Gawar Construction Limited

February 22, 2019

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Commercial Paper	50.00	50.00	[ICRA]A1+; reaffirmed
Total	**50.00**	**50.00**	

*Instrument details are provided in Annexure-1

Rationale

The rating reaffirmation is supported by Gawar Construction Limited's (GCL) healthy financial performance with robust growth in OI[1] (~42% growth in FY2018 and ~40% growth in 9M FY2019), improvement in operating profitability (operating profit margins increased to 11.2% in FY2018 from 7.6% in FY2017) and maintenance of its low reliance on external borrowings. This has helped GCL in maintaining strong credit metrics as reflected in interest coverage of 16.52 times, and debt/OPBIDTA of 0.43 times. The rating continues to derive strength from its healthy liquidity position reflected by unencumbered cash and bank balance and undrawn bank lines, and availability of mobilisation advances from clients (which can be availed if required). The rating also takes support from GCL's track record in road construction industry which, along with robust order inflows in the sector, has helped it in increasing its scale of operation, and healthy revenue visibility from its order book position. The counterparty credit risk also remains low with most clients being public-sector entities.

These apart, GCL's credit profile reflects the concentration of its order book on a few projects, early execution stage of majority of the order book, relatively short residual execution timelines in some projects, and risks inherent in the construction industry. The company's ability to timely execute its order book while maintaining profitability and efficient working capital management will be the key rating sensitivity. The other key rating sensitivity includes a significant increase in GCL's exposure to Hybrid Annuity Model (HAM) projects which could block up sizeable capital and adversely impact its liquidity position, while also exposing to project time & cost overruns. However, with healthy cash accruals, the liquidity position is expected to remain comfortable.

ICRA has noted that over the last one-year GCL has taken up four HAM projects (including two recently opened bids in which GCL has emerged as the L1 bidder), which would require sizeable equity investment (estimated at Rs. 360-410 crore) over the next three years. GCL intends to meet this equity requirement from its current unencumbered cash balance as well as the accruals generated from its core construction business during this period. Hence, the company's ability to continue generating healthy accruals will be crucial in maintaining its credit profile.

[1] OI-Operating Income

Outlook: Not applicable

Key rating drivers

Credit strengths

Healthy execution track record in road construction – The company/promoters have more than two decades of experience in the construction business and have established a track record for successful project execution. In the past, the company was able to complete multiple projects before the schedule timeline, which besides making it eligible for early completion bonus, strengthened its execution track record.

Sizeable order book provides revenue visibility – The company has order in hand with residual work worth ~Rs. 7,900 crore as on January 31, 2019, which is about 3 times its FY2018 OI. Given the average execution period of two years, the order book provides healthy revenue visibility in the medium term. Furthermore, the company's order inflows are expected to remain healthy given the huge pipeline of projects in the highways sector. ICRA notes that the average order size has increased for the company with addition of its own HAM projects and Welspun's HAM projects apart from some large engineering, procurement and construction (EPC) road projects.

Significant growth in OI and profits – GCL's OI has grown by ~42% in FY2018 to Rs. 2,489 crore from Rs. 1,750 crore in FY2017. The growth in OI continued in the current financial year with revenues of Rs. 2,270 crore in 9M FY2019, up 40% from 9M FY2018. This apart, the operating profitability has increased significantly to 11.2% in FY2018 from 7.6% in FY2017 due to lower overhead costs, higher profitability in projects, and early completion bonuses. Revenue growth accompanied by profitability increase resulted in ~177% surge in net cash accruals to Rs. 286 crore in FY2018 from Rs. 104 crore in FY2017.

Low working capital requirements and limited dependence on external debt support credit metrics – The company has been able to efficiently manage its increased working capital and equipment base through internal accruals. This has resulted in lower dependence on external borrowings to fund the same. Furthermore, given its healthy cash accruals, the company has self-funded two public private partnership (PPP) projects (1 OMT, and 1 BOT-Toll) without depending on external debt. The lower dependence on borrowings, along with increased scale of operations and improved profitability, have strengthened its credit metrics over the years with gearing of 0.18 times, TOL/TNW of 1.17 times, and interest coverage of 16.52 times as on March 31, 2018.

Healthy liquidity position – Over the years, the company has built-up cash and bank balance which, along with unutilised fund-based working capital bank lines, provides liquidity comfort. As of January, 2019, the company had unencumbered cash and bank balance of Rs. 125 crore. Hence, it has rarely utilised fund-based working capital limits in the past. The liquidity position is also partly supported by the provision of mobilisation advance in its contracts, which is expected to keep the working capital requirement low. While the equity requirement towards HAM projects is expected to result in utilisation of a part of GCL's surplus liquidity, the cashflows from operations are expected to remain healthy in the medium term, which will support the liquidity position.

Credit challenges

Higher execution risks with most orders in early stage – GCL has received sizeable orders, including large HAM projects in the last one year, which has boosted its order book. Addition of HAM projects, though large, comes with its own benefits like minimum 80% upfront land acquisition, low-cost mobilisation advances from NHAI, inflation-linked price escalations and other lower risks compared with BOT projects. However, fixed-price and fixed-time EPC contracts (excluding escalation provided by NHAI) for HAM projects increases the risk for GCL. The execution remains high as most projects have been awarded in the recent past, the execution is yet to commence or is at an early stage in many of these projects. Further, the execution timelines in some projects are aggressive by the industry standards. However, the demonstrated execution track record of the company to complete projects ahead of the scheduled timelines in the past provides comfort.

