

## Apex Construction Company Private Limited

### Ratings

Facilities	Amount (Rs. in Million)	Ratings <sup>1</sup>	Rating Action
Long Term Bank Facilities	<b>71.07</b>	<b>CARE-NP BB- [Double B Minus]</b>	<b>Reaffirmed</b>
Short Term Bank Facilities	<b>280.00</b>	<b>CARE-NP A4 [A Four]</b>	<b>Reaffirmed</b>
Long Term/ Short Term Bank Facilities	<b>3,148.93</b>	<b>CARE-NP BB-/ A4 [Double B Minus/ A Four]</b>	<b>Reaffirmed</b>
<b>Total Facilities</b>	<b>3,500.00 (Three Thousand Five Hundred Million only)</b>		

*Details of instruments/facilities 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 Apex Construction Company Private Limited (ACC).

### Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of ACC continue to be constrained by its below average financial profile of the company marked by decline in Total Operating Income (TOI) during FY22 (Audited, FY refers to the twelve-month period ending mid-July) along with volatile PBILDT margin profile. The ratings also factor in ACC's working capital intensive nature of business, 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 established track record of operations, moderate; albeit concentrated order book position, moderate counter party risk and escalation clause in majority of the contracts. The ratings also take cognizance of moderate capital structure of the company at the end of FY22.

*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

#### **Below average financial profile marked by decline in TOI during FY22**

During FY22, ACC's TOI declined ~22% year-on-year to Rs. 673 Mn amid lower projects executed by the company during FY22 with slowdown in construction activities in the country mainly owing to lower government capital expenditures. 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 has been highly volatile in past three FYs (FY20-FY22). PBILDT margin improved by 232 bps to 15.30% in FY22. Along with improvement in PBILDT margin, PAT margin of the company increased by 22 bps to 2.09% in FY22. Gross Cash Accruals of the company, however, decreased by ~6% to Rs. 58 Mn in FY22 amid lower income.

#### **Working capital intensive nature of business**

The operations of the company are working capital intensive in nature marked by high collection period. Net operating cycle of the company was relatively higher at 74 days in FY22, increased from 45 days in FY21. The funds are released

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

only after the work certification process is completed and finalization of the bill is done. Customer base primarily includes government departments. The certification and realization of the bill generally takes a period of around two months. There are usually procedural delays in the recovery of debtors and, at times, this exceeds three months. Consequently, average collection period of the company was high at around 131 days in FY22. Similarly, ACC's creditors' days remained high at 101 days, emanating from the challenges faced by the company to effectively manage its working capital cycle. Also, ACC's inventory holding period was around 44 days in FY22 compared to 6 days in FY21 with major inventory being construction materials such as cement and rods mainly due to bulk procurement at the end of FY.

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

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

ACC'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, ACC 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**

ACC has three directors in its Board of Directors led by Managing Director, Mr. Rajan Kumar Bastola, who has been leading the company for more than two decades. Mr. Bastola 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 overall operational management of the company. Mr. Ramesh Bahadur Adhikari and Ms. Rupa Adhikari, Directors, has considerable experience in construction sector and look after overall operations of the company. Furthermore, the board is supported by an experienced team across various functions. The company has long track record of operations of more than two decades in the construction of various infrastructure projects all over Nepal.

**Moderate capital structure of the company**

Capital structure of the company stood moderate with overall gearing ratio (including mobilization advance) and overall gearing ratio (excluding mobilization advance) of 2.27x and 2.09x as on mid-July 2022 (improved from 3.79x and 3.41x respectively as on mid-July 2021). The improvement in overall gearing ratio is mainly on account of increase in tangible net worth base of the company with increase in equity share capital of company by Rs. 50 Mn during FY22. Furthermore, Total Outside Liabilities (TOL)/ TNW of the company improved to 3.80x as on mid-July 2022 from 6.71x as on mid-July 2021. Interest coverage ratio of the company was moderate at 2.54x in FY22 (PY: 2.51x). Total debt/ GCA of the company stood high; albeit improved to 7.61x in FY22 from 8.36x in FY21 owing to decrease in term liabilities of the company.

**Moderate; albeit concentrated order book position**

The company has unexecuted order book of Rs. 1,351 Mn, which is 2.01x of the income from contract of FY22 as on June 23, 2023 providing moderate revenue visibility. The company's order book position is highly concentrated mainly towards road projects (~79% of total order book) mostly from various government departments. This exposes the company to revenue concentration risk in terms of business segment. 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. Timely completion of the projects, including ACC'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 and escalation clause in majority of contracts**

Revenue of ACC is generated majorly via contracts from government departments. 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 cost burden to its 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-FY23. 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 FY23 leading to the slippages in the construction portfolio of BFIs. Near term operating environment for construction companies, including ACC, remains challenging and will remain a key monitorable aspect.

**About the Company**

Apex Construction Company Private Limited (ACC) is a Class "A" construction company of Nepal incorporated on May 19, 1985 with its registered office based in Kathmandu, Nepal. The company is involved in construction of road, building, irrigation projects, bridges and railway works. In addition to doing projects independently, ACC also enters into Joint Ventures (JVs) with other companies in order to meet the eligibility criteria for different construction projects.

### Analytical Approach

CRNL has analysed ACC's credit profile by considering the consolidated financial statements comprising ACC 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	844	858	673
PBILDT Margin (%)	22.04	12.98	15.30
Overall Gearing (times)	2.72	3.79	2.27
Total Outstanding Liabilities/Tangible Net worth (times)	4.83	6.71	3.80
Interest Coverage (times)	4.09	2.51	2.54
Current Ratio (times)	1.13	0.98	0.99
Total Debt/Gross Cash Accruals (times)	4.24	8.36	7.61

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	71.07	CARE-NP BB- [Double B Minus]
Short Term Bank Facilities	Fund Based Limits	280.00	CARE-NP A4 [A Four]
Long Term/ Short Term Bank Facilities	Non Fund Based Limits	3,148.93	CARE-NP BB-/ A4 [Double B Minus/ A Four]
<b>Total</b>		<b>3,500.00</b>	

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### About CARE Ratings Nepal Limited:

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