Key Challenges Facing the Contracting Sector in Saudi Arabia

Emphasis on Implications of Current Practices on Construction Contractors and Suggested Resolutions

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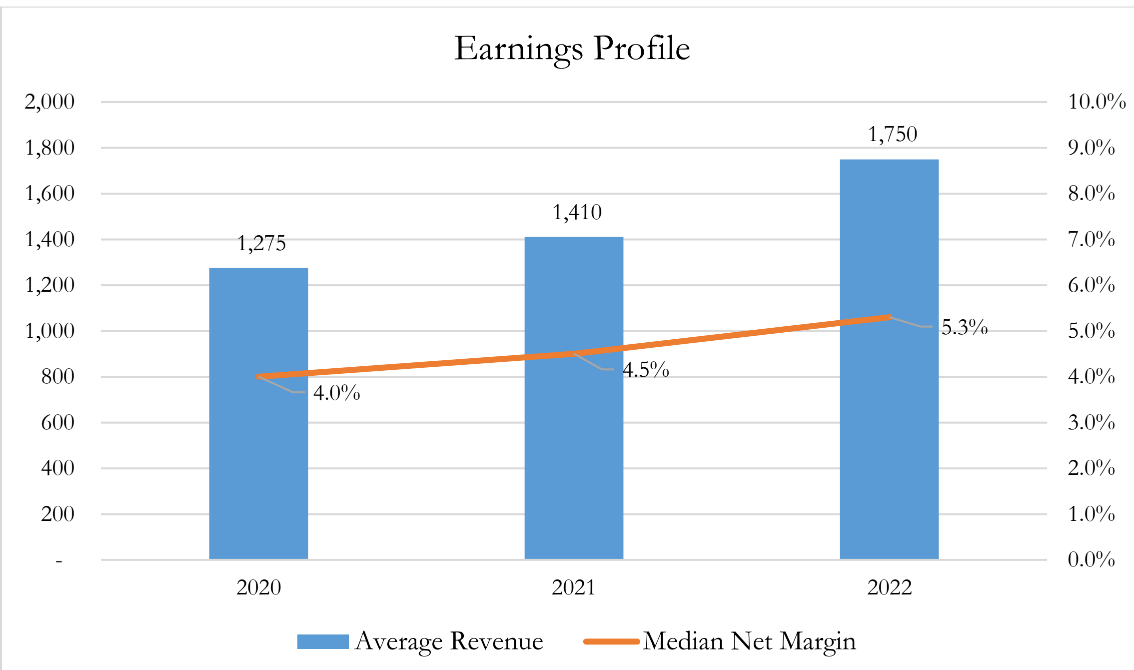
Introduction:

Focusing on Saudi Arabian construction contracting industry, this paper will outline and discuss the main challenges facing contractors, Tassnief's approach in assessing risks associated with such entities and its implications on the overall sector, and suggested resolutions to such challenges. In addition, we annexed our microeconomic analysis of the construction contracting sector including comparative insights from cross-border examples for ease of comparison. Although we extensively cover the technical matters of construction contractors when issuing credit ratings, our analysis prioritize addressing the financial aspects of issues that face those market players.

The aggregated data used to produce the empirical analysis covering the industry players are based on our experience in credit rating analysis conducted over ratees within the contracting industry focusing on the largest fifty players which account for around 20% market share of the industry in Saudi Arabia.

1- Financial Performance – Overview

Construction Contracting Sector's performance is significantly influenced by economic cycles. The cyclicality of the sector in KSA is further magnified due to the Kingdom's dependence on oil prices. As a result, value of contracts awarded over the years has been volatile. Tassnief has noted that margins for the sector are variable and are dependent on the number and value of projects relative to the players in the industry. This fact, coupled with **highly competitive conditions and low barriers to entry (leading to fragmentation of the market), have kept the margins thin and unfavorable – since work being awarded is generally won by the lowest bidder. During the past 3 years, profit margins have been low and range-bound between 4.5% to 5.3%.**