Order book concentration – GCL's order book is concentrated on one segment (more than 90% orders in road sector) and a few projects which makes its performance dependent on the progress in these projects. The top six projects in the order book comprise about half of the total pending order book (as of January 2019) with the addition of large-sized HAM projects. Customer-concentration risk also remains high as the top three customers (NHAI, Welspun, Public Works Department, Uttar Pradesh) constitute two-third of the total pending order book. However, the company has diversified geographically over the years from Haryana to other states, despite remaining focused in North India.

Equity commitment and risk associated with HAM projects – The company was awarded two HAM projects (Rohna-Jhajjar Package 2, and Khajuwala Bap) by the NHAI last year, which require equity commitment of around Rs. 160 crore over next two years. This apart, the company has recently emerged as the L1 bidder in two HAM projects, which would require equity infusion of about Rs. 200-250 crore from GCL over the next three years. Though the total equity requirement towards these projects is sizeable, it has to be infused over the next two to three years. Nonetheless, the company has healthy accruals from construction operations, which can be used to meet this requirement. The company's ability to fund these projects through internal accruals while managing its working capital requirements and maintaining its liquidity position would remain a key rating sensitivity. While HAM-based road projects have lower risk than toll road projects, the execution risks remain and timely completion of these projects within the budgeted cost will be crucial to maintain returns from these investments. Furthermore, in case of cost overrun, GCL is expected to provide financial support to these projects.

Risks inherent in construction industry – GCL is exposed to risks inherent in construction industry including risks of time and cost overruns, and intense competition which can lead to aggressive bidding etc.

Liquidity position

GCL's liquidity position remains healthy with strong accruals, unencumbered cash and bank balance of Rs. 56 crore as on March 31, 2018 and Rs. 125 crore as on January 23, 2019. This apart, GCL has the option of availing mobilisation advance from its clients as per the contractual terms against bank guarantees. As GCL has availed only limited mobilisation advance thus far, there is provision for additional liquidity buffer over the medium term.

On the other hand, the company has to make sizeable investment of ~Rs. 360-410 crore in its four HAM projects (including the two L1 projects) over the next three years, which would largely be funded through internal accruals and accumulated cash balance. The company has demonstrated healthy accruals in the past, which is expected to continue over the medium term, supported by its order book, thereby helping it in maintaining its liquidity cushion. However, addition of HAM projects in the short term can further increase the equity requirement and impact the liquidity position of the company.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Construction Entities
Parent/Group Support	NA
Consolidation / Standalone	The rating is based on standalone financial of the issuer and limited consolidation of the subsidiaries/SPVs (refer Annexure-2). The debt in these SPVs has no recourse on GCL and only support in the form of equity infusion and cashflow mismatches is considered

About the company

Started initially as a partnership concern in 1997, Gawar Construction Ltd (GCL) was incorporated in 2008 as a limited company. It is promoted by Mr. Rajender Singh, Mr. Rakesh Singh, and Mr. Ravinder Singh. Based in Hisar (Haryana), GCL is involved in construction of civil infrastructure including roads, bridges and Government buildings etc. Construction of roads and bridges has been the key focus area of the company. It has been focused on North India and has undertaken projects in multiple states including Haryana, Rajasthan, Uttar Pradesh, Madhya Pradesh, Maharashtra, Uttarakhand, Chhattisgarh, etc.

In FY2018, the company reported a net profit of Rs. 270.9 crore on an OI of Rs. 2,489.1 crore compared with a net profit of Rs. 85.7 crore on an OI of Rs. 1,749.5 crore in FY2017.

Key financial indicators (audited)

	FY2017	FY2018
Operating Income (Rs. crore)	1749.5	2489.1
PAT (Rs. crore)	85.7	270.9
OPBDIT/OI (%)	7.6%	11.2%
RoCE (%)	35.2%	49.8%
Total Debt/TNW (times)	0.13	0.18
Total Debt/OPBDIT (times)	0.40	0.43
Interest coverage (times)	10.8	16.5

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

		Current Rating (FY2019)				Chronology of Rating History for the past 3 years		
	Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating February 2019	Date & Rating in FY2018 February 2018	Date & Rating in FY2017 -	Date & Rating in FY2016 -
1	Commercial Paper	Short Term	50.00	-	[ICRA]A1+	[ICRA]A1+	-	-

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument Details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Commercial Paper	NA	NA	7-365 days	50.00	[ICRA]A1+

Note: Commercial Paper is carved out of working capital bank limits

As of January 31, 2019, the commercial paper was not placed by the company.

Source: GCL

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Gawar Khajuwala BAP Highway Private Limited	100%	Limited consolidation
Gawar Rohna Jhajjar Highway Private Limited	100%	Limited consolidation
Ludhiana Sangrur Infra Road Pvt. Ltd.	100%	Limited consolidation

Apart from the above two entities, GCL will be forming two new SPVs for two projects where it has emerged as L1 bidder.

ANALYST CONTACTS

Shubham Jain
+91 124 4545306
shubhamj@icraindia.com

Abhishek Gupta
+91 124 4545863
abhishek.gupta@icraindia.com

Shiffali Garg
+91 124 4545868
shiffali.garg@icraindia.com

RELATIONSHIP CONTACT

Jayanta Chatterjee
+91 80 4332 6401
jayantac@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries:

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

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ICRA Limited

Corporate Office
Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002
Tel: +91 124 4545300
Email: info@icraindia.com
Website: www.icra.in

Registered Office
1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001
Tel: +91 11 23357940-50

Branches

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