Gaura Construction Private Limited: Ratings reaffirmed

May 27, 2024

Summary of rating action

Instrument (Amounts NPR million)	Previous Rated Amount	Current Rated Amount	Rating action
Long-term, fund-based loan limits	24.1	86.1	**[ICRANP] LBB-**; reaffirmed
Short-term, fund-based loan limits	95.0	130.0	**[ICRANP] A4**; reaffirmed
Short-term, non-fund-based loan limits	1,140.9	1,150.0	
Total	**1,260.0**	**1,366.1**	

Rating action

ICRA Nepal has reaffirmed the long-term rating of [ICRANP] LBB- (pronounced ICRA NP L double B minus) to the long-term loan limits of Gaura Construction Private Limited (GCPL or the company) and also reaffirmed the short-term rating of [ICRANP] A4 (pronounced ICRA NP A four) to the company's short-term loan limits.

Rationale

The ratings reaffirmation takes comfort from GCPL's controlled capitalization structure, characterized by gearing of 0.7 times (aided by a series of equity infusions in recent years), total debt to OPBITDA of 2.6 times, and total outsider liabilities to tangible net worth (TOL/TNW) of 1.7 times as of mid-July 2023. The ratings continue to derive comfort from the company's long operational track record of around four decades in the Nepalese construction sector (albeit on a small base) adding up to the experience of promoters. ICRA Nepal also favourably factors in 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. The ratings also factor in the low counterparty default risk as entire projects on hand relate to the bodies and agencies of the GoN.

Nonetheless, the ratings are mainly constrained by the revenue degrowth by ~13%, as reported by GCPL in FY2023, while the debt levels were largely steady. This, along with spiked borrowing rates during the year led to moderation in coverage indicators (DSCR at 1.5 times for FY2023 as against 2.0 times in FY2022[1]). The company's relatively small scale of operations despite a long track record and its modest pending order book position (1.7 times of FY2023's revenues as of April end 2024) also remains a major concern. The company's liquidity profile also remains stretched with largely sustained overutilization of drawing power (~129% as of mid-July 2023). The ratings are further constrained by the execution risk, with ~90% of the pending work being under 10% completion stage as of April end 2024. Further, the intense competition amid the bidding requirement results in uncertainty regarding the sustainability of revenues while the frequent policy changes and economic cyclicality/slowdown also add up to the concerns. Going forward, GCPL's ability to add adequate new orders and improve the revenue/margin trajectory and timely and adequate liquidity support by the promoters in line with past trends (in case of exigencies) will remain the key rating sensitivities.

Key rating drivers

Credit strengths

Long operational track record – GCPL has been operational in the Nepalese construction sector since 1985 AD, with focus on roads, buildings, and electrical transmission line/substation segments in recent years. The company is classified as a "Class A" contractor as per the classification norms of public procurement regulations, factoring in experience, financial strength, and available resources. Over the years, the promoters have garnered adequate experience in the industry, which remains a positive. Despite the low scale of operations relative to its track record, the infrastructural development pace of the country could support the construction industry over the long term (including GCPL).

[1] *This was 3.8 times as per provisional financials of FY2022, as available during last rating. Major deviation was owing to sharp drop in operating profit margins, upon finalization of audit.*

Controlled capitalisation structure and low counterparty risks – Aided by the steady equity infusions in last three years, the company's capital structure remains satisfactory with gearing ratio of 0.7 times, total debt to OPBITDA of 2.6 times and TOL/TNW of 1.7 times as of mid-July 2023. As of April end 2024, GCPL's entire pending work-in-hand was from the public sector, with the employer being either the GoN, its ministries, or the related agencies. The company largely sources its projects from local-level Government bodies. Hence, the counterparty credit risk remains low. However, cash inflows may remain lumpy on account of the lengthy procedures required to receive payments from the Government entities.

Credit challenges

Steady debt levels despite revenue degrowth leading to moderation in coverage indicators – GCPL reported largely steady debt levels as of mid-July 2023 (vis-à-vis mid-July 2022 levels) despite a 13% decline in operating income during FY2023. Though the company had adequate orders in hand, the revenue drop was on account of slower project execution, while the increased working capital cycle led to largely similar debt levels. While the operating profit margins reported further improvements during FY2023, the reduced scalability, increased debt burden and spiked borrowing rates led to moderation in coverage indicators with DSCR at 1.5 times for FY2023 as against 2.0 times for FY2022.

