

Lama Construction Company Private Limited: [ICRANP] LBB/A4+ assigned

April 19, 2021

Summary of rated instruments:

| Instrument | Current Rated Amount (NPR million) | Rating action |
|-----------------------------------|------------------------------------|------------------------|
| Fund-based; long-term limits | 147.3 | [ICRANP] LBB; assigned |
| Fund-based; short-term limits | 65.0 | [ICRANP] A4+; assigned |
| Non-fund based; short-term limits | 4,255.7 | [ICRANP] A4+; assigned |
| Total | 4,468.0 | |

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

Rating action

ICRA Nepal has assigned a long-term rating of [ICRANP] LBB (pronounced ICRA NP L double B) to the fund-based, long-term limits of NPR 147.3 million of Lama Construction Company Private Limited (LCCPL). ICRA Nepal has also assigned a short-term rating of [ICRANP] A4+ (pronounced ICRA NP A four plus) to the short-term, fund-based limits of NPR 65 million and non-fund-based limits of NPR 4,255.7 million.

Rationale

The assigned ratings consider LCCPL's long track record of over four decades in the Nepalese construction sector and its experienced promoters. The assigned ratings also favourably consider LCCPL's revenue growth the last three to four years (despite degrowth in FY2020 amid the Covid-19 impact). Moreover, the healthy pace of new order inflows in recent times has helped the company maintain a comfortable order book position with the value of pending contracts equivalent to 5.3 times of the FY2020 operating income¹, providing a near to medium term revenue visibility. Low counter-party risk also remains a rating strength as LCCPL mainly deals in public sector contracts where its clients are various department and line ministries under the Government of Nepal (GoN). The rating also factors in the low gearing level of the company with TD/TNW of ~1.3 times and TD/OPBDITA of ~1.2 times in FY2020. The ratings also take comfort from the positive business outlook for contractors, given the GoN's impetus to the infrastructural development of the country, amid the large infrastructure deficit in Nepal. This will provide opportunities for contractors like LCCPL, which is a positive for their growth and profitability. The rating also takes comfort from the low counter-party risk as entire projects on hand relate to the bodies and agencies of the GoN.

The ratings, however, are constrained by the evolving management information system (MIS) capabilities of LCCPL. LCCPL executes most of the projects under joint venture. However, the company does not have a practice of keeping track of the projects handled by the JV partner, which limits its ability to effectively track the probable liability arising from non-performance, which remains a key rating concern. Rating concerns also arise from LCCPL's moderate financial profile resulting from small scale and volatile operating margins. Rating concerns also arise from the moderate liquidity profile of LCCPL, led by its modest profitability and high dividend pay-out, which limits its financial resilience. The ratings also factor in the intense competition prevalent in the construction sector in the country, primarily in public projects. Although the opportunities for construction contractors are likely to remain healthy, the intense competition in the construction sector and the bidding requirement for public projects, result in an uncertainty on new order inflows and long-term revenue prospects. LCCPL is also exposed to regulatory risks as the company primarily deals in public projects. This has also been factored in the assigned ratings.

¹ Standalone for LCCPL, without considering the proportionate share from joint venture projects.

Going forward, the ability of LCCPL to improve its MIS capabilities will remain a key rating sensitivity. The company's ability to scale up its operation and maintain its margins will also have a bearing on its overall financial profile and will remain among the major rating sensitivities.

Key rating drivers

Credit strengths

Long track record of operations – Operating since 1976, LCCPL has had a long presence in the Nepalese construction sector. The company is classified as a 'Class A' contractor as per the classification norms of public procurement regulations, factoring in the experience, financial strength and resources. The promoters over the years have garnered significant experience in the domestic construction industry with formidable presence in the market.

Healthy growth in operating income - LCCPL's operating income (standalone) registered a strong CAGR² of ~40% between FY2017 and FY2020 despite a negative YoY growth of 28% in FY2020 because of the pandemic. The growth remains supported by increase in pace of infrastructure development amid the execution abilities of the contractor.

Healthy and diversified order book and adequate headroom in the bidding capacity – The order book position of LCCPL remains healthy with a contract pipeline worth ~NPR 6.4 billion as of end January 2021. This value of pending work is equivalent to 5.3 times of the FY2020 operating income. This provides a near-term revenue visibility for the contractor. The order book also remains diversified across different segments, despite a relatively higher contribution from the road segment (~45% of pending order book) followed by sewerage management (22%). Also, as of end January 2021, LCCPL has a bidding capacity for fresh contracts worth ~NPR 19.6 billion, which offers adequate headroom to participate in the new bids and contracts, thereby supporting long-term growth prospects.

Low counter-party risk – LCCPL's entire work on hand as on date relates to the public sector, wherein the client is either the GoN and its ministries, or related agencies. As the clients are primarily Government entities, the counter-party credit risk remains low and mitigates the risk arising from relatively high debtor days to a large extent.

