (Audited) | FY22 (Audited) |
|---|-------------------|-------------------|-------------------|
| Income from Operations | 201 | 202 | 217 |
| PBILDT Margin (%) | 11.79 | 17.91 | 16.04 |
| Overall Gearing (times) inc. mobilization advance | 2.27 | 2.24 | 1.91 |
| Total Outstanding Liabilities/ Tangible Net Worth (times) | 3.03 | 2.91 | 2.46 |
| Interest Coverage (times) | 5.15 | 4.88 | 4.39 |
| Current Ratio (times) | 1.75 | 1.70 | 1.56 |
| Total Debt/ Gross Cash Accruals (times) | 4.66 | 4.07 | 4.19 |

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 | 70.78 (Decreased from 117.18) | CARE-NP BB- [Double B Minus] |
| Short Term Bank Facilities | Fund Based Limit | 57.18 (Increased from 29.82) | CARE-NP A4 [A Four] |
| Long Term/ Short Term Bank Facilities | Non-Fund Based Limit | 1,672.05 (Increased from 1,653.00) | CARE-NP BB-/A4 [Double B Minus/ A Four] |
| Total | | 1,800.00 | |

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