

PRESS RELEASE

SHAH ENGINEERING CONSTRUCTION PRIVATE LIMITED

April 2023

Ratings

Instruments/ Facilities	Amount (NPR. Mn)	Ratings	Rating Action
Long Term Bank Facilities	175.00	IRN B+	Assigned
Short Term Bank Facilities	135.00	IRN A4	Assigned
Long Term/Short Term Bank Facilities	1,850.00	IRN B+ / A4	Assigned
Total	2,160.00		

Details of facilities are in Annexure 1 below

Infomerics Credit Rating Nepal Limited (Infomerics Nepal) has assigned the long term rating of IRN B+ (Single B Plus) to the long term bank facilities of NPR 175.00 Mn, the short term rating of IRN A4 (A Four) to the short term bank facilities of NPR 135.00 Mn and IRN B+ (Single B Plus) /A4 (A Four) to the long term/short term bank facilities of NPR 1,850.00 Mn.

Detailed Rationale

The ratings assigned to the bank facilities of Shah Engineering Construction Private Limited (SECPL) derive strength from its experienced promoters 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 SECPL existence in a competitive industry with a policy cap in number of contracts executed at a time. Further, the ratings also note SECPL's exposure to project execution risks, interest rate volatility risk and defect liability risks. Going forward, the ability of the company to successfully execute current projects in hand while managing revenue growth, maintaining profit margins and improving net worth base will remain a key rating sensitivities.

Detailed Description of Key Rating Drivers

Key Rating Strengths

Experienced promoters and established track record of operations

SECPL is led by Mr. Sanjiv Kumar Shah, Chairman, who has been leading the company since its inception in 2001 and has more than two decades of experience in the field of the construction business. Similarly, the other directors also have relevant experience in the construction contract business. Furthermore, the board is supported by an experienced team across various departments.

Average order book position with short-term revenue visibility

Till mid-April 2023, the unexecuted orders in hand of the company stood at ~NPR 1,249 Mn (including SECPL's share in JVs). SECPL's order book position remains satisfactory as of mid-April 2023, with an unexecuted order in hand of ~5 times the operating income in FY22. Furthermore, the order book reflects short-term revenue visibility as majority of the projects are in scheduled to be completed within the next year.

Moderate counter party risk with escalation clauses in major contracts

SECPL's revenue is entirely generated via contracts for various governmental projects. These contracts relate to a range of projects including roads, bridges and buildings for which SECPL operates as a contractor as well as a sub-contractor. 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 SECPL 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, albeit on a low scale

The financial profile of SECPL is characterized by improving Total Operating Income (TOI), moderately leveraged gearing ratios, adequate debt coverage indicators, and adequate profitability margins. The EBITDA margins of SECPL was ~14% in FY22 vis-à-vis ~16% in FY21 and ~15% in FY20. Despite decline in the EBITDA margin, its absolute value has improved with the improvement in the TOI of SECPL. The TOI of SECPL has improved by NPR 261 Mn in FY22 from NPR 205 Mn in FY21 and NPR 217 Mn in FY20. The overall gearing ratio of SECPL remains adequate at 3.22x in FY22, although it has deteriorated from 2.82x in FY21 due to increased reliance on external financing (including mobilization advances) despite a slight improvement in the company's tangible net worth base. Additionally, the interest coverage ratio also remained comfortable at 3.71x in FY22 which however was deteriorated from 4.40x in FY21. The scale of SECPL remains modest and the TOI of the company has remained volatile in the past, going forward the ability of SECPL to scale up its operation while improving its financial profile will remain crucial.

