

## Dawa Nirman Sewa: [ICRANP] LBB-/A4 assigned

January 09, 2023

### Summary of rating action:

Instrument	Current Rated Amount (NPR million)	Rating action
Fund based; long term limits	11.4	[ICRANP] LBB-; assigned
Fund based; short term limits	19.5	[ICRANP] A4; assigned
Non-fund based; short-term limits	603.4	[ICRANP] A4; assigned
<b>Total</b>	<b>634.3</b>	

\* 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 minus) to the long-term limits of Dawa Nirman Sewa (Dawa or the firm) and a short-term rating of [ICRANP] A4 (pronounced ICRA NP A four) to the short-term limits (including proposed limits) of the firm.

### Rationale

The assigned ratings factor in Dawa's diversified portfolio of construction projects (related to road, building and bridge), despite its small scale. The ratings also derive comfort from the adequate financial indicators of the firm, characterised by improving operating margins and adequate debt coverage metrics. Moreover, the healthy pace of new order inflows in the recent times has helped Dawa maintain an adequate order book position with the value of pending contracts equivalent to ~2 times of FY2022 operating income, which provides near-term revenue visibility. The ratings also take 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. This will provide opportunities for contractors like Dawa, which is a positive for their growth and profitability. The ratings also factor in the low counterparty default risk as entire projects-on-hand relate to the bodies and agencies of the GoN.

The ratings, however, remain constrained by Dawa's relatively smaller scale of operations compared to its industry peers. Ratings concern also arise as the firm's major portion of project portfolio being concentrated in Karnali Pradesh (Province 6), resulting in geographical concentration risk. This could affect the firm's revenue prospects in the event of any changes in the dynamics of the region. Also, the absence of an adequate on-balance sheet liquidity with weak cash cushion, no headroom in the drawing power limits for managing short-term working capital requirements through bank financing (in case of delayed release of payments by its counterparties), gives rise to liquidity concern for Dawa. Although the opportunities for construction companies 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. Further, the ratings factor in Dawa's exposure to regulatory risks as the firm primarily deals in public projects.

Going forward, the firm's ability to scale-up its operations, strengthen and stabilise the operating profit margins and reserves position to withstand any potential risk, will remain a key rating sensitivity. Further, the firm's ability to manage its liquidity in the event of delayed payment release from its counterparties will also remain a key monitorable and a rating sensitivity factor.

## Key rating drivers

### Credit strengths

**Adequate and diversified order book position** – Dawa’s order book remained adequate as of mid-December 2022, with pending value of the contracts to be executed equivalent to ~2 times of the firm’s standalone FY2022 operating income, providing a near-term revenue assurance. Further, the firm’s pending order book is well diversified across segments like roads, buildings, and bridges.

**Low counterparty risk** – The majority of the current projects being handled by Dawa relates to the public sector, wherein the employer is either the Government of Nepal, its ministries, or related agencies. As of mid-December 2022, the entire pending order book comprised Government contracts. As the clients are primarily Government entities, the counterparty credit risk remains low and mitigates the non-realisation risk, to a large extent.

**Good financial profile with low gearing and adequate debt coverage metrics** – Dawa’s financial profile remained good, albeit on a low scale, with a gearing and total debt/OPBDITA<sup>1</sup> of 0.6 times each in mid-July 2022. Further, the firm’s low working capital intensity, over the years, has largely reduced its reliance on financial institutions for working capital requirements, resulting in healthy interest coverage and debt service coverage ratio.

### Credit challenges

**Small scale of operations along with geographical concentration** – Dawa, despite having an operational track record of over one and a half decade, continues to operate on a lower scale compared to its peers, limiting its bidding capacity for large projects. Its small scale, revenue and reserve base also makes the company less resilient towards any incremental business/liquidity shocks.

