

Dharma S Nirman Sewa Private Limited

Ratings

Facilities	Amount (Rs. in Million)	Ratings ¹	Rating Action
Long Term/Short Term Bank Facilities	800.00	CARE-NP BB/A4 [Double B/A Four]	Assigned
Total Facilities	800.00 (Eight Hundred Million Only)		

Details of instruments/facilities in Annexure 1

CARE Ratings Nepal Limited (CRNL) has assigned ratings of 'CARE-NP BB/A4' to the long term/short term bank facilities of Dharma S Nirman Sewa Private Limited (DSNSPL).

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of DSNSPL are constrained by its modest order book position with low capital base, tender based nature of operations in the highly competitive construction industry, exposure to volatile interest rate, and risk of delay in project execution.

The ratings, however, derive strengths from experienced promoter and moderate track record of operations. The ratings also factor in growing scale of operations with moderate capital structure, favourable operating cycle and moderate counter party risk along with 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, manage healthy revenue growth and maintain profitability margins without deteriorating its solvency and coverage indicators will be the key rating sensitivities.

Detailed Description of the Key Rating Drivers

Key Rating Weaknesses

Modest and concentrated order book position with limited revenue visibility

As on August 30, 2023, the unexecuted orders at hand of the company stood at Rs. 456 Mn, which is 1.01x of its income from contract of FY23 (Unaudited, FY refers to the twelve-month period ending mid-July), providing short term revenue visibility going forward. Furthermore, the order book is primarily concentrated towards road works (~61%), building projects, and water supply projects by entering into JVs with one of the projects accounting for ~30% of total order book position. Having a concentrated order book on a single project links the company's performance to the same and any delays in execution of one such project can materially impact the company's financial health. Timely completion of the projects would be critical for the business prospects of the company and also has a direct bearing on its margins.

The company's ability to substantially scale up to larger sized contracts having better operating margins is also constrained by its comparatively low paid-up capital of Rs. 10 Mn as on mid-July 2023. Relatively small scale of operations in a competitive industry could limit the pricing power and imposes challenges in achieving economies of scale. Most often, such companies often are unable to capitalize on production efficiencies, and cost savings resulting in higher production costs, lower profit margins, and reduced competitiveness in the industry. Though, the risk is partially mitigated by the fact that the scale of operations is growing steadily on a year-on-year basis over FY21-FY23.

Tender based nature of operations in highly competitive construction industry

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

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

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

DSNSPL's interest expenses 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 firm is exposed to volatile interest rate.

Risk of delay in project execution

Given the nature of projects awarded, DSNSPL 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 promoter and moderate track record of operations

DSNSPL is promoted by Mr. Dharma Lal Tamang, Managing Director, who has been leading the company since its inception in February 2015. Mr. Tamang has an experience of over four decades in the construction sector which bodes well for the overall business prospects of the company in an increasingly competitive industry. He is looking after the execution of projects undertaken by the company. Furthermore, he is supported by an experienced team across various functions. The company has moderate track record of operations of over eight years in the construction of various infrastructure projects all over Nepal.

Growing scale of operations with moderate capital structure

DSNSPL's scale of operations has been growing steadily over FY21-FY23 with its total operating income (TOI) growing at a compounded annual growth rate (CAGR) of 71% during the 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. PBILDT margin and PAT margin of the company improved by 69bps to 6.49% and by 21 bps to 3.16% respectively, during FY23. Similarly, Gross Cash Accruals (GCA) of the company increased by ~24% to Rs. 17 Mn during FY23.

Capital structure of DSNSPL stood moderate with overall gearing ratio (including/excluding mobilization advance) of 0.65x as on mid-July 2023, deteriorating from 0.17x as on mid-July 2022 and a comfortable interest coverage ratio of 4.18x. Furthermore, Total Debt to GCA ratio was moderate at 2.05x in FY23 (FY22:0.51x).

Favourable operating cycle

DSNSPL's inventory holding period was around 14 days in FY23 with major inventory being cement, rods and other construction materials as the company has to maintain inventory at various sites for smooth execution of project works. The company primarily works with government departments and the funds are released only after work certification process is completed and finalization of the bill is done, which according to the management of the company, usually takes around one to two weeks. With an average inventory holding period of 14 days, average collection period of 12 days

and average creditor period of 17 days, the total operating cycle for DSN SPL stood favourable at around 9 days. Consequently, the average utilization of fund-based working capital limits stood moderate at around 60% of sanctioned limits during FY23.

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, as per the Fiscal Policy 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

Dharma S Nirman Sewa Private Limited (DSNSPL) is a class "A" construction company of Nepal incorporated on February 09, 2015 with its registered office in Kavrepalanchok, Nepal. The company is involved in construction of roads, building, water supply works etc. across Nepal. In addition to doing projects independently, DSN SPL 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	FY21 (A)	FY22 (A)	FY23 (UA)
Income from Operations	154	344	450
PBILDT Margin (%)	10.34	5.80	6.49
Overall Gearing (times)	0.45	0.17	0.65
Total Outstanding Liabilities/Tangible Net worth (times)	0.77	1.04	1.34
Interest Coverage (times)	3.47	7.89	4.18
Current Ratio (times)	3.40	1.83	1.67
Total Debt/Gross Cash Accruals (times)	1.45	0.51	2.05

A: Audited, UA: Unaudited

Annexure 1: Details of the Facilities rated

Name of the Bank Facilities	Type of the Facility	Amount (Rs. In Million)	Ratings
Long Term/Short Term Bank Facilities	Fund Based/Non-Fund Based Limits	800.00	CARE-NP BB/A4 [Double B/A Four]
Total Facilities		800.00	

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About CARE Ratings Nepal Limited:

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