Key Rating Weaknesses

Project execution risk

SECPL 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, SECPL's significant reliance on road projects, which account for ~90% of its unexecuted orders, poses a significant risk to project execution. The majority of these road projects are concentrated in Madhesh province, further aggravating the potential for execution risk. 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, SECPL'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 5,000¹ 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 BFI²s 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 SECPL to the risk of

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

² Bank and Financial Institutions

interest rate volatility. Further, SECPL 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

Applicable Criteria:

[Corporate Credit Rating Methodology](#)

About the Company:

Shah Engineering Construction Private Limited (SECPL) is a Class “A” construction company of Nepal which was incorporated on November 12, 2019. The registered office of the company is located at Sambhunath 06, Saptari. The company is involved in construction of roads, buildings, bridges etc. In addition to working on projects individually, SECPL also forms joint ventures (JVs) in order to meet the requirements for participating in various construction projects.

Financial Indicators (Standalone)

For the year ended* As on	FY20	FY21	FY22
	Audited	Audited	Audited
Total Operating Income (in NPR Mn.)	217	205	261
EBITDA Margin (%)	14.56	16.49	14.06
Interest Coverage Ratio (x)	7.01	4.40	3.71
Current Ratio (x)	1.11	1.15	1.68
Overall Gearing Ratio (x)	2.12	2.82	3.22

* 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-Term Loan	Long Term	175.00	IRN B+
Fund Based Bank Facilities-Working Capital (WCL)	Short Term	135.00	IRN A4
Non Fund based Bank Facilities- LC/BG ³	Long Term/ Short Term	1,850.00	IRN B+/ A4
Total Facilities		2,160.00	

Analyst Contacts

Ms. Grishma Dhungana

Tel No.+977-1-4483304/4485906

grishma.dhungana@infomericsnepal.com

Mr. Dipesh Pote Shrestha

Tel No.+977-1-4483304/4485906

dipesh.shrestha@infomericsnepal.com

Relationship Contact

Mr. Rabin Pudasaini

Tel No.+977-1-4483304/4485906

rabin.pudasaini@infomericsnepal.com

³ Letter of Credit (LC), Bank Guarantee (BG)

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 Private Limited (Infomerics India) which is a SEBI registered and RBI accredited Credit Rating Agency licensed in 2015. Infomerics Nepal aims to provide investors with objective analysis and evaluation of credit worthiness of Banks, NBFCs, Large Corporates and Small and Medium Scale Units (SMUS) via its rating and grading services. Thus, it is playing a key role in serving the financial markets by reducing the information asymmetry among varied lenders and investors and facilitating borrowers/issuers to various fundraising opportunities/avenues. Infomerics observes and maintains ethical standards in its activities. For more information, visit <https://infomericsnepal.com/>

Infomerics Credit Rating Nepal Limited

Tanka Prasad Marga, Baneshwor Height, Kathmandu

Phone: +977-1-4483304/4485906

Email: info@infomericsnepal.com

Web: www.infomericsnepal.com

Disclaimer: Ratings assigned by Infomerics Nepal are an opinion on the credit risk of the issue / issuer and not a recommendation to buy, hold or sell securities. Infomerics Nepal reserves the right to change, suspend or withdraw the credit ratings at any point in time. Ratings assigned by Infomerics Nepal are opinions on financial statements based on information provided by the management and information obtained from sources believed by it to be accurate and reliable. The credit quality ratings are not recommendations to sanction, renew, disburse or recall the concerned bank facilities or to buy, sell or hold any security. We, however, do not guarantee the accuracy, adequacy or completeness of any information, which we accepted and presumed to be free from misstatement, whether due to error or fraud. We are not responsible for any errors or omissions or for the results obtained from the use of such information. Most entities whose bank facilities/instruments are rated by us have paid a credit rating fee, based on the amount and type of bank facilities/instruments. In case of partnership/proprietary concerns/Association of Persons (AOPs), the rating assigned by Infomerics Nepal is based on the capital deployed by the partners/proprietor/ AOPs and the financial strength of the firm at present. The rating may undergo change in case of withdrawal of capital or the unsecured loans brought in by the partners/proprietor/ AOPs in addition to the financial performance and other relevant factors

Nepal