October 06, 2022

Hindustan Shipyard Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term fund-based – Working capital facilities	175.00	175.00	[ICRA]BBB+(Stable) reaffirmed
Long term/Short term – Non fund based working capital facilities	1,821.43	1,801.43	[ICRA]BBB+(Stable)/[ICRA]A2; reaffirmed
Long term/Short term – Unallocated	3.57	23.57	[ICRA]BBB+(Stable)/[ICRA]A2; reaffirmed
Total	**2000.00**	**2000.00**	

**Instrument details are provided in Annexure-I*

Rationale

The reaffirmation of the ratings considers the status of Hindustan Shipyard Limited (HSL, the company) as one of the public-sector defence shipyards in India, under the Ministry of Defence, and its strategic importance to the Government of India's (GoI's) plans to strengthen national security. Completely owned by the GoI, the company receives periodical support from the Government in terms of financial packages or loans on favourable terms. It is one of the few yards in India with experience in submarine refits and receives regular ship repair orders. The reaffirmation of the ratings considers its healthy order book position of Rs. 2,052.43 crore as on March 31, 2022 and expected confirmation of a large Indian Navy order in H2 FY2023, for which HSL has already been nominated, providing healthy revenue visibility.

The ratings are, however, constrained by the company's modest financial profile, characterised by a weak capital structure on the back of its negative net worth position due to the erosion from past losses. HSL's financial performance has been weak in the past owing to subdued order flow, working capital constraints and delays in project execution, leading to liquidated damages. The financial performance moderated in FY2021 with operational and net losses, partly due to the adverse impact of the pandemic on its operations. However, the revenues improved in FY2022, while the operating margins remained modest.

The ratings are also constrained by HSL's stretched receivables and accrued income due to the nature of the contracts. In the past, HSL had used funds earmarked for capex (after taking approvals) for its working capital requirements. However, at present, it depends on bank facilities for working capital requirements and the utilisation of the same moderated in the recent fiscals due to mobilisation advances received for some of the projects. ICRA notes the high contingent liabilities arising from tax-related issues and disputes with customers and suppliers, although a few of the claims have been settled recently. Any incremental devolvement of contingent liabilities remains an event risk and will be monitored.

Going forward, a healthy revenue growth driven by a strong order book position is likely to improve its financial profile, capital structure and coverage indicators. The outlook for defence orders for shipyards remains favourable amid the large-scale modernisation of the Indian Navy and Coast Guard and the GoI's focus on the Make in India initiative. However, the company will have to compete for both competitive as well as nominated orders with other defence PSU and private sector yards for these contracts. Its participation in the bidding will depend on its ability to complete the new orders in hand on time to avoid cost overruns and imposition of liquidated damages (LD), given the primarily fixed-priced contracts with a provision for LD in case of delays.

Further, the company has requested the GoI for financial restructuring, under which loans from the Government, including the interest-free perpetual loan, will be converted to equity. Further, the company has also requested for additional revenue grants from the Government. If agreed upon, this will result in positive net worth and HSL's capital structure will improve. The timely acceptance of the financial restructuring/additional grants by the GoI will aid the company in acquiring the Mini Ratna status and participate in larger orders through competitive bidding, which remains a rating sensitivity factor.

ICRA notes that HSL has pending dues to its parent i.e. GoI on certain loans extended to it in FY2019. ICRA understands from the management and the auditor comments that the company had applied for a restructuring of these loans in FY2021 and that the restructuring proposal is in active consideration by the GoI. Further, in ICRA's view, the above instance is unlikely to impact the company's ability and willingness to continue to service its debt obligations to other financial creditors, beyond the risk level that the assigned ratings signify.

The Stable outlook on the [ICRA]BBB+ rating reflects ICRA's expectation that HSL's revenue will witness healthy growth, along with margin improvement in the medium term, aided by healthy orders in hand providing strong order visibility. ICRA expects the company's capital structure and coverage indicators to witness a gradual improvement.

