

Sakcham Nirman Company Private Limited

Ratings

Facilities	Amount (Rs. Million)	Ratings ¹	Rating Action
Long Term Bank Facilities	69.97	CARE-NP BB- [Double B Minus]	Reaffirmed
Short Term Bank Facilities	290.00	CARE-NP A4 [A Four]	Reaffirmed
Long Term/ Short Term Bank Facilities	1,740.03	CARE-NP BB-/A4 [Double B Minus/A Four]	Reaffirmed
Total Bank Facilities	2,100.00 (Two Billion and One Hundred Million Only)		

**Details of Facilities in Annexure-1.*

CARE Ratings Nepal Limited (CRNL) has reaffirmed rating of 'CARE-NP BB-' assigned to the long-term bank facilities and 'CARE-NP A4' assigned to the short-term bank facilities of Sakcham Nirman Company Private Limited (SNCPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of SNCPL are constrained by below average financial profile marked by fluctuating income & profitability and leveraged capital structure owing to the elongated operating cycle. The ratings are also constrained by working capital intensive nature of the business, tender based nature of operations in highly competitive nature of industry and exposure to volatile interest rate.

The ratings, however, derive strength from experienced promoters in the related construction field, moderate order book position and moderate counter party risk.

Going forward, the ability of the company to improve its order book position, successfully execute the projects in time and recover contract proceeds as well as manage its growth in revenue while improving its profitability margins will be crucial and act as the key sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Fluctuating income and profitability profile

The total operating income (TOI) of the company has been fluctuating over last three financial years (FY20-FY22). After growing to Rs. 591 Mn in FY21 from Rs. 216 Mn in FY20, the company's TOI declined again in FY22 to Rs. 402 Mn. The decline in the revenue during FY22 was mainly on account of lower execution of projects at hand. Despite lower TOI, PBILDT margin has improved from ~17.24% in FY21 to ~23.60% in FY22 owing to the favourable execution mix. 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. However, PBILDT margin of the company has also remained highly volatile and fluctuated between 10%-28% during the last 4 financial years (FY19-FY22). The company reported net profit of Rs. 4 Mn in FY22 (FY21: Rs. 15 Mn).

Furthermore, due to its relatively short track record of around five years, the ability of the company to scale up to larger-sized contracts having better operating margins will only grow with accumulated experience and track record. SNCPL's

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

ability to successfully bid for larger construction contracts, improve its order book position and stabilize its revenue and profitability profile will remain key from analytical perspective.

Leveraged capital structure

The capital structure of the company remains leveraged marked by overall gearing ratio of 3.02x at the end of FY22 (FY21: 4.87x respectively). The year-on-year improvement in gearing levels at the end of FY22 was aided by infusion of additional fund of ~Rs. 51 Mn by the promoters which led to increase in the net-worth of the company. Consequently, TOL/TNW ratio of SNCPL improved from 8.28x in FY21 to 4.22x in FY22. However, capital structure still remains relatively leveraged amid comparatively higher dependence on bank borrowings for meeting working capital needs. Working capital borrowings increased to Rs. 289 Mn at the end of FY22 from Rs. 247 Mn previous fiscal amid stretching operating cycle. Debt service indicators like interest coverage ratio and total debt to GCA deteriorated on a y-o-y basis in FY22.

Working capital intensive nature of business

The operations of the company are working capital intensive in nature marked by high inventory holding period and increasing collection period. The collection period of SNCPL was ~235 days in FY22 (FY21: ~215 days). As the company is new entrant in the construction sector, it has entered into sub-contracting work with liberal payment terms. Due to delay in payment realization, the company has high liabilities towards its creditors, resulting into creditors' payment days of ~241 days in FY22 (FY21: ~150 days). The average inventory holding period also stood high at ~198 days in FY22 (FY21: ~6 days) with major inventory being construction materials such as cement and rods coupled with high work-in-progress inventory. All the above factors contributed to elongated total operating cycle of SNCPL which stood at ~193 days in FY22 (FY21: ~72 days) during the year end. Consequently, these factors lead to reliance of the company on bank finance to meet its working capital requirements. The utilization of working capital loan remains on higher side, normally over 90% of sanctioned limits.