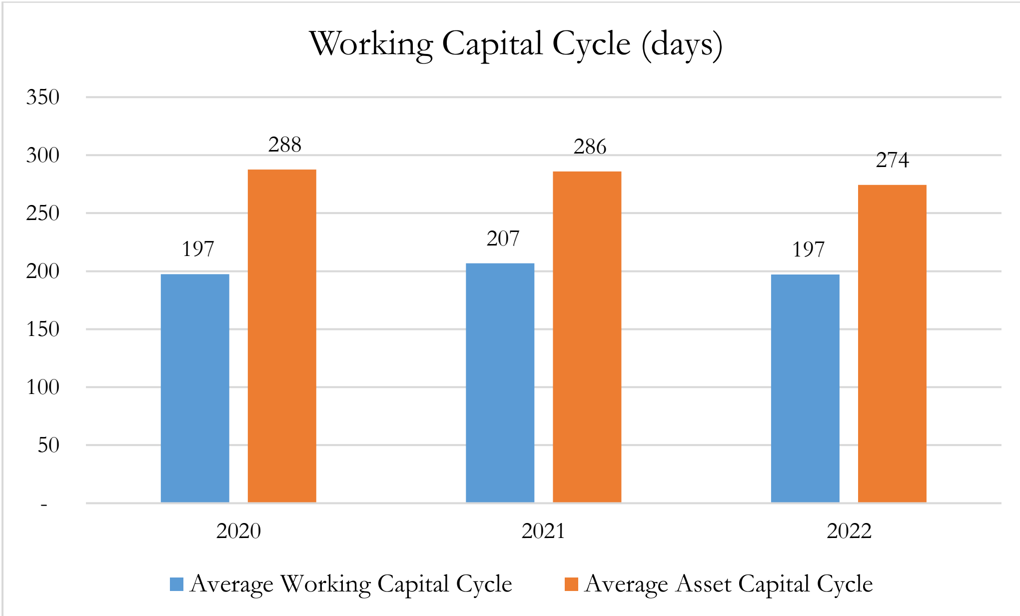
Industry Data

Description	Adjusted NWC	Asset WCC	Total Liabilities/Equity (Adjusted)	Total Debt/Equity	Revenue	Net profit margin	Equity	Total Equity (Adjusted)
2020								
Maximum	640	673	8.2	2.5	6,148	32%	1,984	1,984
Minimum	27	75	0.3	0.0	66	-22%	-38	29
75th Percentile	264	382	2.5	1.0	1,919	10%	669	669
25th Percentile	119	210	0.9	0.3	223	1%	96	112
IQ Range	145	172	1.6	0.7	1,696	9%	573	557
Median	181	254	1.5	0.5	545	4%	223	273
Average	197	288	2.0	0.8	1,275	5%	460	502
2021								
Maximum	501	599	6.6	2.0	7,467	32%	2,003	2,003
Minimum	20	56	0.3	0.0	24	-102%	-36	8
75th Percentile	259	374	2.8	1.0	1,920	9%	673	709
25th Percentile	117	190	0.9	0.3	226	1%	107	143
IQ Range	142	185	1.9	0.8	1,694	8%	566	566
Median	179	252	1.7	0.6	706	5%	236	318
Average	207	286	2.0	0.7	1,410	2%	486	536
2022								
Maximum	718	1,023	12.0	2.5	9,448	21%	3,679	3,679
Minimum	26	0	0.1	0.0	83	-11%	6	23
75th Percentile	255	378	2.8	1.3	2,162	12%	804	826
25th Percentile	102	136	1.1	0.2	345	4%	132	194
IQ Range	153	241	1.6	1.1	1,817	8%	672	632
Median	165	235	1.6	0.6	1,004	5%	235	383
Average	197	274	2.6	0.8	1,750	7%	662	721

Data are based on Tassnief's investment grade clients representing over 20% of market share.

2- Working Capital Cycle

In general, contracting companies' working capital cycle is extensive. To put this into perspective, as per the selected sample by Tassnief, **the average working capital cycle – including unbilled revenue – stood at 197 days (more than half a year)**. **Additionally, just including the asset side of the net working capital cycle, the average days for trade receivables, unbilled revenues and inventory is 235 days**. This shows a staggering **three** fourths of a year passing before the illiquid assets in working capital cycle is converted into cash.



Major **reasons for extended working capital cycle** as per Tassnief's client survey are as follows:

1) Long drawn-out procedures pertaining to payment by project owners.
2) Absence of earmarking funds for the projects.
3) Liquidity situation of the project owners.
4) Change in management of the project owner.
5) Lengthy approval process for work executed on the request of the project owner but outside the scope of the contract or after expiry of contract. (variation orders)

