

Kshamadevi Construction Solution Private Limited: Ratings downgraded to [ICRANP] LBB-/A4

December 11, 2023

Summary of rating action

Instrument	Last Rated Amount (NPR million)	Current Rated Amount (NPR million)	Rating action
Fund-based; long-term limits	57.6	200.0	[ICRANP] LBB-; downgraded from [ICRANP] LBB
Fund-based; short-term limits	220.0	642.8	[ICRANP] A4; downgraded from [ICRANP] A4+
Non-fund based; short-term limits	1,122.4	3,470.0	[ICRANP] A4; downgraded from [ICRANP] A4+
Total	1,400.0	4,312.8	

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

Rating action

ICRA Nepal has downgraded the long-term rating of Kshamadevi Construction Solution Private Limited (KCSPL or the company) from [ICRANP] LBB (pronounced ICRA NP L double B) to [ICRANP] LBB- (pronounced ICRA NP L double B minus) and the short-term rating of [ICRANP] A4+ (pronounced ICRA NP A four plus) to [ICRANP] A4 (pronounced ICRA NP A four).

Rationale

The ratings downgrade mainly factors in the stress developed in KCSPL's short-term liquidity position for FY2023 amid the relatively higher working capital intensity (NWC/OI of ~76% on standalone financials) triggered by rising inventory days and reduced creditor support. The stretched liquidity position is reflected in the marginally overdrawn drawing power utilization for mid-July 2023. Rising working capital intensity has necessitated sharp increase in bank loan utilization on a relatively moderate revenue growth, which coupled with the prevailing high-interest rate environment has squeezed the company's debt coverage metrics. ICRA Nepal takes note of the company's debt funded capex plans, in line with the increase in order-book position which is likely to further increase the debt levels going forward. Although the company plans to infuse additional equity and ramp up the operating revenue going forward, its ability to do so amid the general slowdown in construction sector remains to be seen. As KCSPL gradually moves towards public sector project, its incremental revenue and liquidity profile is likely to remain exposed to the pace of capital expenditure from public sector, which has remained slower in the recent years.

Nonetheless, the ratings continue to factor in KCSPL's experienced promoters (Kshamadevi Group) and their prior experience in trading of construction materials, despite the limited track record of construction company. The ratings also consider the healthy addition of new projects in KCSPL's order book, which has improved the company's revenue visibility, with the value of proportionate pending contracts equivalent to ~10 times of FY2023's standalone income (provisional). The ratings also take comfort from the positive business outlook for contractors, given the Government of Nepal's (GoN) impetus to infrastructural development in the country, amid the large infrastructure deficit, which remains positive for growth and profitability prospects of contractors such as KCSPL. Although the slow pace of payment from public sector to the contractor has aggravated liquidity concerns for the contractor, the assigned rating nonetheless takes comfort from the low counterparty risk in public sector projects which is being focussed by KCSPL in recent period.

Going forward, KCSPL's ability to scale up its operations, manage its capitalization profile and liquidity to ensure adequate debt coverage indicators will remain key rating sensitivity. The company's ability to timely execute its sizeable work in hand and check the possible risk arising from non-performance will also remain as key rating monitorable.

Key rating drivers

Credit strengths

Prior experience in construction sector through trading activities – KCSPL is a unit under the Kshamadevi Group, one of the growing players in the construction sector. The company's sister units are mainly involved in trading of construction materials as well as in providing services related to interior works, among others. In this respect, KCSPL acts as a forward integration for the group's business and is likely to benefit from the synergy accruing from other sister units. KCSPL mainly procures required materials/services from its sister units, which benefits the business for the entire Group as well as enhances the execution capacity of KCSPL to some extent.

Healthy order book position – The order book position of KCSPL remains healthy with the pending value of the contract to be executed worth ~NPR 4 billion (considering KCSPL's standalone projects and its share in JV projects). The current value of its pending work is equivalent to ~10 times of the FY2023 standalone revenue. This provides medium-term revenue visibility for the company. However, the company's near-term financials will depend on its ability to execute these projects in a timely manner.