Tender based nature of operations in highly competitive nature of industry

The company majorly undertakes government contracts mainly on sub-contract basis with its JVs, which are awarded through the tender-based system. The tender-based business is characterized by intense competition and the growth of the business depends on its ability to successfully bid for the tenders and emerge as the lowest bidder. The concentration on government contracts also makes the company susceptible to any changes pertaining to government policy in regard to awarding tenders to contractors. 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.

Key Rating Strengths

Experienced promoters in the related fields

SNCPL has total three directors in its board. The company is promoted by Mr. Dambar Bahadur Khadka and his family members holding 100% of total share capital of the company. Mr. Dambar Bahadur Khadka, Chairman, has work experience of over two decades in the construction sector and looks after overall operations of the company. Ms. Pramila Khadka, Director, has work experience of over a decade in construction business. The directors are further supported by experienced management team.

Moderate order book position

As on mid-July 2023, the unexecuted order of the company stood at Rs. 990 Mn which is 2.46x of its income from contracts during FY22. The order book is primarily concentrated towards road works and associated construction activities. Timely completion of the projects, including SNCPL'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

Counter party risk remains moderate given the projects are from government departments, which have been making timely payment to the company in the past. The debtor days are generally high mainly due to huge billing usually done by construction companies in Nepal including SNCPL to government departments at the year-end for completed works. In construction business, work done by the company needs to be verified by the consultants/ engineers beforehand in order to raise the bill to the concerned authority which takes time of around a month. However, lower than budgeted capital expenditure by the government in FY22 and FY23 has led to elongation of the collection period of the company during the period. Swift realization of debtors leading to improved liquidity position will be critical from analytical 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. However, in Budget Announcement for FY24, the government has emphasized spending in infrastructure, energy and industries sector with allocation of budget of Rs. 131,596 Mn. (~8% of total budget) to Ministry of Physical Infrastructure and Transportation and Rs. 87,450 Mn. (~5% of total budget) to Ministry of Energy, Water Resources and Irrigation. The near-term operating environment for construction companies would hinge on the government's ability to spend on capital expenditure as budgeted, which has been on the lower side over FY22-FY23.

About the Company

Sakcham Nirman Company Private Limited (SNCPL), incorporated on October 2, 2018 as a Class-D construction company of Nepal with registered office based in Samakhushi, Kathmandu. The company is involved in construction of roads, bridges, canals, embankment and irrigation works across various parts of Nepal. The company enters into Joint Ventures (JVs) with other companies in order to meet the eligibility criteria for different construction projects for bidding and execution of contracts.

Financial Performance

For the Period Ended / as at Mid-July	(Rs. Million)	
	2021 (12m, A)	2022 (12m, A)
Total Operating Income	591	402
PBILD Margin (%)	17.24	22.60
Overall Gearing Ratio (times)	4.87	3.02
Interest Coverage (times)	2.39	1.95

For the Period Ended / as at Mid-July	2021	2022
	(12m, A)	(12m, A)
Current Ratio (times)	0.91	1.00
Total Debt/ Gross Cash Accruals (times)	6.85	9.23

A: Audited

Annexure 1: Details of the Facilities rated

Nature of the Bank Facilities	Type of Facility	Amount (Rs. Million)	Ratings
Long Term Bank Facilities	Term Loan	69.97	CARE-NP BB-
Short Term Bank Facilities	Fund Based Limits	290.00	CARE-NP A4
Long Term/ Short Term Bank Facilities	Non-Fund Based Limits	1,740.03	CARE-NP BB-/A4
Total Facilities		2,100.00	

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About CARE Ratings Nepal Limited:

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