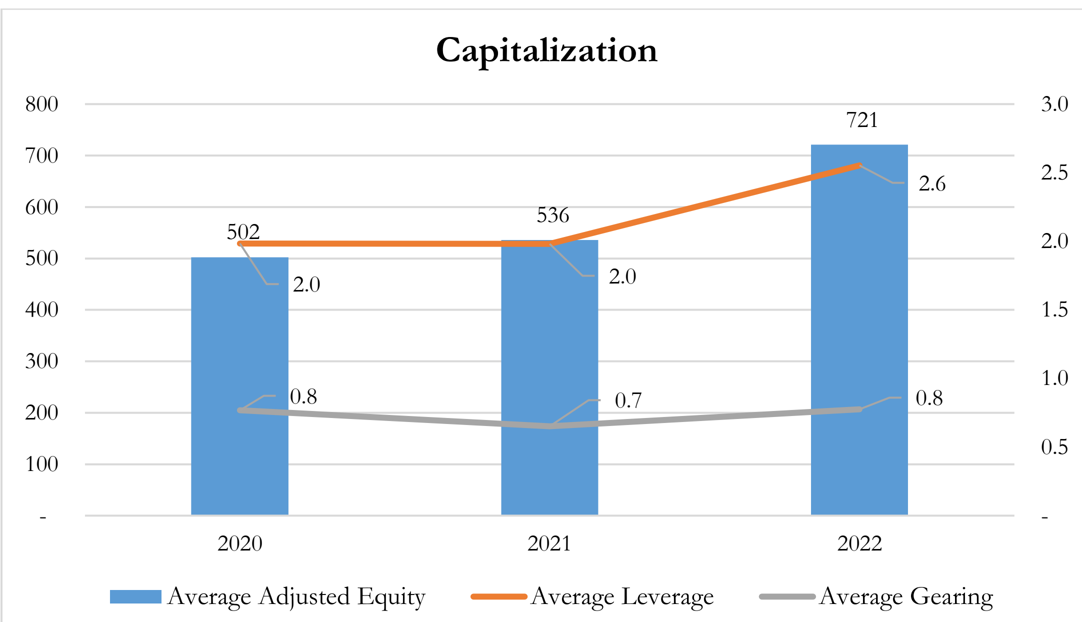
<u>Implications</u>

Due to the liquidity crunch faced in the Kingdom in 2016, contractors resorted to prolonged borrowings in order to fund the illiquid current assets. The extreme effect in certain cases was bankruptcy, whereas generally the profitability profile of the sector faced a decline owing to interest costs in a thin margin industry.

Going forward, extended working capital cycles will be a constraint on the growth of the sector and eventually impact the execution timeline of Vision 2030 projects. The estimated contracts value until 2030 is around SAR 8.5 trillion. Assuming equal distribution of project awards, this will result in an annual funding requirement by an amount of SAR 600 billion.

3- Funding issues

As outlined above, due to the working capital-intensive nature of the industry, contractors fund their balance sheets largely through payables to subcontractors and or suppliers. This has led to high levels of leverage in the contracting industry pressured other supporting industries (i.e. supply chain hazard). This is also evident from the increase in revenues and consequent increase in average industry leverage from 2.0x at end 2020 to 2.6x at end 2022. Due to increasing leverage levels of contracting companies, banks became reluctant in lending contractors in general. This is showcased in the figure below, where the gap between the gearing (interest bearing liabilities to adjusted equity) and leverage (total liabilities to adjusted equity) is 1.8x.



4- Nature of contracts (Adverse Contractual Terms)

Contracting in Saudi Arabia is characterized to **predominantly** have **fixed-price contracts.** However, fixed-price contracts (which do not have **cost escalation clauses**) along with **frequent scope changes** including **design changes** impacts the performance and liquidity of contractors. While contracts are based on fixed price, companies struggle to get any prolongation cost compensation although most projects shift beyond contractual dates due to design changes requested by the client (mostly Governments entities) during the project lifespan. In these cases, revenue recognition slows down considerably whereas recurring/overhead expenses continue as resources must be kept onsite. This has significant impact on contractor's financial standing. In most cases, contractors are unable to reallocate resources to undertake other projects when incurring losses under such projects without material adverse effects on their profitability profile. This further reduces the bankability of such projects/contractors.

Tassnief believes that **early involvement of contractors** (at time of project design and initiation)**, transparent communication with project owners,** and the **introduction of liquidated damages for consulting engineering firms** may partly mitigate this risk. Over the medium term, **changes to the nature of contracts** will help mitigate this risk and improve risk profile of contractors.

Globally, contractors have a balanced mix of contracts' conditions related to pricing approaches. Some of these approaches are alliances, cost-plus, collaborative & negotiated work, unit price, and target cost. Such pricing approaches create favorable contractual terms where contractors' overall profitability, bankability, and overall financial health is better off. This is evident in the below examples which we gathered from large contracting companies in Germany, UK and France.

HOCHTIEF Group (Germany)

	FY2021	FY2022	HY2023
Order Book EUR Bn.		51.4	
Lower risk Contracts %	66%	84%	80%

Alliance style, Cost-plus, collaborative & negotiated work, Unit price, Target cost, etc.

