

Sapana Nirman Sewa Private Limited

Ratings

Facilities	Amount (Rs. in Million)	Ratings ¹	Rating Action
Long Term Bank Facilities	30.00	CARE-NP BB [Double B]	Reaffirmed
Short Term Bank Facilities	1,758.08	CARE-NP A4 [A Four]	Reaffirmed
Total Facilities	1,788.08 (One Thousand Seven Hundred Eighty Eight Million and Eighty Thousand Only)		

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' assigned to the short term bank facilities of Sapana Nirman Sewa Private Limited (SNS).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of SNS continue to be constrained by its concentrated, albeit moderate order book position, working capital intensive nature of business marked by elongated inventory holding at the end of FY22 (Audited; FY refers to the twelve-month period ending mid-July). The ratings also factor in the tender based nature of operations in highly competitive construction industry, risk of delay in project execution, particularly amid the ongoing slowdown in infrastructure spending by the government.

The ratings, however, derive strength from the established track record of operations of company along with experienced promoters. The ratings also take cognizance of steady operational performance of the company in FY22 along with moderate capital structure. 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, profitably scale up the operations of the company leading to sustained revenue growth while maintaining profitability margins while improving its overall financial risk profile will be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Concentrated; albeit moderate order book position

The company has unexecuted order book of Rs. 1,970 Mn, which is 5.35x of the income from contract of FY22 as on April 30, 2023 providing mid-term revenue visibility. The company's order book position, however, remains concentrated towards road and bridge projects mainly from various government departments including provincial and local bodies. Furthermore, of the total outstanding orders, 3 projects account for around 57% of the total order book position. Concentration over few segments and projects could expose the company towards revenue concentration risk. 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. The 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.

Working capital intensive nature of business marked by elongated inventory holding

The operations of the company are working capital intensive in nature marked by high inventory holding at the end of FY22. Average inventory holding period of SNS was around 158 days in FY22; albeit decreased from 188 days in FY21

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

which majorly include construction materials such as cement and rods. High inventory period of the company is majorly due to piling up of construction materials as the company has to maintain inventory at various sites for smooth execution of project works. Furthermore, average payable days of the company are also high in past three years (FY20-FY22) which are indicative of company funding its working capital requirements by stretching its creditors and is reflective of a stretched liquidity position of the company.

Tender based nature of operations in highly competitive construction industry

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

The company'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. Thus, funding taken by the company from BFIs is exposed to volatile interest rate.

Risk of delay in project execution

Given the nature of projects awarded, SNS 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's 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 record of operations

SNS has three directors in its Board of Directors led by Mr. Hari Prasad Dhakal, Managing Director, who has been leading the company since its inception in July 1984. Mr. Dhakal has experience of more than three 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 execution of projects undertaken by the company. Mr. Bisharjan Bartaula and Mr. Keshav Kumar Gautam, 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 three decades in the construction of various infrastructure projects all over Nepal.

Steady financial performance in FY22

SNS's TOI grew ~8% year-on-year to Rs. 378 Mn during FY22 boosted by completion of projects in hand which were in the final stage of completion. 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 improved by 103 bps to 20.93% in FY22. Consequently, PAT margin of SNS increased by 7 bps to 2.57% in FY22. However, Gross Cash Accruals (GCA) of the company declined by around 9% to Rs. 37 Mn in FY22.

Capital structure of SNS stood moderate with overall gearing ratio (excluding mobilization advance) of 2.47x as on mid-July 2022, improved from 2.63x as on mid-July 2021. Overall gearing ratio (including mobilization advance) stood at 3.04x as on mid-July 2022, improved from 3.28x as on mid-July 2021. Gearing levels have improved at the end of FY22 supported by increased net worth base, which was on account of accretion of profits to the reserves of the company at the end of FY22. Interest coverage ratio stood moderate at around 2.10 times in FY22 (FY21: 2.10x); however, total debt to GCA stood high at 8.78x at the end of FY22 (FY21: 7.85x) on account of decline in GCA during FY22. Furthermore, Total Outside Liabilities (TOL)/ TNW of the company also stood high at 3.93x at the end of FY22, although improving from 4.18x at the end of FY21 aided by increased net worth base at the end of FY22.

Moderate counter party risk and escalation clause in majority of contracts

Revenue of SNS is generated majorly via contracts from government departments. The order book is primarily concentrated towards road and bridge projects from government departments. Counter party risk remains moderate over the long term 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 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-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 SNS, remains challenging and will remain a key monitorable aspect.

About the Company

Sapana Nirman Sewa Private Limited (SNS) is a Class "A" construction company in Nepal, incorporated on July 18, 1984 with registered office in Hetauda, Nepal. The company is mainly involved in various type of construction projects which includes road works, bridge works, irrigation works and river training works. In addition to doing projects independently, SNS also enters into Joint Ventures (JVs) 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	213	350	378
PBILDT Margin (%)	31.19	19.90	20.93
Overall Gearing (times)	7.21	3.28	3.04
Total Outstanding Liabilities/Tangible Net worth (times)	7.92	4.18	3.93

For the Period	FY20 (A)	FY21 (A)	FY22 (A)
Interest Coverage (times)	1.76	2.10	2.10
Current Ratio (times)	2.12	1.80	1.52
Total Debt/Gross Cash Accruals (times)	9.82	7.85	8.78

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	30.00	CARE-NP BB [Double B]
Short Term Bank Facilities	Fund Based Limits	274.00	CARE-NP A4 [A Four]
Long Term/ Short Term Bank Facilities	Non Fund Based Limits	1,484.08	CARE-NP BB/ A4 [Double B/ A Four]
Total		1,788.08	

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About CARE Ratings Nepal Limited:

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