Key rating drivers and their description

Credit strengths

Owned by the GoI and strategic importance to the Indian defence sector – HSL is fully owned by the GoI under the Ministry of Defence. Being one of the defence public sector shipyards in India, the company is strategically important for national security. The GoI has periodically provided support in the form of financial packages or loans on favourable terms to the company.

Healthy orders in hand, good order visibility and experience in defence projects – The company had a healthy order book position of Rs. 2,052.43 crore as on March 31, 2022, consisting of a large order for constructing two diving support vessels (DSVs) and another order for construction of pontoons for the India Navy. Further, the company has been nominated for several large orders, of which the order for fleet support vessels (FSVs), is expected to be firmed up in H2 FY2023. The company has already tied up with a Turkish shipyard for the project. The order value is worth ~Rs. 19,000 crore. Under the refit segment, the company was nominated for a Rs. 500-crore refit order for Sindhukirthi which is expected to be signed in H2FY2023. Under the ship repair segment, the company has been getting regular orders, which have relatively better margins.

Favourable outlook on Indian defence orders – The Indian armed forces are in the midst of modernisation and both the Indian Navy and the Indian Coast Guard have aggressive plans for fleet upgradation, which resulted in large orders in recent years. With the GoI's focus on the Make in India campaign, a large part of these orders are likely to be given to Indian shipyards both on nomination and competitive bidding basis.

Credit challenges

Modest financial profile; stretched receivables and accrued income – The company has a modest financial profile with its profitability impacted by the past delays in project execution, resulting in the imposition of liquidated damages. The financial performance moderated in FY2021 with operational and net losses, partly due to the adverse impact of the pandemic on its operations. However, the revenues improved in FY2022 while the operating margins remained modest. Though the margin improved in FY2022 on account of higher operating efficiency, the net worth continues to be negative on account of erosion from accumulated losses. However, the company has requested the GoI's approval for financial restructuring, which if approved is expected to turn the net worth positive. The timely approval of the scheme remains a rating sensitivity factor as it will help HSL participate in competitive bidding for larger orders.

Going forward, with large orders in hand, the revenue and profitability are expected to improve. Its capital structure and coverage indicators are likely to witness a gradual improvement. The company follows milestone-based billing. However, the payments can get stretched due to disputes, delays in client-side approval or in case of retention money. Moreover, owing to the nature of ship repair contracts, there could be a significant build-up of accrued income as billing might be done at the end of the contracts. Despite some stretch in receivables and accrued income, the fund-based working capital utilisation remained low in FY2021 and FY2022 due to mobilisation advances received for some of the orders.

Susceptible to raw material price volatility and liquidated damages – The fixed-price nature of the competitively bid contracts and the provision for liquidated damages in most contracts make the company's financial profile susceptible to raw material price volatility, cost escalations and imposition of liquidated damages in case of delays in project execution. This might have an adverse impact on its profitability.

Competition from public and private shipyards – The company faces intense competition from both public and private shipyards for commercial as well as defence contracts. It has earlier lost several competitively bid contracts as well as larger nomination contracts due to its weak financial profile. However, with an improvement in its order book and expected enhancement in the financial profile, HSL's ability to take competitive orders is likely to improve. Further, the competition has also moderated, to some extent, as some of the larger private sector yards are facing financial troubles.

High contingent liability; potential devolvement is an event risk – The company has high contingent liabilities related to taxes, disputes with customers and suppliers. Most of its large claims are being contested at various forums. One long contested claim with Essar Oil Limited went against HSL and it had to make a partial payment in FY2019 (provision made in FY2018). However, the company received support from the GoI in the form of a term loan with a 10-year repayment duration and a two-year moratorium, which has mitigated the impact. There is status quo on the said liability, except that HSL has sought the ministry's intervention for the resolution. Subsequently, some of the claims of other customers have been settled in recent fiscals, moderating its contingent liability. Although the management is of the view that the other larger claims are not tenable as they are not in accordance with contract terms, any potential devolvement of contingent liability remains an event risk.

Concentration risk due to dependence on defence orders – The company's current order book and expected orders will be driven by defence sector orders, exposing it to concentration risks and making it vulnerable to any changes in the GoI's policies or delays in the award of nominated orders.