Balfour Beatty (UK)

	FY2022	HY2023
Order book GBPb	17.4	
Cost Plus Contracts % (Fixed cost plus a percentage fee)	16%	16%
Target Cost Contracts % (Final price is based on actual cost plus a fee up to a determined target cost)	90%	68%
Fixed Price Contracts % (Contractor agrees to complete the project based on a fixed price)	10%	16%

These lower risk contract structures utilized in the UK are uncommon in the US, where the early issuing of subcontracts for buildings jobs and bonding of the supply chain protects the Group's US margin. These approaches are not only prudent to protect against job specific issues, but also mitigate against escalating labor and material costs in high inflationary conditions, such as those faced in 2022.[1]

Vinci

Most of the Group's projects are relatively short in duration, particularly those carried out as part of VINCI Energies' activities and in roadworks, which means that changes in costs can generally be factored into quotes for new contracts. Some long-term contracts contain price adjustment clauses based on changes in sectoral indices. **In particular, construction contracts signed with public sector customers in France fall into this category.**[2]

AECOM

	September 2022
Order book SAR	151b
Cost reimbursable	41%
Guaranteed maximum price (contractor guarantees that the project will not cost more than a maximum price. However, if the costs are lower the owner will share savings with the contractor)	33%
Fixed Price %	26%

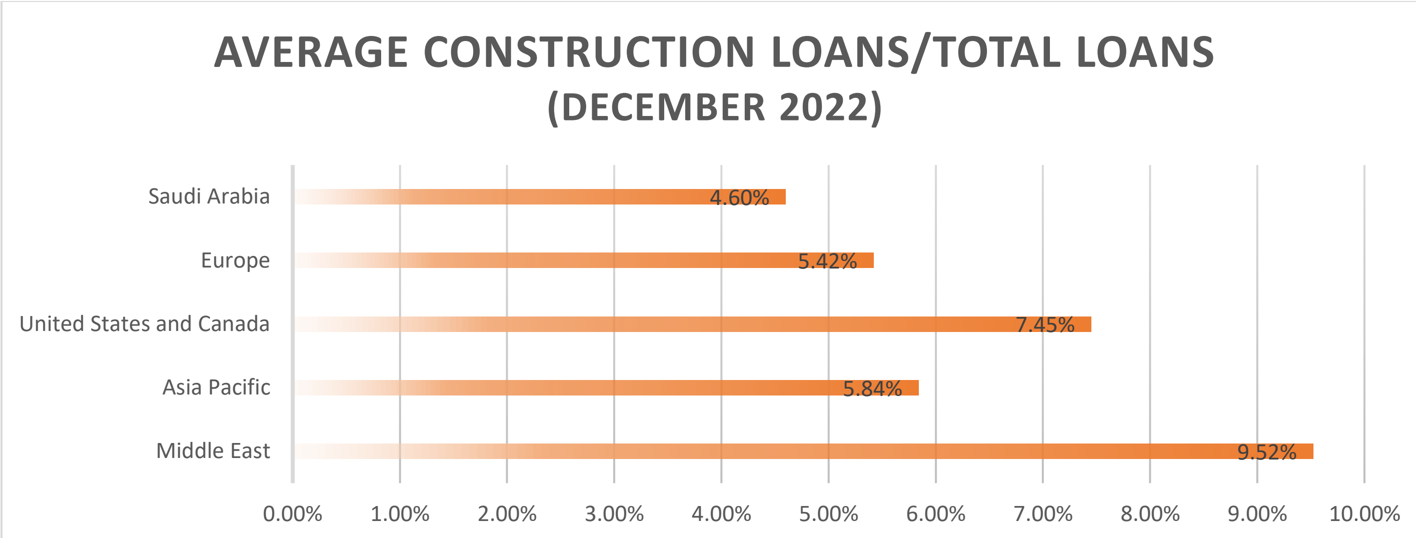
[1] *https://www.balfourbeatty.com/*
[2] *https://www.vinci.com/publi/vinci/a11y/2022/vinci-urd/article/172/*

- Therefore, Tassnief proposes that local market shift towards better contracts to adopt **FIDIC-like contractual terms** to ensure that all parties have more definitive responsibilities and obligations and are **more enforceable**. Such contracts should also cater to compensate for any scope changes, cost escalation (to protect contractors against fluctuations in costs for unforeseen reasons) and variation orders. This will be critically important to limit the risks of large contractors and thereby improve access to finance which will allow them to grow and assume larger projects by time. As such, this shall enhance market conditions and enhance overall capacity, thus favorably adjust the supply-demand equilibrium.[3]

5- Access to Financing

SAR Millions	2016	2017	2018	2019	2020	2021	2022	6M2023	9M2023
Bank Total Loan Portfolio	1,351,407	1,405,210	1,442,705	1,552,529	1,782,590	2,059,220	2,349,071	2,471,333	2,543,851
Building and Construction loans	104,388	89,642	97,326	92,850	92,468	98,080	109,055	121,945	123,324
Building & Constructioı Exposure	**7.7%**	**6.4%**	**6.7%**	**6.0%**	**5.2%**	**4.8%**	**4.6%**	**4.9%**	**4.8%**

[3] https://aecom.com/



- Penetration of bank financing to the construction sector has declined from 7.7% at end-2016 to 4.8% as at end-9M 2023. This is lower than penetration by the average Middle East banks and also as compared to other regions as shown in the above figure. The average Middle East penetration of financing to contractors is 9.5% while north American average stands at 7.45%. This suggests that **local banks are generally shying away from this sector relative to other jurisdictions.** This appetite dilemma shall be resolved by the suggested solutions in this document and shall enhance the overall sector's capacity to reach the high demand over the industry in both government and private sectors.
- Banking sector's loan book has increased at a CAGR of 9.65% over the last 6 years while construction loan book from Banks has increased by less than 1%.