Low counter-party risk – The majority of the current projects under KCSPL are related to public sector, with either the Government of Nepal, its ministries, or allied organizations as the employer. Since most of the clients are government bodies, the counter-party default risk is low, which cushions the risk arising from high debtor days. However, a long receivable cycle makes KCSPL more dependent on bank financing to meet its working capital needs, which has an effect on the company's liquidity, gearing level and debt coverage metrics.

Credit challenges

Small scale of operations – KCSPL, established as a private limited company in 2013, has around ten years of an operational track record in the Nepalese construction sector. However, given the company's focus on small private sector clientele in the past, its scale of operations remains lower than its industry peers, limiting its experience and bidding capacity for large projects.

Rising debt, working capital intensity and stretched liquidity – KCSPL's working capital intensity (NWC/OI) has increased from 33% in FY2022 to ~76% in Mid-July 2023 (standalone basis), largely on account of rising inventory days coupled with lesser credit support from its suppliers. As a result, the reliance on bank debt has gone up significantly vis-à-vis interim growth in revenue and profit accruals, straining the debt coverage metrics and liquidity profile. Liquidity concern is further accentuated with the company having no drawing power against its net trading assets, lowering its ability to withstand major liquidity shocks as of Mid-July 2023. The company's incremental liquidity profile will largely depend on the planned equity injection in FY2024 and its ability to ramp up revenues according to the order book growth.

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

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](#)

Link to previous rating rationale:

[Kshamadevi Construction Solution Private Limited Rationale December 2022](#)

About the company

Kshamadevi Construction Solution Private Limited (KCSPL) is a private company under the Kshamadevi Group providing construction services relating to road, buildings, interior works, electrical and lighting works both to public and private sector clients. KCSPL is classified as a Class-D contractor as per the classification norms of the Government of Nepal.

KCSPL is a closely held company with its entire equity stake held by five individuals—Mr. Hom Bahadur Basnet, Chairman and Managing Director (43% stake), followed by Mr. Niranjana Kumar Shrestha and Mr. Bhesh Bahadur Basnet (20% each), Mr. Shree Krishna Basnet (10%) and Mr. Basanta Raj Neupane (7%).

Key Financial Indicators

Particulars	Audited				Provisional
	FY2019	FY2020	FY2021	FY2022	FY2023
Operating Income-OI (NPR Million)	382.8	475.2	511.5	337.8	424.1
OPBDITA/OI (%)	7.5%	7.7%	7.1%	6.0%	11.1%
Total Debt/Tangible Net Worth-TNW (times)	0.7	0.6	1.3	1.1	1.8*
Total Outside Liabilities/ TNW (times)	5.1	4.2	7.1	3.8	2.4
Total Debt/OPBDITA (times)	1.3	1.3	2.0	3.5	5.6
Interest Coverage	6.1	5.9	4.9	2.2	1.3
DSCR (times)	4.1	3.7	2.1	1.6	1.2
Current Ratio	1.2	1.2	1.1	1.2	2.5
Net Working Capital/OI (%)	15%	18%	19%	33%	76%

*treating promoter loan as share advances, as reported by the management. Including promoter loan in total loan, TD/TNW ratio comes to 5.1 times.

Annexure-1: Instrument Details

Instrument	Current Rated Amount (NPR million)	Rating action
Fund based; long term limits	50.0	[ICRANP] LBB-; downgraded from [ICRANP] LBB
Fund based; long term limits (proposed)	150.0	
Fund based; short term limits	242.8	[ICRANP] A4; downgraded from [ICRANP] A4+
Fund based; short term limits (proposed)	400.0	
Non-fund based; short-term limits	1,720.0	[ICRANP] A4; downgraded from [ICRANP] A4+
Non-fund based; short-term limits (proposed)	1,750.0	
Total	4,312.8	

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About ICRA Nepal Limited:

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