Credit Challenges

Moderate financial profile– LCCPL's financial profile remains moderate with total outside liabilities to tangible net worth (TOL/TNW) of 8.1 times in FY2020 (7.8 times as of FY2019 end), because of substantial creditor support and customer advances. With heavy dividend pay-out, the Net Cash Accruals (NCA) for the company remains low resulting in moderate NCA to total debt (NCA/TD) of 46% in FY2020 (12% in 2019). The DSCR also remains moderate at 1.6 times. LCCPL's substantial reliance on creditor financing/mobilisation advance and high dividend pay-out ratio in the last few years have resulted in a muted current ratio (~0.8 time in FY2019 and FY2020 end). Moderate financial position partly arises from the low scale and moderate operating margins of the contractor vis-à-vis its peers in the industry.

Evolving management information system – LCCPL, as of now, does not have a system of tracking updates on the execution status of projects handled through JV partner/s, thereby limiting its ability to effectively track the probable liability arising from non-execution (the contact agreement makes all parties jointly and severally liable for non-performance). Further, the MIS does not readily provide the consolidated financials with the contractor's share in all the projects and, thus, the actual consolidated financial position of the contractor cannot be ascertained.

High dividend pay-out - The company has been paying a steady dividend in recent years. Between FY2018-FY2020, the average dividend pay-out ratio was ~99%. Moderate profitability and high dividend pay-out ratio reduce the financial resilience of the company to withstand probable liquidity shocks in future.

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 public projects (entire portfolio for LCCPL) creates uncertainty regarding the future revenue inflow.

² Compound Annual Growth Rate

Regulatory risk - Being a company concentrated in the public construction sector, LCCPL remains exposed to the risk of regulatory changes, mainly in the Public Procurement Act and related regulations. This is also underscored by frequent regulatory changes brought about by the amendment to the public procurement regulations by the Government in the last two to three years. Further, any stringent changes in the Act and regulations could have a material impact on players like LCCPL.

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

Lama Construction Company Private Limited (LCCPL) started operations in 1976 as a “Class D” construction firm. It was upgraded to “Class A” in 1989 and registered as a private limited company in 1994. The company enjoys a diversified presence across different segments such as roads, bridges, buildings, water supply and sewerage management projects, among others.

The company mainly deals in public contracts, which made up its entire order book as of end January 2021. The company is a domestic player, whose projects at present are concentrated within domestic geographic boundaries.

LCCPL is a closely held company, wherein the entire paid-up capital is held by three individuals, with 49% shareholding by Mr. Jip Tshering Lama Sherpa (managing director), followed by 27% by Mr. Pitamber Badu (director) and the balance 24% by Mrs. Lahmu Lama.

Key Financial Indicators (standalone)

| | Audited | | |
|--|---------|---------|---------|
| | FY2018 | FY2019 | FY2020 |
| Operating Income-OI; sales (NPR million) | 870.8 | 1,662.3 | 1,205.9 |
| OPBDITA ³ /OI (%) | 13.7% | 4.2% | 9.1% |
| Total Debt/Tangible Net Worth (TNW; times) | 4.3 | 1.6 | 1.3 |
| Total Outside Liabilities/TNW (times) | 10.0 | 7.8 | 8.1 |
| Total Debt/OPBDITA (times) | 3.5 | 2.4 | 1.2 |
| Interest Coverage (times) | 4.9 | 2.9 | 5.5 |
| DSCR ⁴ (times) | 1.2 | 0.5 | 1.6 |
| NWC ⁵ /OI (%) | -4% | -9% | -14% |
| Current ratio | 1.0 | 0.8 | 0.8 |

**consolidated financials including LCCPL’s proportion share in joint venture project is not available.*

Annexure-1: Instrument Details

| Instrument | Current Rated Amount (NPR million) | Rating action |
|--|------------------------------------|------------------------|
| Fund based; long term limits (Term loan/Hire Purchase Loan) | 147.3 | [ICRANP] LBB; assigned |
| Fund based; short term limits (Overdraft/demand loan/TR/short term loan) | 65.0 | [ICRANP] A4+; assigned |
| Non-fund based; short-term limits (LC-Sight/Usance/ | 4,255.7 | [ICRANP] A4+; assigned |

³ Operating profit before depreciation, interest, tax and amortization

⁴ Debt service coverage ratio

⁵ Net working capital intensity

| Instrument | Current Rated Amount (NPR million) | Rating action |
|---|------------------------------------|------------------------|
| Bank guarantees/ Credit Commitment limit) | | |
| Fund based; short term limits-within non-fund based (Demand Loan, TR/STL) | (270.0) | [ICRANP] A4+; assigned |
| Total | 4,468.0 | |

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About ICRA Nepal Limited:

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