SAR in Billions	Banking Sector						Building and Construction					
	Portfolio		NPL		Infection		Portfolio		NPL		Infection	
Year	**2021**	**2022**	**2021**	**2022**	**2021**	**2022**	**2021**	**2022**	**2021**	**2022**	**2021**	**2022**
Banking Sector	1,954	2,233	33.6	36.36	1.7%	1.6%	82.9	95.2	7.9	6.7	9.6%	7.0%

- Proportion of non-performing loans (NPLs) for the construction sector is significantly higher at 7% vis-à-vis 1.6% for the banking sector.

- These above indicators show that banks financing to the sector has been lagging relative to other sectors and NPLs from the sector are significantly higher than overall banking sector NPLs.

Building & Construction Loans Contribution to Total Loan Portfolio			
		2021	2022
1	Saudi National Bank	4%	3%
2	Al Rajhi Bank	1%	1%
3	Riyad Bank	7%	8%
4	Saudi British Bank (Awwal)	6%	6%
5	Banque Saudi Fransi	9%	11%
6	Alinma Bank	5%	5%
7	Arab National Bank	6%	4%
8	Bank Albilad	2%	2%
9	Saudi Investment Bank	10%	8%
10	Bank AlJazira	3%	3%

- The largest two banks represent around 50% of the banking sector loan book yet only contribute 25% of the total lending to the construction contracting industry players.

SAR Billions		Banking Sector						Building and Construction					
		Portfolio		NPL		Infection		Portfolio		NPL		Infection	
Bank		2021	2022	2021	2022	2021	2022	2021	2022	2021	2022	2021	2022
1	Saudi National Bank	505.9	553.7	11	11.4	2.2%	2.1%	17.9	17.6	2.8	2.9	15.7%	16.9%
2	Al Rajhi Bank	459	573.3	3	3.1	0.7%	0.5%	3.3	6.3	0.71	0.005	21.7%	0.1%
3	Riyad Bank	218	242.9	3.6	4.2	1.7%	1.7%	15.99	18.5	1.1	0.76	7.3%	4.1%
4	Saudi British Bank (Awwal)	166	181	4.2	4.3	2.5%	2.4%	9.6	11.7	1.2	0.97	12.5%	8.3%

5	Banque Saudi Fransi	148.7	159.8	3.9	4.2	2.6%	2.6%	12.7	17.3	0.79	0.8	6.3%	4.6%
6	Alinma Bank	128	147.6	2.3	2.9	1.8%	2.0%	6.5	7.9	0.58	0.008	8.8%	0.1%
7	Arab National Bank	127.6	145	2.2	2.6	1.7%	1.8%	7.4	6.3	0.42	0.69	5.7%	11.0%
8	Bank Albilad	84.6	92.8	0.9	1.2	1.1%	1.3%	2	2.3	0.074	0.13	3.6%	5.6%
9	Saudi Investment Bank	52.8	64.8	1.1	1.1	2.1%	1.7%	5.4	5	0.041	0.18	0.8%	3.6%
10	Bank AlJazira	63.7	72	1.4	1.2	2.2%	1.7%	2.1	2.1	0.14	0.16	6.6%	7.8%
	Top-10 Banks	**1,954.9**	**2,233**	**33.6**	**36.3**	**1.7%**	**1.6%**	**82.9**	**95.2**	**7.9**	**6.7**	**9.6%**	**7.0%**

- Tassnief believes that higher infection in the portfolio and risky nature of the industry are key factors on account of which Banks have adopted a cautious approach towards lending to the sector. Addressing the key risks facing the sector is key to improving access to financing.
- Given the sizeable scale of projects to be executed over the next 5 years, banking sector has a key role to play in funding mega projects. Therefore, addressing the key risk faced by the sector would be critical for giving comfort to Banks.

6- Other challenges for the sector

- Wage inflation driven by labour shortage and increased cost of living.
- Increased demand for talent in the market driven by the construction boom.
- Financing challenges due to a rising interest rate and local banks capacity (money and credit creation theory suggests that the kingdom might need more banks to cater for the expected demand over financing).
- Supply chain constraints and rising cost of material.
- Increased competition with regional contractors.

