

Om Sai Ram Construction Private Limited

Ratings

Facilities	Amount (Rs. in Million)	Ratings ¹	Rating Action
Long Term Bank Facilities	195.00 (Increased from 162.90)	CARE-NP BB [Double B]	Reaffirmed
Short Term Bank Facilities	195.00 (Increased from 5.00)	CARE-NP A4 [A Four]	Reaffirmed
Long Term/ Short Term Bank Facilities	3,150.00 (Increased from 1,832.10)	CARE-NP BB/ A4 [Double B/ A Four]	Reaffirmed
Total Facilities	3,540.00 (Three Thousand and Five Hundred Forty Million 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 Om Sai Ram Construction Private Limited (OSRC).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of OSRC continue to be constrained by its below average financial risk profile marked by leveraged capital structure and decline in profitability margins leading to moderation in debt coverage indicators during FY22 (Audited; refers to the twelve-month period ending mid-July). The ratings continue to factor in working capital intensive nature of business, tender based nature of operations in highly competitive construction industry, exposure to volatile interest rates, government regulations and risk of delay in project execution, particularly amid the ongoing slowdown in infrastructure spending by the government.

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

Declining trend in profitability leading to moderation in financial profile in FY22

During FY22, OSRC's Total Operating Income (TOI) grew by ~11% y-o-y to Rs. 568 Mn primarily on account of timely execution of the projects in hand. However, the operating income of the company is still lower than the revenue booked by the company during pre-covid period. 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. The PBILDT margin of the company has remained highly volatile and fluctuated between 13%-23% during the last 4 financial years (FY19-FY22). PBILDT margin declined to 15.73% in FY22 from 19.07% in FY21 amid increased input prices and increased execution of low margin projects. Consequently, PAT of OSRC declined to Rs. 4 Mn in FY22 from Rs. 18 Mn in FY21.

Furthermore, capital structure of OSRC stood moderately leveraged with overall gearing ratio (including mobilization advance) of 2.32x as on mid-July 2022, which increased from 2.00 as on mid-July 2021 on account of increase in working capital loans and mobilization advances related to its new projects bagged by company during FY22. Total debt of the company, which mainly comprises of term loans, mobilization advance & working capital borrowings, increased to Rs. 380 Mn in FY22 from Rs. 319 Mn in FY21 on account of increased working capital borrowings for funding working capital needs

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

of the company. Also, total outside liability to total net worth and total debt to gross cash accruals remained relatively high at 4.80x and 5.27x respectively as on mid-July 2022 (4.79x and 4.43x, respectively, as on mid-July 2021). Furthermore, the interest coverage was moderate at 2.41x in FY22, which decreased from 4.06x in FY21 owing to decreased PBILDT and increased interest expenses due to increased bank borrowings during the year.

Working capital intensive nature of business

The operations of the company are working capital intensive in nature marked by high inventory holding period and moderate collection period. OSRC's inventory holding period was around 120 days in FY22 compared to 93 days in FY21 with major inventory being construction materials such as cement and rods coupled with high inventory of finished goods during year end. Furthermore, funds are released only after the work certification process is completed and finalization of the bill is done. However, average collection period of the company improved to 31 days in FY22 (FY21: 69 days) due to better realizations. These factors lead to increased reliance of the company on borrowings to meet its working capital requirements.

Tender based nature of operations in highly competitive construction industry

Majority of OSRC's projects are tender-based government contracts wherein the company has to quote a bid. With multiple players active in the industry, OSRC'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 OSRC. OSRC had Rs. 37 Mn as finance cost in FY22, which increased from Rs. 24 Mn in FY21, thus squeezing its net profitability. OSRC'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, OSRC 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 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

OSRC is promoted by Mr. Bijay Kumar Shah, Managing Director, who has been leading the company since its inception from February 2010. Mr. Shah 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 execution of projects undertaken by the company. Furthermore, the board is supported by an experienced team across various functions. The company has moderate track record of operations of more than a decade in the construction of various infrastructure projects all over Nepal.

Moderate order book position

As on June 30, 2023, the unexecuted orders in hand of the company stood at Rs. 1,361 Mn, which is 2.41x of the income from contract of FY22, providing mid-term revenue visibility. The company's order book position remains in distribution towards road projects (~58% of total order book) and other segments majorly being building and bridge projects mostly from government departments/ bodies. Timely completion of the projects, including OSRC'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 the contracts

Revenue of OSRC is majorly generated via contracts from government departments. The order book is primarily concentrated towards building and 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 on increased price burden to the customers in a timely manner is critical for maintaining a stable profitability profile.

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 OSRC, remains challenging and will remain a key monitorable aspect.

About the Company

OSRC, incorporated on February 24, 2010, is a Class-A construction company of Nepal with registered office based in Satdobato, Lalitpur, 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 different part of Nepal. In addition to doing projects independently, OSRC also enters into Joint Ventures (JVs) with other companies in order to meet the eligibility criteria for construction projects.

Financial Performance

(Rs. Million)

For the Period Ended / as at Mid-July,	FY20 (A)	FY21 (A)	FY22 (A)
Income from Operations	339	513	568
PBILDT Margin (%)	23.39	19.07	15.73
Overall Gearing (times)	1.96	2.00	2.32
Interest Coverage (times)	4.35	4.06	2.41
Current Ratio (times)	0.70	0.79	0.77
Total Debt/ Gross Cash Accruals (times)	2.81	4.43	5.27

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	195.00	CARE-NP BB [Double B]
Short Term Bank Facilities	Fund Based Limits	195.00	CARE-NP A4 [A Four]
Long Term/ Short Term Bank Facilities	Non-Fund Based Limits	3,150.00	CARE-NP BB/ A4 [Double B/ A Four]
Total		3,540.00	

Contact Us

Analyst Contact

Ms. Monika Rawal

+977-01-4012630

monika.rawal@careratingsnepal.com

Mr. Santosh Pudasaini

+977-01-4012628

pudasaini.santosh@careratingsnepal.com

Relationship Contact

Mr. Achin Nirwani

+977-9818832909

achin.nirwani@careratingsnepal.com

About CARE Ratings Nepal Limited:

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