

PRESS RELEASE

SHUBHA CONSTRUCTION PRIVATE LIMITED

July 2023

Rating

Facilities	Amount (NPR. Mn)	Rating	Rating Action
Long Term Bank Facilities	0.62	IRN B+	Assigned
Short Term Bank Facilities	21.00	IRN A4	Assigned
Long Term/Short Term Bank Facilities	778.38	IRN B+ / A4	Assigned
Total	800.00		

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 0.62 Mn, the short term rating of IRN A4 (A Four) to the short term bank facilities of NPR 21.00 Mn and IRN B+ (Single B Plus) /A4 (A Four) to the long term/short term bank facilities of NPR 778.38 Mn.

Detailed Rationale

The ratings assigned to the bank facilities of Shubha Construction Private Limited (SCPL) 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 SCPL's existence in a competitive industry with a policy cap in number of contracts executed at a time. Further, the ratings also note SCPL'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 key rating sensitivities.

Detailed Description of Key Rating Drivers

Key Rating Strengths

Established track record of operations with experienced promoters

SCPL has an established track record of more than three decades and currently operates as a Class "A" construction company of Nepal. The company is led by Mr. Santosh Kaji Shrestha, Chairman, who has more than a decade of experience in the construction sector. Similarly, the other directors of the company also have relevant experience in management and construction business. Furthermore, the board is aptly supported by an experienced team across various departments.

Average order book position with mid-term revenue visibility

As of mid-June 2023, the unexecuted orders in hand of the company stood at ~NPR 355 Mn (including Shubha's share in JVs). SCPL's order book position remains adequate as of mid-June 2023, with an unexecuted order in hand of ~2 times the operating income in FY22. Furthermore, the order book reflects mid-term revenue visibility as all the projects are in scheduled to be completed within the next two years.

Moderate counter party risk with escalation clauses in major contracts

SCPL generates its revenue via contracts from Government of Nepal and its agencies as well as from private employers. 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. However, for projects

involving private parties, the counterparty risk is elevated due to the potential for delayed payments without any recourse. Nevertheless, most contracts include price adjustment clauses that safeguard SCPL against unfavorable changes in construction material prices. This is crucial, especially considering the current global inflationary trend. However, the coverage provided by the escalation clauses is capped, thus SCPL 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 average financial profile of SCPL is marked by moderately leveraged capital structure and adequate debt coverage indicators. The overall gearing ratios of SCPL remains adequate at 0.89x due to high requirement for non-fund based limits rather than fund-based limits, given its tender based nature of operations. Nevertheless, the overall gearing ratio of SCPL has slightly deteriorated from 0.60x in FY21 and 0.67x in FY20. SCPL's interest coverage ratio remains adequate at 2.76x as of mid-July, 2022 which however has deteriorated from 2.92x in FY21 on account of higher cost associated with bank facilities in recent years. SCPL has registered a significant improvement in its operating revenue as reflected by the compounded annual growth rate (CAGR) of ~40% in the last five years ending FY22. Despite the significant growth observed over the past five years, SCPL's revenue profile has remained volatile in the recent years and the company has reported a dip in revenue by ~13% in FY22 to NPR 165 Mn from NPR 190 Mn in FY21. Furthermore, the profitability of SCPL has also remained volatile over the years as reflected by EBITDA Margins of 8.67% in FY22 vis-à-vis 4.62% in FY21 and 7.46% in FY20. The scale of SCPL remains modest and going forward the ability of SCPL to scale up its operation while improving its overall financial profile will remain crucial.

Key Rating Weaknesses

Project execution risk

SCPL's business model has some inherent risks 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. 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, SCPL'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 borrowings 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 monthly basis. The interest rates charged by BFIs have been historically volatile

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

² Bank and Financial Institutions

over the past 2-3 years and thus borrowing from banks and financial institutions exposes SCPL to the risk of interest rate volatility. Further, SCPL 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:

Shubha Construction Private Limited (SCPL) is a Class “A” construction company of Nepal which was incorporated on October 9, 1989. The registered office of the company is located at Nayabazar, Kathmandu. In addition to working on projects individually, SCPL 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.)	85	190	165
EBITDA Margin (%)	11.74	4.62	8.67
Interest Coverage Ratio (x)	7.88	2.92	2.76
Current Ratio (x)	1.27	2.26	3.15
Overall Gearing Ratio (x)	0.67	0.60	0.89

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	0.62	IRN B+
Fund Based Bank Facilities-Working Capital (WCL)	Short Term	11.00	IRN A4
Fund Based Bank Facilities-WCL (Proposed)	Short Term	10.00	IRN A4
Non Fund based Bank Facilities- LC/BG ³	Long Term/ Short Term	701.34	IRN B+/ A4
Non Fund based Bank Facilities- LC/BG (Proposed)	Long Term/ Short Term	77.04	IRN B+/ A4
Total Facilities		800.00	

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

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



Infomerics Credit Rating Nepal Limited

Mr. Rabin Pudasaini

Tel No.+977-1-4483304/4485906

rabin.pudasaini@infomericsnepal.com

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