Liquidity position: Adequate

The liquidity is expected to remain adequate on the back of healthy advance for the orders to be finalised and sufficient buffer in working capital limits (average utilisation of ~6% in FY2022). While the company has sizeable capex plans in the coming fiscals, the same is expected to be funded through a pending portion of the refurbishment & replacement of machineries and infrastructure (RRMI) fund that the company received in the past and term loan (sanctioned). Further, if the latest restructuring plan is approved, the liquidity position is expected to improve as it entails additional infusion of capital by the Government through revenue grant and conversion of existing Government loans into revenue grant.

Rating sensitivities

Positive factors – HSL's ratings could be upgraded if there is a substantial growth in revenue and profitability, aided by additional new orders and better working capital management.

Negative factors – Negative pressure on HSL's ratings might arise if there is a significant decline in revenues and margin due to delays in project execution, leading to LD imposition and losses. Weakening of the order book position, stretch in the working capital cycle or devolvement of contingent liability would also impact the company's liquidity and credit profile and may trigger a downgrade.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating Approach- Implicit parent or group support
Parent/Group support	Parent/Group Company: Government of India; the assigned ratings factors in the strategic importance of HSL as a defence shipyard and the track record of the GoI's support.
Consolidation/Standalone	Standalone

About the company

HSL was founded in 1941 by Sri Walchand Hirachand, as Scindia Steam Navigation Company Limited at Visakhapatnam (Andhra Pradesh). In 1961, the company became a fully-owned GoI undertaking. Since then, it has been under the Ministry of Shipping. However, in 2010, it was designated as a defence shipyard and functions under the administrative control of the Ministry of Defence. The company has three segments — ship building, ship repair and submarine refits.

Key financial indicators (audited)

HSL Standalone	FY2021	FY2022
Operating income	393.3	727.8
PAT	(14.0)	50.8
OPBDIT/OI	-16.1%	5.3%
PAT/OI	-3.6%	7.0%
Total outside liabilities/Tangible net worth (times)	(3.1)	(3.4)
Total debt/OPBDIT (times)	(8.5)	15.6
Interest coverage (times)	(11.6)	1.7

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2021)				Chronology of rating history for the past 3 years		
		Type	Amount rated (Rs. crore)	Amount outstanding as on Mar 31, 2022 (Rs. crore)	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021	Date & rating in FY2020
					Oct 06, 2022	Sep 02, 2021	Jun 12, 2020	May 27, 2019
1	**Fund-based working capital facilities**	Long term	175.0	--	**[ICRA]BBB+ (Stable)**	**[ICRA]BBB+ (Stable)**	**[ICRA]BBB+ (Stable)**	**[ICRA]BBB+ (Stable)**
2	**Non fund-based working capital facilities**	Long term and short term	1801.43	--	**[ICRA]BBB+ (Stable) /[ICRA]A2**	**[ICRA]BBB+ (Stable) /[ICRA]A2**	**[ICRA]BBB+ (Stable) /[ICRA]A2**	**[ICRA]BBB+ (Stable) /[ICRA]A2**
3	**Unallocated**	Long term and short term	23.57	--	**[ICRA]BBB+ (Stable) /[ICRA]A2**	**[ICRA]BBB+ (Stable) /[ICRA]A2**	**[ICRA]BBB+ (Stable) /[ICRA]A2**	**[ICRA]BBB+ (Stable) /[ICRA]A2**

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term fund-based – Working capital	Simple
Long-term/ Short -term – Non Fund-based working capital	Very Simple
Unallocated	Not applicable

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: www.icra.in

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	**Working capital Fund-based**	NA	NA	NA	175.00	[ICRA]BBB+ (Stable)
NA	**Working capital Non-fund Based**	NA	NA	NA	1801.43	[ICRA]BBB+ (Stable) /[ICRA]A2
NA	**Unallocated**	NA	NA	NA	23.57	[ICRA]BBB+ (Stable) /[ICRA]A2

Source: Company

Annexure II: List of entities considered for consolidated analysis – Not Applicable

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About ICRA Limited:

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