Modest pending order book position and relatively small scale of operations – The company's medium-term revenue visibility remain a concern given the low pace of fresh order addition in recent quarters, leading to modest pending order book (only three pending contracts as of April end 2024, amounting to 1.7 times FY2023's standalone operating income). Despite its long operational track record, GCPL operates on a smaller scale compared to its peers, which makes it less resilient to business and liquidity shocks. The slow pace of business acquisition amid the recent construction sector slowdown, affecting both private and government sectors, also pose challenges. The company's ability to add adequate new orders and improve the revenue and margin trajectory would remain a key rating monitorable.

Stretched liquidity profile and project execution risk – The company reported an increase in working capital intensity (net working capital to operating income ratio) to 8% for FY2023, from -8% in FY2022, mainly driven by high debtor days at 150 as of mid-July 2023 (amid delayed payments from government projects), coupled with reduced creditor days to 90 (193 for FY2022). The company's liquidity remains stretched, as reflected in a weak current ratio of 0.7 times and largely sustained overutilization of drawing power (~129% as of mid-July 2023). Additionally, as of end April 2024, ~90% of the pending projects were under 10% completion stage, exposing GCPL to significant project execution risks. Delays in these projects could lead to non-performance risks such as bank guarantee devolvement, blacklisting, and liquidated damages, which could erode the company's financial profile and competitive positioning.

Intense competition and regulatory risks – The construction sector of Nepal is highly competitive, given the presence of a large number of players. Moreover, the bidding requirement for public projects (entire portfolio for GCPL) creates uncertainty regarding the sustainability of revenues. Hence, GCPL also remains exposed to the risk of regulatory changes, mainly in the Public Procurement Act and the related regulations. This risk is accentuated considering the frequent regulatory changes brought in by the amendments and economic cyclicality/slowdown. Any future amendments imposing stricter provisions for timely completion and/or provisions of liquidated damages could have a material impact on players like GCPL. Rating concerns also emanate from the industry-wide practice of underbidding in the majority of the projects, which could affect the company's profitability and its ability to deliver projects within the estimated time/cost.

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

Links to the applicable criteria:
[Corporate Credit Rating Methodology]
[Rating Methodology for Construction Entities]

Link to the last rating rationale:
[Rationale Gaura Construction Private Limited Fresh BLR December 2022]

About the company

Gaura Construction Private Limited (GCPL) started its operations from December 1985 (promoters started construction business as a firm from 1976, which was taken over by GCPL from 1985). The company is classified as a class-A contractor as per the classification norms of the Government of Nepal, and it primarily deals in building, road and hydro-electrical projects, etc. GCPL is a closely held company wherein the entire equity stake is held by four individuals and two companies with the largest stake of 40% held by its Managing Director, Mr. Kumar Poudel.

Key Financial Indicators (Standalone)

	Audited			
	FY2020	**FY2021**	**FY2022**	**FY2023**
Operating Income-OI (Revenues in NPR million)	18	127	365	319
OPBITDA/OI (%)	67%	14%	11%	16%
Total Debt/Tangible Net Worth (TNW; times)	1.1	1.6	1.1	0.7
Total Outside Liabilities/TNW (times)	2.4	3.3	3.3	1.7
Total Debt/OPBITDA (times)	3.3	6.6	3.3	2.6
OPBITDA/Interest (Interest coverage; times)	2.5	3.8	2.6	1.9
DSCR (times)	2.5	1.7	2.0	1.5
Net Working Capital/OI (%)	-135%	-41%	-8%	8%
Current Ratio	0.3	0.4	0.6	0.7

Analyst Contacts:

Mr. Sailesh Subedi (Tel No. +977-1-4519910/20)
sailesh@icranepal.com

Mr. Rajib Maharjan (Tel No. +977-1-4519910/20)
rajib@icranepal.com

Mr. Nahid Siddiqui (Tel No. +977-1-4519910/20)
nahid.siddiqui@icranepal.com

Relationship Contacts:

Ms. Barsha Shrestha (Tel No. +977-1-4519910/20)
barsha@icranepal.com

About ICRA Nepal Limited:

ICRA Nepal Limited, the first Credit Rating Agency of Nepal, is a subsidiary of ICRA Limited (ICRA) of India. It was licensed by the Securities Board of Nepal (SEBON) on October 3, 2012. ICRA Nepal is supported by ICRA Limited through a technical support services agreement, which envisages ICRA helping ICRA Nepal in areas such as rating process and methodologies, analytical software, research, training, technical and analytical skill augmentation.

Our parent company, ICRA Limited, was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency. Today, ICRA and its subsidiaries together form the ICRA Group of Companies.

For more information, visit www.icranepal.com

ICRA Nepal Limited,
Sunrise Bizz Park, 6th Floor, Dillibazar, Kathmandu, Nepal.
Phone: +977-1-4519910/20

Email: info@icranepal.com
Web: www.icranepal.com