G20 Countries

We noticed that construction contractors within the rest of G20 countries generally show higher profitability and better capitalization in terms of leverage and gearing. Below table aggregates some key financial gages and ratios to help relate Saudi construction contractors sector to the leading developed countries' players where we believe the suggested resolutions should greatly help in achieving such market conditions for local contractors.

G19 Countries	Net Margin FY2022 (%)	Debt/Equity FY2022 (x)	Leverage (x)	Total Equity FY2022 (USD Mil)	Total Liabilities FY2022 (USD Mil)
Average	12	0.5	1.6	2,075	3,821
Median	6	0.7	1.3	970	1,204

Source: S&P Capital IQ

Suggested Solutions

In order to alleviate contractor capacity concerns, Tassnief proposes the significant changes to the Contracts' Terms and Conditions. Such changes shall address the following main issues:

- Allow **higher advances** especially for projects of scope that create mobilization costs.
- **Lower the required retention amount or tenor** after completion of projects.
- Clear responsibilities and scope to **avoid scope creep** and reduce hazards affecting contractors as a result of variation orders.
- **Cost escalation to be addressed** more properly within contractual terms.
- Clear and transparent **payment process** as well as reduced **turnaround time** for payments with easier legal enforcement.
- Clear **payment terms** and **penalties for delayed payments** to be stipulated in contracts while protecting those terms from any unforeseen amendments due to any change in project owner's management or internal policies.

In order to address the challenges mentioned in this document, the Government could implement the solutions mentioned above in order to reduce/mitigate the sector risks and encourage banks and financial institutions (FIs) to improve lending to contractors thereby enhancing overall capacity of the construction sector.

In addition, and to ensure timely execution, it might be helpful to formulate a governmental/regulatory body (SCA or other(s)) that shall assume responsibilities of enhancing conditions of the contracting industry and monitor implementation of changes being undertaken to address the challenges including payment behaviour and allocation of projects across government entities.

Tassnief's View on the Construction Contracting Sector

The construction sector has a rating of BBB- (Triple B Minus) with the highest rating to any client in the sector being **A** (Single A). Kindly note that credit ratings are stacking of companies according to their risk profile and sector risk. The rating for the contracting sector is arrived at using the following key factors:

- **Cyclicality: high cyclicality**; a cyclical industry's performance generally has high exposure to the business cycle, such that revenues generally are higher in periods of high growth and expansion and are lower in periods of economic downturn and contraction
- **Industry structure**: **fragmented**; fragmented nature of the industry resulting in highly competitive intensity. A fragmented industry is characterized by large number of small industry players. A fragmented industry is characterized by high competitive intensity which impacts margins for industry players.
- **Barriers to entry: low barriers to entry;** barriers to entry are economic hurdles that a new entrant faces while entering that market. Barriers to entry could be on account on account of capital costs, competition, legal barriers, marketing barriers or small size of the market. Low barriers to entry are reflective of the threat of new entrants in the market.
- **Contract risk: high contract risk**; predominantly fixed price contracts and frequent design & scope changes where prolongation cost are not covered.
- **Size of the industry & systemic importance**: **Large;** the sector represents the second largest non-oil sector, a sizeable proportion of GDP and has systemic importance given its critical role in the vision 2030.

Annexure I: Operating Environment Analysis - Contracting

Introduction

Contracting services industry encompass a wide range of activities, allowing businesses to access professional undertaking of specific projects, tasks, or ongoing support. These services include construction, engineering, information technology, marketing and advertising, human resources, and other services where specialized expertise are required.

Some of the major types of contracts used in the contracting industry in KSA include:

- Lump sum: It is one kind of construction contracts where a project owner specifies the work plan and specifications, and a contractor quotes a fixed price for the entire project. In this type of contracts, the risk of cost increase impacts the profitability of the project.

- Cost-plus: Under a cost-plus contract, the contractor is reimbursed by the project owner for all costs incurred during the project in addition to a predetermined profit margin.

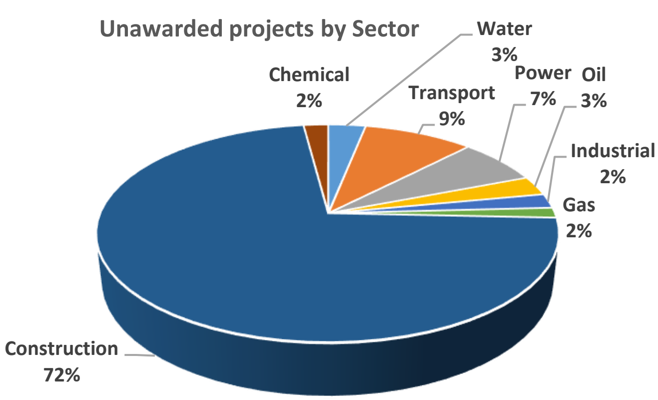
- Unit rate: A unit rate contract is based on the project's expected material quantities and unit pricing. The final cost of the project will be determined by the actual quantities required to complete the work. In this case, the price per unit is fixed thereby shifting the risk to the contractor. Furthermore, quantity is not guaranteed and the same may be dependent on market forces.

