

PRESS RELEASE

SIMRAN CONSTRUCTION September 2023

Ratings

Facilities	Amount (NPR. Mn)	Ratings	Rating Action
Long Term Bank Facilities	14.98	IRN D	Assigned
Short Term Bank Facilities	20.00	IRN D	Assigned
Long Term/Short Term Bank Facilities	995.02	IRN D	Assigned
Total	1,030.00		

Details of facilities are in Annexure 1 below

Infomerics Credit Rating Nepal Limited (Infomerics Nepal) has assigned the rating of IRN D to the long term bank facilities of NPR 14.98 Mn, short term bank facilities of NPR 20.00 Mn and long term/short term bank facilities of NPR 995.02 Mn.

Detailed Rationale

The ratings assigned to the bank facilities of Simran Construction (Simran) factors in the ongoing mismatch of cash flows resulting in delays in servicing of its debt obligation exceeding the period as outlined in Infomerics Nepal's Default Recognition Policy. Further, Infomerics Nepal also notes Simran Construction's long track record of operations, moderate counter party risk, below-average financial risk profile, small scale of operations, existence in a competitive industry with a policy cap in number of contracts executed at a time, exposure to project execution risks due to absence of escalation clauses, interest rate volatility risk and defect liability risks. Going forward, a track record of timely debt servicing of debt obligations will remain key rating sensitivities.

Detailed Description of Key Rating Drivers

Key Rating Strengths

Long track record of operations

The firm has more than two decades long presence in the Nepalese construction sector. Simran Construction is presently involved in the construction of roads, bridges, buildings along with other construction activities. The firm is led by Mr. Bal Bahadur Rana Magar who has more than two decades of experience in the sector. Further, the operations of the firm are aptly supported by an experienced management team across various departments.

Moderate counter party risk

Simran Construction primarily operates as contractor for governmental projects related to roads, bridges and buildings. Simran Construction's exposure to 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.

Key Rating Weaknesses

Below-Average financial risk profile

The below average financial profile of Simran Construction is evidenced from its weak net worth base as of mid-July 2023 on account of losses incurred in the past few years, along with its volatile revenue profile. The total operating income (TOI) dipped by ~55% in FY22, falling from NPR 48 Mn in FY21 to NPR 22 Mn. While FY23 saw a significant TOI improvement at NPR 93 Mn, there was a substantial drop in the EBITDA

margin, declining from 51% in FY22 and 20% in FY21 to 12% in FY23. This decline is primarily due to the absence of escalation clause in most contracts, exposing the company to inflation risks. Nevertheless, the overall gearing of Simran Construction improved slightly to 0.85x in FY23 vis-à-vis 1.19x in FY22 and 1.09x in FY21, due to the scheduled repayment of long term loans. The interest coverage ratio stood at 2.96x as of mid-July 2023. Furthermore, Simran's scale is relatively modest compared to its peers. Going forward, the firm's ability to scale up its operation while improving its financial risk profile remain crucial.

Small scale of operation

Simran Construction, despite having an operational track record of two decades, continues to operate on a lower scale compared to its peers, limiting its bidding capacity for large projects. As of the end of May 2023, Simran Construction's order book stood at NPR 320 Mn (including Simran's share in JVs), which corresponds to ~3 times of its operating income in the FY23. The firm's relatively small scale of operations and reserve base also makes the company less resilient towards any incremental business/liquidity shocks. Further, Simran Construction's entire portfolio is concentrated in Gandaki Province (Province 4) of the country, giving rise to geographical concentration risk and any changes in the dynamics of the region could affect Simran's financial and operational profiles.

Project execution risk, elevated by lack of escalation clauses in major contracts

Simran Construction's business model carries inherent risks. The projects are susceptible to delays in procedural approvals, site clearances and other operational issues, which exposes the company to the risk of project execution delays, consequently delaying revenue realization. Moreover, the absence of escalation clauses in the majority of contracts heightens the project execution risks, as any significant delays in project execution can lead to increased cost burdens for Simran Construction. Additionally, given the existing 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 a policy cap on 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, Simran'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 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 BFIs 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 Simran Construction to the risk of interest rate volatility. Further, Simran Construction 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:

Simran Construction is a Class “B” construction firm of Nepal which was incorporated on August 2, 2005. The registered office of the firm is located at Pokhara, Kaski and it primarily undertakes projects related to the construction of roads, bridges and buildings. In addition to working on projects individually, Simran 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	FY21	FY22	FY23
	Audited	Audited	Unaudited
Total Operating Income (in NPR Mn.)	48	22	93
EBITDA Margin (%)	19.86	51.34	12.17
Interest Coverage Ratio (x)	3.84	3.24	2.96
Current Ratio (x)	0.53	0.75	0.89
Overall Gearing Ratio (x)	1.09	1.19	0.85

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	14.98	IRN D
Fund Based Bank Facilities-Working Capital (WCL)	Short Term	20.00	IRN D
Non Fund based Bank Facilities- LC/BG ¹	Long Term/ Short Term	925.00	IRN D
Non Fund based Bank Facilities- LC/BG (Proposed)	Long Term/ Short Term	70.02	IRN D
Total Facilities		1,030.00	

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About Infomerics Credit Rating Nepal Limited:

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



Infomerics Credit Rating Nepal Limited

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