

PRESS RELEASE

HIGHTENSION SWITCHGEARS PRIVATE LIMITED

November 2022

Ratings

Instruments/ Facilities	Amount (NPR. Mn)	Ratings	Rating Action
Short Term Bank Facilities	420.00	IRN A4	Assigned
Long Term/Short Term Bank Facilities	1,580.00	IRN BB-/ A4	Assigned
Total	2,000.00		

Details of facilities are in Annexure 1 below

Infomerics Credit Rating Nepal Limited (Infomerics Nepal) has assigned short term rating of IRN A4 (A Four) to the short term bank facilities of NPR 420.00 Mn and IRN BB- (Double B Minus) /A4 (A Four) to the long term/short term bank facilities of NPR 1,580.00 Mn.

Detailed Rationale

The ratings assigned to the bank facilities of Hightension Switchgears Private Limited (HTSG) derive strength from its established track record of operations under experienced promoters and management team in construction sector, moderate counter party risk, moderate financial risk profile and its moderate order book position. These rating strengths, however, are constrained by HTSG's working capital intensive nature of business and existence in a competitive industry with policy cap in number of contracts executed at a time. Further, the ratings also note HTSG's low asset base, sectorial concentration, project execution risks, susceptibility to interest rate volatility and lack of escalation clauses in majority of the contracts. Going forward, ability of the company to increase its project portfolio with successful execution of current projects in hand, recovery of contract proceeds in a timely manner while managing revenue growth, sustenance of profit margins and net worth base will remain key rating sensitivities.

Detailed Description of Key Rating Drivers

Key Rating Strengths

Long track record of operations with experienced promoters and management team

The company has been in operation for more than three decades in the Nepalese construction sector, especially in substation development and power transmission activities. HTSG is led by Mr. Dwarika Shrestha, Chairman, with over three decades of experience in construction activities. Further, the promoters are supported by a team of technically qualified and experienced professionals, leading to a better understanding of the market dynamics and timely execution of projects undertaken by HTSG.

Moderate counterparty risk

The majority of the projects handled by HTSG are for a single government entity, Nepal Electricity Authority (NEA). As on mid-October, 2022 the entire pending order book comprised of contracts with NEA. Thus, the counter party payment risk pertaining to NEA is moderate as it is fully owned by government of Nepal and has been regular in making payments to concerned parties which provides comfort despite relatively high debtor days.

Moderate order book position

HTSG has been awarded additional new contracts in the recent period resulting in a sizable order book position of ~NPR 2.05 billion vis-à-vis operating income of FY22. HTSG's order book position remain comfortable

as of mid-October 2022 with the current value of work in hand ~4x the operating income in FY22. Hence, providing short-term revenue assurance as majority of the work in hand are due in the next 1 to 1.5 years.

Moderate financial risk profile

HTSG's financial profile is marked by relatively stable operating margin as reflected in the EBITDA margin of 9.72% in FY22 vis-à-vis 9.04% in FY21 and 8.25% in FY20. Despite the decline in TOI in FY21 and FY22, the margin has remained largely stable with the decline in the cost of production. The interest coverage ratio remains moderate at 2.51x in FY22 which however has deteriorated from 6.82x in FY21 due to increased working capital requirements leading to higher dependence on bank finance. The tangible net-worth base of the company has been continuously declining given the planned profit extraction in the form of dividend, resulting in more leveraged capital structure marked by higher overall gearing ratio (including mobilization advance) of 2.91x in FY22 vis-à-vis 1.82x in FY21. Nevertheless, with the expectation of improvement in the operating base and overall margins, these indicators are likely to improve over the medium term.

Key Rating Weaknesses

Working capital intensive nature of business

The gross current assets of HTSG were sizable at 311 days as of mid-July 2022. The collection period was high at 254 days and inventory holding period was 57 days as of mid-July 2022. Nonetheless, the mobilization advances received from NEA provides some comfort. Given the nature of business, operations are expected to remain working capital intensive over near to medium term.

Existence in competitive industry with policy cap in number of contracts

The company receives its majority of its works from governmental agencies which are subject to competitive bidding process. Thus, HTSG's ability to obtain new projects while maintaining profit margins remain crucial. Further, the business also remains dependent on stability in Government policies and fiscal policies. Moreover, recent regulation of Government limits contractor to participate in a maximum five contracts at a time. Nevertheless, with the recent Government initiative of prohibiting foreign companies to participate in a contract up to NPR 3,000 Mn (previously NPR 1,000 Mn) remains positive to the domestic contractors. Also, in order to take the contract up to NPR 10,000 Mn, the foreign companies must form a joint venture with a Nepalese company, which is also expected to enhance technical capacity of Nepalese contractors going forward.

Sectorial concentration and project execution risk

HTSG's order book remain highly concentrated towards electric and civil works of substations and transmission lines, exposing HTSG to sectorial concentration risks. Moreover, HTSG's business model has some inherent risks and the company is vulnerable to financial losses arising from delays in project execution. The majority of HTSG's contracts do not include an escalation clause and a significant change in the cost of the items sold could affect the profitability and project execution capabilities of HTSG. The project execution risk is further aggravated due to company's practice of sub-contracting civil and fitting works.

Interest rate and defect liability risk

The Interest rates on deposits and borrowing remains a significant factor in the Nepalese economy. In line with NRB's directives, the BFIs typically charge interest rate on loans by adding a premium to the base rate which are revised on a quarterly basis. The interest rates charged by BFIs have been historically volatile over the past 2-3 years and thus borrowing from banks and financial institutions exposes HTSG to risk of interest rate volatility. Further, HTSG is susceptible to financial losses arising out of defects identified by the client during the defect liability period as per the terms of the construction contracts.

Analytical Approach: Standalone

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Applicable Criteria:

[Corporate Credit Rating Methodology](#)

About the Company:

HTSG was incorporated on August 18, 1988 with its registered office in A. T. Complex, Kathmandu, Nepal. Due to its long track record the company has been successful in establishing itself as a contractor specializing in electric and civil works of substations and transmission lines. The company is promoted by four individual shareholders.

Financial Indicators (Standalone)

For the year ended* As on	FY20	FY21	FY22
	Audited	Audited	Unaudited
Total Operating Income (in NPR Mn.)	1,043	538	507
EBITDA Margin (%)	8.25	9.04	9.72
Interest Coverage Ratio (x)	16.56	6.82	2.51
Current Ratio (x)	3.10	1.78	1.66
Overall Gearing Ratio (x)	0.88	1.82	2.91

* Classification as per Infomerics Nepal standards

Annexure:1 Detail of Facilities:

Name of Instruments/ Facilities	Type of Facilities	Amount (NPR Mn.)	Ratings
Fund Based Bank Facilities-Working Capital (WCL)	Short Term	160.00	IRN A4
Fund Based Bank Facilities-WCL (Proposed)	Short Term	260.00	IRN A4
Non Fund based Bank Facilities- LC/BG ¹	Long Term/ Short Term	1,380.00	IRN BB-/A4
Non Fund based Bank Facilities-LC/BG (Proposed)	Long Term/ Short Term	200.00	IRN BB-/A4
Total Facilities		2,000.00	

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About Infomerics Credit Rating Nepal Limited:

Infomerics Credit Rating Nepal Ltd. is Nepal's third Credit Rating Agency licensed by the Securities Board of Nepal (SEBON) on March, 2022. Infomerics Nepal is a subsidiary of Infomerics Valuation and Rating

¹ Letter of Credit (LC), Bank Guarantee (BG)



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