

## Pratistha Construction Private Limited: [ICRANP] LB+/A4 (assigned)

June 22, 2020

### Summary of rated instruments:

Instrument	Current Rated Amount (NPR million)	Rating action
Fund-based; long-term limits	39.4	[ICRANP] LB+ assigned
Fund-based; short-term limits	63.0	[ICRANP] A4 assigned
Non-fund based; short-term limits	757.5	[ICRANP] A4 assigned
Fund-based; short-term limits-proposed	84.8	[ICRANP] A4 assigned
Non-fund based; short-term limits-proposed	33.6	[ICRANP] A4 assigned
<b>Total</b>	<b>978.3</b>	

\* Instrument details are provided in [Annexure-1](#)

### Rating action

ICRA Nepal has assigned a long-term rating of [ICRANP] LB+ (pronounced ICRA NP L B plus) to the fund-based long-term limits of NPR 39.4 million of Pratistha Construction Private Limited (Pratistha). ICRA Nepal has also assigned a short-term rating of [ICRANP] A4 (pronounced ICRA NP A four) to the short-term fund-based limits of NPR 147.8 million (including proposed NPR 84.8 million) and short-term non-fund based limits of NPR 791.1 million (including proposed limit of NPR 33.6 million).

### Rationale

The rating remains constrained by Pratistha's small scale of operations and highly leveraged capital structure. The rating also factors in the presence of projects running behind schedule which, coupled with limited updates on execution status of projects handled through JV partner, limits Pratistha's ability to effectively track the probable liability arising from non-execution. Given the thin capitalisation (although proposed to be increased in near future) and limited liquidity cushion, Pratistha's ability to absorb any such shocks remains limited. The rating also remains constrained by the concentration of Pratistha's order book in sports infrastructure-related projects (stadiums and buildings), despite the addition of new projects from other arena<sup>1</sup> in the last 6-12 months. The rating concerns also arise from liquidity challenges faced by Pratistha because of delayed recovery from its customers (mainly Government ministries, departments, and projects) resulting in high receivable days. This has increased the company's reliance on external financing for meeting its working capital requirement. The receivable days could increase further, given the decreased spending capacity of the Government organisations, which could strain the company's liquidity and debt-servicing ability over the near term. The rating also factors in the regulatory risk associated with the construction sector in the country. While the opportunities for the construction contractors are likely to remain healthy, the intense competition in the construction sector and bidding requirement for the public projects, results in an uncertainty on the new order inflows and long-term revenue prospects.

Nonetheless, the assigned ratings consider Pratistha's long track record of in the Nepalese construction sector and its experienced promoters. The ratings also favourably consider the healthy pace of new order inflows in the recent times that has helped Pratistha in maintaining a comfortable order book position with the value of pending contracts equivalent to ~5 times of FY2019 operating income, providing a medium term revenue visibility. The rating also takes comfort from the positive business outlook for contractors, given the Government of Nepal's (GoN) impetus to the infrastructural development of the country, amid the large infrastructure deficit in Nepal. This will provide opportunities for contractors like Pratistha, which is a positive for their growth and profitability. The rating also takes comfort from the low counter-party default risk as entire projects on hand relate to the bodies and agencies of the Government of Nepal (GoN).

<sup>1</sup> Such as irrigation and roads

The company's ability to secure new orders and execute its pending orders within time will be a key monitorable and rating sensitivity. Further, ICRA Nepal takes note of the current delay in the release of payment from the GoN because of resource constraint induced by the ongoing Covid-19 pandemic. The company's ability to manage its working capital in case of a further delay in the release of payment will also be a key monitorable and rating sensitivity.

## Key rating drivers

### Credit strengths

**Long track record of operation** – Incorporated in 1989, Pratistha is one of the old companies in the Nepalese construction sector. The company's activity and its revenue profile started to grow and diversify (although on a lower scale) after being taken over by its current promoters in early 2002. The company is classified as a Class A contractor as per the classification norms of public procurement regulations, factoring in the prior experience, financial strength and resources. The promoters, over the years, have garnered significant experience, especially in the construction of sport stadiums, hospitals, academic buildings, among others.

**Healthy current order book and adequate headroom in the bidding capacity** – The company has been able to make healthy additions of new contracts in recent times, resulting in a sizeable order book position vis-à-vis its operating revenue. The order book position of Pratistha remains comfortable with total contract worth ~NPR 1,352 million (consolidated basis considering Pratistha's share in JVs) as of mid-June 2020 and pending value of the contract worth ~NPR 507 million. The current value of pending work is equivalent to ~5 times of the standalone operating income for FY2019. This provides a medium-term revenue assurance. Also, as of May-end 2020, Pratistha has a bidding capacity for fresh contracts worth ~NPR 720 million, which makes it well placed to participate in the new bids and contracts, thereby supporting near-term growth prospects.

**Low counter-party risk, though long receivable cycle is a challenge** – Most of the current projects being handled by Pratistha relates to the public sector wherein the employer is either the Government of Nepal, its ministries, or the related agencies. As of the mid-June 2020, the entire pending order book comprises of Government contracts. As the clients are primarily Government entities, the counter-party credit risk remains low and mitigates the risk arising from high debtor days to a large extent. Nonetheless, a lengthy receivable cycle increases Pratistha's dependence on external financing for meeting the working capital requirement with a resulting impact on the gearing level and the debt coverage metrics. The receivable days are likely to increase further in the post-Covid era, given the diminished spending capacity of the Government and its line ministries.

