

## PRESS RELEASE

### D.S. CONSTRUCTION COMPANY PRIVATE LIMITED

May 2023

#### Rating

Facilities	Amount (NPR. Mn)	Rating	Rating Action
Long Term Bank Facilities	175.85	IRN BB-	Assigned
Short Term Bank Facilities	230.00	IRN A4	Assigned
Long Term/Short Term Bank Facilities	2,094.15	IRN BB-/ A4	Assigned
<b>Total</b>	<b>2,500.00</b>		

Details of facilities are in Annexure 1 below

Infomerics Credit Rating Nepal Limited (Infomerics Nepal) has assigned the long term rating of IRN BB- (Double B Minus) to the long term bank facilities of NPR 175.85 Mn, the short term rating of IRN A4 (A Four) to the short term bank facilities of NPR 230.00 Mn and IRN BB- (Double B Minus) /A4 (A Four) to the long term/short term bank facilities of NPR 2,094.15 Mn.

#### Detailed Rationale

The ratings assigned to the bank facilities of D.S. Construction Company Private Limited (DSCPL) derive strength from its experienced promoter and management in construction fields with established track record of operations along with escalation clauses in the major contracts, moderate counter-party risk, average order book position and financial profile. These rating strengths, however, are constrained by DSCPL's existence in a competitive industry with a policy cap in number of contracts executed at a time. Further, the ratings also note DSCPL's exposure to project execution risks due to high project concentration, interest rate volatility risk and defect liability risks. Going forward, the ability of the company to successfully execute current projects in hand, improve profit margins and net worth base while managing revenue growth will remain a key rating sensitivities.

#### Detailed Description of Key Rating Drivers

##### Key Rating Strengths

##### Experienced promoter and established track record of operations

DSCPL is led by Mr. Dhurba Karki, Managing Director, who has been leading the company since its inception in 1984 and has around four decade of experience in the field of construction business. Furthermore, other directors of the company also have relevant experience in the construction sector. Furthermore, the board is aptly supported by an experienced team across various departments.

##### Average order book position with short-term revenue visibility

Till April end 2023, the unexecuted orders in hand of the company stood at ~NPR 940 Mn (including DSCPL's share in JVs). DSCPL's order book position remains adequate as of mid-April 2023, with an unexecuted order in hand of ~2.65 times the operating income in FY22. Furthermore, the order book reflects short-term revenue visibility as majority of the projects are scheduled to be completed within the next one year.

##### Moderate counter party risk with escalation clauses in major contracts

DSCPL's revenue is entirely generated via contracts for various governmental projects. These contracts relate to a range of projects including roads, bridges and buildings. The company's counter party risk remains moderate given the projects are from government departments and agencies, which have been making timely

payments to the company in the past. Further, escalation clauses are included in the majority of the contracts, which protect it against any adverse changes in prices of key construction materials. This is crucial, especially considering the current global inflationary trend. Nevertheless, the coverage provided by the escalation clauses is capped, thus DSCPL still retains a portion of the raw material price volatility risk. From a rating point of view, the company's ability to pass on rising price burdens to customers (employers) promptly while maintaining profit margin remains critical.

## Average financial profile

The financial profile of DSCPL is characterized by improving total operating income (TOI), adequate debt coverage indicators, and moderately leveraged capital structure. The TOI of DSCPL has improved to ~NPR 355 Mn in FY22 vis-à-vis NPR 316 Mn in FY21 and NPR 184 Mn in FY20. The EBITDA margins of DSCPL slightly declined to ~16% in FY22 from ~17% in FY21. Despite decline in the EBITDA margin, its absolute value of DSCPL has slightly improved to ~NPR 56 Mn in FY22 from ~NPR 55 Mn in FY21, with the improvement in the TOI of DSCPL. Moreover, the improvement in DSCPL's tangible net worth along with slight moderation in borrowings has led to improved overall gearing ratio of 1.65x in FY22 vis-à-vis 1.95x in FY21 and 1.82x in FY20. The interest coverage ratio remained adequate at 1.79x in FY22, which however has slightly deteriorated from 1.88x in FY21. The scale of DSCPL has been improving over the years and the company's ability to maintain growth in revenue while improving profitability margins, coverage & capitalization indicator remains a key monitorable.

## Key Rating Weaknesses

### Project execution risk

DSCPL's business model has some inherent risk and the projects are susceptible to delays in procedural approvals, site clearances and other operational issues exposing the company to the risk of delay in project execution leading to delays in realization of revenues. Additionally, DSCPL's significant reliance on road projects, which account for ~98% of its unexecuted orders, poses a significant risk to project execution. Furthermore, given the policy of limiting outstanding government contracts at a time the timely execution of the order in hand is critical.

### Existence in a competitive industry with policy cap in number of contracts

The company receives the majority of its work from governmental agencies which are subject to a competitive bidding process. Further, the business also remains dependent on stability in government policies and fiscal policies. Moreover, recent regulation of Government limits contractors to participate in a maximum of five contracts at a time. Thus, DSCPL's ability to obtain new projects while maintaining profit margins remains crucial. Nevertheless, the recent Government initiative of prohibiting foreign companies to participate in a contract up to NPR 5,000<sup>1</sup> Mn (previously NPR 3,000 Mn) remains positive to the domestic contractors. Further, the foreign companies must form a joint venture with a Nepalese company in order to take the contract up to NPR 10,000 Mn, this is also expected to enhance technical capacity of Nepalese contractors going forward.

### Interest rate and defect liability risk

The Interest rates on deposits and borrowing remain a significant factor in the Nepalese economy. In line with NRB's directives, the BFI<sup>2</sup>s typically charge an interest rate on loans by adding a premium to the base rates which is 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 DSCPL to the risk of

<sup>1</sup> 12<sup>th</sup> amendment to public procurement regulation as published in Nepal gazette on July 04, 2022

<sup>2</sup> Bank and Financial Institutions

interest rate volatility. Further, DSCPL 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:** Consolidated

**Applicable Criteria:**

[Corporate Credit Rating Methodology](#)

**About the Company:**

D.S. Construction Company Private Limited (DSCPL) is a Class “A” construction company of Nepal which was incorporated on August 31, 1984. The registered office of the company is located at Hetauda-11, Makwanpur. In addition to working on projects individually, DSCPL also forms joint ventures (JVs) in order to meet the requirements for participating in various construction projects.

**Financial Indicators (Consolidated)**

For the year ended* As on	FY20	FY21	FY22
	Audited	Audited	Audited
Total Operating Income (in NPR Mn.)	184	316	355
EBITDA Margin (%)	Neg	17.33	15.88
Interest Coverage Ratio (x)	NM	1.88	1.79
Current Ratio (x)	1.34	1.14	1.12
Overall Gearing Ratio (x)	1.82	1.95	1.65

*Earnings before Interest Tax Depreciation Amortization (EBITDA)*

\*Classification as per Infomerics Nepal standards

**Annexure:1 Detail of Facilities:**

Name of Instruments/ Facilities	Type of Facilities	Amount (NPR Mn.)	Rating
Fund Based Bank Facilities-Term Loan	Long Term	175.85	IRN BB-
Fund Based Bank Facilities-Working Capital (WCL)	Short Term	230.00	IRN A4
Non Fund based Bank Facilities- LC/BG <sup>3</sup>	Long Term/ Short Term	2,094.15	IRN BB-/ A4
<b>Total Facilities</b>		<b>2,500.00</b>	

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<sup>3</sup> Letter of Credit (LC), Bank Guarantee (BG)

**About Infomerics Credit Rating Nepal Limited:**

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