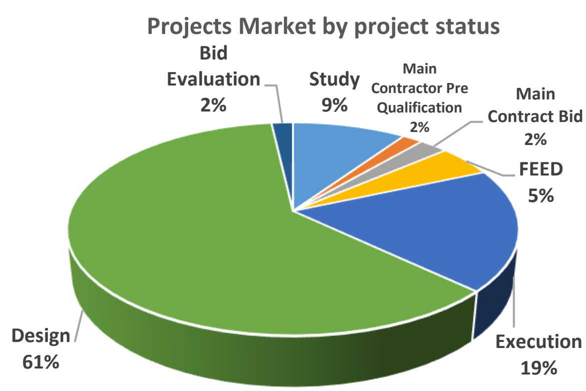
Contracting Firms in KSA

Saudi Arabia's contracting sector is mainly segmented by two industries, construction, and services industries. The construction industry consists mostly of engineering and construction of roads, buildings, dams, water and sewage networks, electrical and mechanical works among others; while the services industry consists primarily of operation and maintenance, information technology and communication, event management and catering.

The COVID-19 pandemic had a substantial influence on Saudi Arabia's project market, resulting in a 53% decrease in spending. The drop in oil prices, which impacted government spending, had a negative impact on the projects market in 2020. However, once the post-pandemic recovery began, investor confidence returned, resulting in a growth revival. As a result, the value of unawarded projects in Saudi Arabia has risen to over USD 1.1 trillion, making it the largest market in the GCC area.

The industry is growing owing to lucrative opportunities as a result of its Vision 2030, NTP 2020, and several current reforms to diversify away from reliance on oil revenue. Due to the activation of key PIF projects such as The Red Sea Co, Qiddiya, Neom, and Diriyah Gate, the construction sector has begun to recover in 2022 after 4 to 5 years of stagnation. Saudi Arabia's pipeline value of unawarded projects of USD 1.1 trillion includes projects in various stages from study to main contractor bid.





Around 70% of the projects in the pipeline are in the construction sector, with residential, cultural, leisure, and hospitality being the top sub-sectors. Around 75% of the USD1.1 trillion worth of projects are in the design stage while around 6% of the projects are at the FEED stage (Basic Engineering which is conducted after completion of Conceptual Design or Feasibility Study).

Tassnief has noted accelerated pace of work on some of the large mega projects including NEOM, King Salman Park, Red Sea, and Qiddiya amongst others. This is expected to continue to facilitate growth for contracting firms. This along with continued growth, although at a relatively slower pace, from the housing sector will facilitate growth for industry players. Additionally, Public Investment Fund (PIF), the sovereign wealth fund of KSA is investing in local contracting companies, mostly in the construction sector. This investment will facilitate capacity enhancement and growth while adopting advanced technology and widening bottlenecks in the supply chain. This will enable KSA enterprises to undertake mega size projects. In line with trend noted by Tassnief, PIF is investing in sectors like event management, facility management, and Information Technology among others.

Given the sizeable number of projects which entail significant investment, any weakening in fiscal position of the sovereign due to sharp decline in oil prices may pose significant challenges for the entire value chain including construction and engineering firms. Tassnief does not expect this scenario over the next 2 years under its base case assumption and under realistic stress test scenarios.

Construction is the second largest non-oil sector in KSA. A study by Mordor Intelligence indicates that the value of the Saudi Arabian Construction Market is USD 65.58 billion in 2022. It is forecasted to escalate to a valuation of USD 75.1 billion by 2028, exhibiting a compounded annual growth rate (CAGR) of 2.75% over the 2023-2028 period. The national government's strategic endeavors, such as enhancing transportation and energy infrastructures and its intent to diversify the economic foundation beyond oil, are anticipated to bolster the sector's average annual growth by approximately 5% throughout the specified forecast period. The Saudi Arabian Construction Market delineates its segmentation into several categories: commercial construction, residential construction, industrial construction, infrastructure (specifically transportation construction), and energy and utility Construction. Prominent entities within this sector encompass the likes of Nesma & Partners, Al Bawani, Al Mabani General Contractors Company, Al Rashid Trading & Contracting Company. Due to strategic frameworks like Vision 2030 and NTP 2020, coupled with ongoing reforms targeting economic diversification beyond oil, the Saudi Arabian construction market is poised for substantial growth. These aforementioned strategic frameworks, coupled with an influx of private sector investments and continuous reforms, are projected to be pivotal growth catalysts for the Saudi construction sector in the upcoming years. The national Vision 2030 initiative, complemented by substantial investments in housing and infrastructure sanctioned by local entities, is rejuvenating the construction realm, subsequently piquing the interest of an increasing cadre of global participants.

