

## Renu Construction Company Private Limited

### Ratings

Facilities	Amount (Rs. in Million)	Ratings <sup>1</sup>	Rating Action
Long Term Bank Facilities	<b>12.20</b> (Decreased from 159.00)	<b>CARE-NP BB-</b> [Double B Minus]	<b>Revised from</b> <b>CARE-NP BB</b>
Short Term Bank Facilities	<b>887.80</b> (Increased from 641.00)	<b>CARE-NP A4</b> [A Four]	<b>Reaffirmed</b>
<b>Total Facilities</b>	<b>900.00</b> (Nine Hundred Million Only)		

*Details of instruments/facilities in Annexure 1*

CARE Ratings Nepal Limited (CRNL) has revised the rating assigned to the long term bank facilities of Renu Construction Company Private Limited (RCCPL) to 'CARE-NP BB-' from 'CARE-NP BB'. CRNL has reaffirmed the rating of 'CARE-NP A4' assigned to the short term bank facilities RCCPL.

### Detailed Rationale & Key Rating Drivers

The revision in rating assigned to the bank facilities of RCCPL takes into account the deterioration in its overall financial risk profile during FY22 (Audited; FY refers to the twelve-month period ending mid-July) with leveraged capital structure and elongated operating cycle marked by high inventory period and average collection period at the end of FY22. The ratings also factor in the tender based nature of operations in highly competitive construction industry, absence of escalation clause in the contracts, 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 the experienced promoters and moderate track record of operations of company. The ratings also factor in low counter party risk over the medium-term.

*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 will be key rating sensitivities.*

### Detailed Description of the Key Rating Drivers

#### Key Rating Weaknesses

#### Weak financial performance in FY22

RCCPL's Total Operating Income (TOI) declined ~74% year-on-year to Rs. 103 Mn during FY22 amid lower projects executed by the company during FY22 with slowdown in construction activities in the country mainly owing to lower government capital expenditures. Similarly, profitability margins of the company had declined in FY22 with decline in PBILDT margin by 221 bps to 8.53% in FY22 and net losses in FY22. Consequently, company had cash losses during FY22. In 9MFY23 (Provisional; refers to the nine-month period ending mid-April), the company reported total operating income of Rs. 126 Mn.

Capital structure of RCCPL stood leveraged with overall gearing ratio (excluding mobilization advance) of 2.18x as on mid-July 2022, deteriorating from 1.18x as on mid-July 2021. Overall gearing ratio (including mobilization advance) stood at 2.50x as on mid-July 2022, deteriorated from 1.55x as on mid-July 2021. Gearing levels deteriorated at the end of FY22 amid decline in tangible net worth of the company, which was on account of cumulation of losses to the reserves of the company at the end of FY22. Interest coverage ratio stood stressed at below unity for FY22 (FY21: 2.38x); also, total debt to GCA stood negative at the end of FY22 (FY21: 11.43x) on account of negative cash accruals during FY22.

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

Furthermore, Total Outside Liabilities (TOL)/ TNW of the company also stood high at 3.32x at the end of FY22, deteriorated from 2.33x at the end of FY21 amid decline in increased net worth base at the end of FY22.

### **Elongated operating cycle**

The operations of the company are working capital intensive in nature marked by high inventory holding and debtors at the end of FY22. Average inventory holding period elongated to 337 days at the end of FY22 from 70 days at the end of FY21 mainly attributable to bulk purchases by the company at the end of FY22. The funds are released only after the work certification process is completed and finalization of the bill is done. Lengthy certification processes normally lead to high work in progress and inventory levels. Furthermore, retention deposit is deducted by the clients from running bills which gets refunded to the contractor after some period, usually twelve months, on successful execution of the contracted work. Consequently, average collection period of RCCPL elongated to 204 days in FY22 from 39 days in FY21. 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 with some instances of delays in servicing of debt obligations.

### **Concentrated portfolio of orders with absence of escalation clause in contracts**

The company has unexecuted order book of Rs. 902 Mn, which is 8.71x of the income from contract of FY22 as on May 31, 2023, providing moderate revenue visibility. RCCPL's order book position is entirely concentrated towards rural electrification works of Nepal Electricity Authority (NEA) and Government municipalities. Also, the company's long-term business growth prospect remains limited by its modest scale of operations and presence in a niche segment. The ability of the company to scale up to larger-sized contracts is constrained by its comparatively modest scale of operations which limits the pricing power and benefits of economies of scale of the company.

RCCPL procures its construction materials mainly from local vendors. As the company doesn't have price escalation clauses in most of its contracts which could insulate the company from any adverse fluctuation in construction material prices and labour expenses, it is vulnerable to any raw material/labour cost hikes which can adversely impact its profitability margins. Timely completion of the projects while increasing scale of operations and maintaining a stable profitability margin would be critical from credit perspective.

### **Tender based nature of operations in highly competitive construction industry and exposure to Government regulations**

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

Sustained requirement for short-term working capital borrowings results in a high interest expense for RCCPL. RCCPL had Rs. 24 Mn as finance cost in FY22, which increased from Rs. 18 Mn in FY21, thus squeezing its net profitability. RCCPL'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. Thus, funding taken by the company is exposed to volatile interest rates.

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

Given the nature of projects awarded, RCCPL 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**

RCCPL has two directors in its Board of Directors chaired by Mr. Pramod Kumar Mahaseth, who has been leading the company since its inception in 2014. Mr. Mahaseth has experience of more than two decades in the rural electrification contract business which bodes well for the overall business prospects of the company in an increasingly competitive industry. Ms. Renu Kumari Shah, Director, has an experience of more than eight years in rural electrification contracts. Furthermore, the board is supported by an experienced team across various functions. The company has moderate track record of operations of around nine years in rural electrification projects.

#### **Low counter party risk**

Revenue of RCCPL is generated majorly via rural electrification contracts from Nepal Electricity Authority (NEA) and Government municipalities. The order book is majorly concentrated towards rural electrification projects from NEA. Counter party risk remains low given the projects are from NEA and government municipalities, 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 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**

Renu Construction Company Private Limited (RCCPL) is Class "D" Construction Company of Nepal, incorporated in the year 2014, with registered office based in Siraha, Nepal. The company is involved in rural electrification projects of Nepal

Electricity Authority (NEA) and Government municipalities. In addition to doing projects independently, RCCPL also enters into Joint Ventures (JV) with other companies in order to meet the eligibility criteria for different construction projects.

## Financial Performance

(Rs. Million)

For the Period	FY20 (A)	FY21 (A)	FY22 (A)
Income from Operations	292	391	104
PBILDT Margin (%)	12.04	10.74	8.53
Overall Gearing (times)	1.93	1.55	2.50
Total Outstanding Liabilities/Tangible Net worth (times)	2.64	2.33	3.32
Interest Coverage (times)	2.04	2.38	0.37
Current Ratio (times)	2.52	1.76	1.55
Total Debt/Gross Cash Accruals (times)	16.68	11.32	Negative

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	12.20	CARE-NP BB- [Double B Minus]
Short Term Bank Facilities	Fund Based Limits	242.02	CARE-NP A4 [A Four]
Short Term Bank Facilities	Non Fund Based Limits	645.78	CARE-NP A4 [A Four]
<b>Total</b>		<b>900.00</b>	

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