### Credit Challenges

**Small scale of operations and concentrated order book** - Despite being a Class A contractor; Pratistha performed on a relatively small scale of operations till FY2018. Although the scale of operations has improved in FY2019 its sustainability remains to be seen. Pratistha's business is largely concentrated on sports and building-related projects which poses concentration risk. Any change in the dynamics of the sector could affect Pratistha's long-term revenue potential.

**Weak financial profile with high gearing and high working capital intensity**– Pratistha's financial profile remains weak with a gearing of ~4 times and total debt/OPBDIT<sup>2</sup> of 3.6 times as of mid-July 2019 on a relatively low net worth base NPR 13 million. The working capital intensity (NWC/OI) as on end FY2019 was ~50%, primarily because of the high recovery period due to the delay in the payment release for the executed projects. Further, the company's substantial reliance on external financing resulted in a muted current ratio of ~1.1 times as on mid-July 2019 (<1 time as of mid-July-2018). However, the proposed equity injection<sup>3</sup> by the management is likely to improve the gearing and other financial indicators of the company.

<sup>2</sup> OPBDIT – Operating profit before depreciation, interest, and taxes

<sup>3</sup> As per the updated company registrar's document dated June 30, 2019, Pratistha's authorized and paid up capital has been increased to NPR 30 million and NPR 20 million from NPR 20 million and NPR 2.1 million, respectively. Hence, management is required to raise fresh equity of ~NPR 13 million in near future (paid up capital was ~NPR 7 million in FY2019 end).

**Intense competition amid the bidding requirement for public contract projects** - The construction sector in Nepal is highly competitive, given the presence of many players – both big and small. Moreover, the bidding requirement for the public projects (entire portfolio for Pratistha) creates uncertainty regarding the future revenue inflow.

**Regulatory risk** - Being a company concentrated in the public construction sector, Pratistha remains exposed to the risk of regulatory changes, mainly in the Public Procurement Act and the related regulations. This risk remains further underlined considering regulatory changes brought in by the amendments (8<sup>th</sup>, 9<sup>th</sup> and 10<sup>th</sup>) in the public procurement regulations by the Government. Further, a bill to amend the Public Procurement Act 2064 (the Act governing public contracts and the bidding process) is currently under consideration in the Parliament. This amendment, if it implements stricter regulations, could have a material impact on players like Pratistha.

**Analytical approach:** For arriving at the ratings, ICRA Nepal has applied its rating methodology as indicated below.

**Links to applicable criteria:**

[Corporate Credit Rating Methodology](#)

## About the company

Pratistha Construction Company Private Limited (Pratistha) was started in the year 1989 AD. It is classified as a Class-A contractor by the Government of Nepal. The company primarily works in the construction of administrative building, hospitals, sports stadiums, among others.

It mainly deals in public contracts which make up the entire contract on hand as of mid-June 2020. The company is largely a domestic player and at present is concentrated within the domestic geographic boundaries. The company reported an annual turnover (standalone) of ~NPR 101 million (in FY2019).

Pratistha is a closely held company wherein the entire paid-up capital of NPR 7.1 million - including share application of NPR 5 million (as of mid-July 2019) is held by three individuals. Mr. Dhurba Prasad Rijal, the Managing Director holds 70% stake followed by Mrs. Pramila Acharya Rijal (20%) and Mr. Bikash Subedi (10%). The company has received approval from the Office of Company Registrar to increase its paid up capital to NPR 20 million.

## Key Financial Indicators (Standalone)

Amount in NPR million	Audited		
	FY2017	FY2018	FY2019
Operating Income	20.7	32.0	101.1
OPBDITA/OI (%)	23.8%	26.9%	14.1%
PAT/OI (%)	1.6%	5.7%	4.9%
Gearing (times)	14.3	7.4	3.9
OPBDITA/Interest (times)	1.9	2.6	2.6
DSCR (times)	1.6	1.3	1.7
NWC/OI (%)	64%	39%	50%
Total Outside Liabilities/TNW (times)	26.6	11.8	7.7
Total Debt/OPBDITA (times)	3.6	2.7	3.6

*\*Pratistha does not have the practice of preparing and auditing consolidated revenue statement. As per the one-off consolidated provisional financials prepared for FY2019, the consolidated Operating income for FY2019 is NPR 249 million.*

## Annexure-1: Instrument Details

Instrument	Current Rated Amount (NPR million)	Rating action
<b>Existing Limits</b>		
Fund based; long term limits (Hire Purchase Loan/Term Loan)	39.4	[ICRANP] LB+ (Assigned)
Fund based; short term limits (Overdraft)	23.0	[ICRANP] A4 (Assigned)
Fund based; short term limits (Demand loan/Short Term loan)	40.0	[ICRANP] A4 (Assigned)
Non-fund based; short-term limits (LC-Sight/Usance/Bank guarantees/ Credit Commitment limit)	757.5	[ICRANP] A4 (Assigned)
Fund based; short term limits-within non-fund based (Demand loan/Short Term loan)	(79.9)	[ICRANP] A4 (Assigned)
<b>Proposed Limits</b>		
Fund based; short term limits (Demand loan/Short Term loan)	84.8	[ICRANP] A4 (Assigned)
Non-fund based; short-term limits (LC-Sight/Usance/Bank guarantees/ Credit Commitment limit)	33.6	[ICRANP] A4 (Assigned)
<b>Total</b>	<b>978.3</b>	

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### About ICRA Nepal Limited:

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