Key areas of consideration for the contracting sector

- **Economic conditions:** Overall economic health of the country plays a crucial role in the contracting sector. Economic fluctuations, such as changes in GDP growth, oil prices (as KSA is an oil-dependent economy), and inflation rates, can impact the demand for projects and the availability of funds for investment. The cyclical nature of the industry, coupled with project execution risk (explained below) are key areas of consideration by Tassnief.
- **Government policies & regulations:** Changes in government policies and regulations can significantly impact the contracting sector. For instance, alterations in taxes, duties and iqama fee, licensing requirements, or visa regulations for foreign workers can affect

how contracts are awarded and executed. This can impact contractor's liquidity and capitalization needs as well as the profitability profile.

- **Changing competition dynamics:** Tassnief has noted highly competitive intensity in recent years due to low barriers of entry as well as government initiated projects attracting local and international firms.

  However, level of competition is variable and is dependent on the number and value of projects being awarded. For example, in the current environment the mega projects awarded leads contractors to have high revenue recognition owing to large scale work being undertaken. This has a trickle-down effect to small scale contractors in the form of increased sub-contracting by large players as well as lower number of players when tendering for relatively small-scale projects.

- **Project Execution Risk:** Delivering a project on time, within the budget whilst achieving the project's objectives are key characteristics of successful project execution. Unfortunately, due to real world scenario, complexity and scale of large projects successful project execution is not achieved at times. Given below are key risks that might lead to deviation in results from

  - **Delay in project initiation design changes**: Tassnief has noted that in certain cases there are budget constraints by the project owners that have led to delays in project initiation despite the award of contract. Furthermore, there have been examples where design changes (scope creep) have taken place which halt project progress. In these cases, revenue recognition slows down considerably whereas recurring expenses continue, as resources must be kept onsite. This has a significant impact on the contractor's financial health, as the contractor faces losses in the project and additionally, cannot reallocate resources to undertake other projects. Tassnief believes that early involvement of the contractor at the time of project initiation, clear communication with project owners and imposition of liquidated damages for consulting firms may partly facilitate in managing this risk.

- **Market risk:** Given that KSA has pre-dominantly fixed price contracts, absence of escalation clauses is a key risk. Although at the time of bidding for projects, contractors estimate the input prices for procurement, certain long-term contracts have yielded lower margins than expected owing to increase in procurement prices.
- **Resource availability:** Given the sharp increase in awarded projects in 2022 and in the ongoing year, supply chain constraints in terms of availability of raw materials and machinery is posing challenges for industry players and resulting in higher cost of completing projects. Furthermore, the availability of skilled and unskilled labor can impact the contracting sector's productivity and costs. Wage inflation driven by labor shortage and increased cost of living is expected to be a major challenge for the industry in the upcoming years.
- **Other risk considerations** Project completion risk is an overarching risk which occurs when a project's objectives have not been achieved in a timely manner. There can be various underlying reasons like lagging in project schedule, poor/outdated studies pertaining to the project, delays by other players involved in the project, lack of resources, low performance and scope creep. The financial implications of completion risk can have the following affects.
  - Profitability – Lower revenue recognition in addition to liquidated damages which hampers profitability.
  - Liquidity – Holding payment by the project owners which can negatively impact the working capital cycle and the overall liquidity.
  - Elevated funding requirement due to liquidity concerns and losses

- **Risk of payment delays:** Payment delays from government sector clients can pose challenges in managing working capital for contracting firms, affecting cash flow and operational efficiency.
- **Substantial working capital needs necessitate higher capital requirement:** Larger contracting firms often face a prolonged working capital cycle due to longer project

durations and payment terms, necessitating effective financial management which leads requirement of greater financial flexibility in order to keep business running.

- **Margins:** Tassnief has noted that the margins for the sector are variable and are dependent on the number and value of projects relative to the players in the industry. For example, between 2016-2021 margins have generally remain subdued due to highly competitive intensity proportionate to the projects award. However, as the government has been aggressive in award of recent mega projects where margins are high, earning profile of contractors is expected to improve on a timeline basis. Tassnief will consider the industry cycle when evaluating profitability. Over the years, Tassnief has rated players in the contracting sector through the cycle and will continue to do so.
- **Slowdown in investments by government:** The decline in oil prices may lead to a decrease in government investments in projects which in turn would negatively impact the overall demand and growth of the sector.