Further, most of the projects are in Karnali Pradesh (Province 6) of the country, giving rise to geographical concentration risk. Any change in the dynamics of the region could affect Dawa’s financial and operational profiles. Also, nearly 92% of the pending order book was under the slow-moving category as of mid-December 2022, which exposes Dawa to project execution risk. Given the small scale, the company’s ability to withstand any risk arising from non-performance (guarantee devolvement, blacklisting, etc.), remains low.

**Liquidity risk** – Dawa’s liquidity position remains stretched, reflected in its moderate current ratio of 1.4 times in end-FY2022. This is a result of relatively weaker profitability and reserves and high reliance on the supplier’s credit and mobilisation advances for working capital management. Dawa also has low on-balance sheet liquidity and no drawing power against its net current assets, which lowers its ability to withstand any liquidity shocks in the event of any slowdown in the sector. Any delays in the receipt of payments from the employers could result in liquidity stress for the firm, and could affect its ability to meet its liabilities (including bank loan repayments).

**Intense competition for public-contract projects and slowdown in Government capex** – The construction sector of Nepal is highly competitive, given the presence of varied players. Moreover, the bidding requirement for public projects (entire portfolio for Dawa) creates an uncertainty regarding the firm’s future revenue inflow.

The capital spending from the Government side has slowed down in the recent years. The inherently slow pace of capital spending by the public sector, coupled with the disturbances created by bureaucratic hurdles, public disturbance, site clearance, etc., could significantly impact the revenue profile of contractors like Dawa working for the public projects.

**Regulatory risk** – Dawa, concentrated in the public construction sector, remains exposed to the risk of regulatory changes, mainly in the Public Procurement Act and the related regulations. This risk remains further underlined

<sup>1</sup> OPBDITA – Operating profit before depreciation, interest, taxes and amortisation

considering the frequent regulatory changes brought in by the amendments. Any future amendments imposing stricter provisions for timely completion and/or provisions of liquidated damages, could have a material impact on the public-contract focused players like Dawa.

**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](#)

[Rating Methodology for Construction Entities](#)

## About the company

Dawa Nirman Sewa started its operations in 2007. It is registered as a firm and classified as a Class-D contractor as per the classification norms of the Government of Nepal. The firm mainly deals in civil construction work, primarily related to road, buildings, and bridge projects in the public sector.

Dawa is a closely held firm, wherein the entire equity stake of NPR 5.2 million is solely held by the proprietor, Mr. Pama Mutup Lama.

## Key Financial Indicators:

Particulars	Audited				Provisional
	FY2018	FY2019	FY2020	FY2021	FY2022
Operating Income-OI (NPR Million)	45.4	80.7	119.7	134	110.8
OPBDITA/OI (%)	4.00%	4.70%	8.30%	10.60%	16.7%
Total Debt/Tangible Net Worth-TNW (times)	0.2	0.8	1.1	0.8	0.6
Total Outside Liabilities/ TNW (times)	0.4	2.3	2.1	0.9	0.7
Total Debt/OPBDITA (times)	0.3	1.8	1.4	0.9	0.6
Interest Coverage	26.2	3.7	3.3	3	2.3
DSCR (times)	26.2	3.4	2.6	1.9	1.7
Current Ratio	4.9	1.2	1.1	1.5	1.4
Net Working Capital/OI (%)	2%	7%	1%	2%	5%

## Annexure-1: Instrument Details

Instrument	Current Rated Amount (NPR million)	Rating action
Fund based; long-term limits (Hire Purchase Loan/Term Loan)	11.4	[ICRA NP] LBB-; assigned
Fund based; short-term limits (Trust Receipt Loan)	19.5	[ICRA NP] A4; assigned
Non-fund based; short-term limits (Advance Payment Guarantee/ Bid Bond Guarantee/Performance Bond/ Line of Credit)	603.4*	ICRA NP] A4; assigned
<b>Total</b>	<b>634.3</b>	

\*Includes proposed limits of NPR 103.9 million

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### **About ICRA Nepal Limited:**

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