December 19, 2023

ISGEC Heavy Engineering Limited: Ratings reaffirmed and assigned for the enhanced amount

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Fund-based Working Capital	600.00	600.00	[ICRA]AA(Stable); reaffirmed
Short-term – Non-fund Based Working Capital	3800.17	3,800.17	[ICRA]A1+; reaffirmed
Short-term/Long-term - Fund-based/Non-fund Based Working Capital	1,099.83	1,099.83	[ICRA]AA(Stable)/[ICRA]A1+; reaffirmed
Long-term Fund-based Term Loan	-	50.00	[ICRA]AA(Stable); assigned
Total	**5,500.00**	**5,550.00**	

**Instrument details are provided in Annexure-I*

Rationale

ICRA has considered the consolidated financials of ISGEC Heavy Engineering Limited (IHEL) while assigning the credit ratings. The reaffirmation of the rating continues to draw comfort from steady order flows transpiring in healthy and well diversified consolidated order book for Engineering Business of Rs 8667 crore as on September 30, 2023, and expectations of further improvement in profitability and coverage metrics of the company. In ICRA's opinion, the expansion in operating profits expected with healthy pace of order execution and stabilisation of commodity prices along with the reduction in debt from the FY2023 levels would allow improvement in interest coverage and total debt/OPBIDTA in the medium term. The total debt on IHEL's books had significantly increased between FY2018 and FY2023 on account of higher working capital intensity of the engineering, procurement and construction (EPC) operations, acquisition of CBPI Philippines assets[1]and debt-funded distillery capex at Saraswati Sugar Mills Limited (SSML; rated [ICRA]A(Stable)/A1).

The working capital intensity of the engineering business has increased over the past few years owing to the shift in the order profile towards Government clients where IHEL avails mobilisation advances to a lesser extent due to their interest-bearing nature. However, going forward, the working capital intensity in the project businesses is expected to moderate with IHEL's focus on reducing civil-heavy orders, and restricting tenor of new orders to less than 2 years. Further, the working capital intensity of the sugar business has improved significantly owing to decline in sugar stock, resulting in improvement in NWC/OI at a consolidated level to 25.4% in FY2023, but still remains elevated (27.5% in FY2022 and 9.6% in FY2018).

The ratings favourably factor in the established position of IHEL as a well-diversified engineering company, aided by its long-term technical tie-ups/alliances with several recognised global heavy engineering companies as well as its in-house design and manufacturing capability. This apart, the ratings factor in the well-diversified healthy order book across industry segments, customers and geographies, covering a wide range of product segments. Additionally, the company has a sufficient cushion in both fund-based and non-fund-based limits to address its fresh order requirements over the near to medium term. Further, the absence of cash margin requirements supports the company's financial flexibility.

Further, the Group's operating margins are subject to volatile raw material prices, particularly for fixed-price EPC contracts, given the long order execution period of about 18-24 months. Headwinds in the commodity prices as well as time and cost overrun due to delay in project execution amid covid-19 had resulted in a decline in IHEL's operating profit margins (OPM;

[1] IHEL was under arbitration with Cavite Biofuels Producers Inc or CBPI, Philippines for whom the former was executing a sugar project on EPC basis. As a part of settlement arrived at in October 2019, IHEL acquired 100% equity stake in the entities owning entire assets of the said project.

standalone level) in FY2022 to 4.0%. However, the standalone OPM improved to 6.4% in FY2023 and further to 7.6% in H1FY2024, driven by higher manufacturing segment contribution to revenues, which has higher margins, and receding of commodity headwinds. The proportion of earlier longer duration orders in orderbook has reduced during FY2023 and H1FY2024, and the new orders are expected to have better margins as IHEL has factored in higher level of commodity prices at the time of bidding for the same. This should aid improvement in margins as well as coverage metrices.

Further, the policy of fully hedging its forex exposures also mitigates the currency fluctuation risks to a large extent. Additionally, the margins in the sugar business remain vulnerable to changes in government policy (which are favourable currently) and agro-climatic conditions.

The Stable outlook on the rating reflects ICRA's opinion that IHEL will continue to benefit from its established position as a leading diversified engineering company with a healthy and well-diversified order backlog.

Key rating drivers and their description

Credit strengths

Established position as a leading diversified heavy engineering company engaged in manufacturing and project business – The company has a strong market position in the capital goods segment, which contributes to majority of its revenues and profits. Apart from the in-house capabilities, IHEL has several technology joint ventures (JVs) and strategic technology partnerships with international majors. Moreover, IHEL's long track record of more than 75 years in the industry and its ability to absorb and indigenise technology bolster its market position.

Over FY2023-H1FY2024, the EPC business contributed ~50-55% to IHEL's gross revenues (reducing from ~60% over FY2019-FY2022), ~31-34% came from manufacturing (increasing from ~26-29% over FY2019-FY2022) with the balance from the sugar and ethanol operations. With captive manufacturing and fabrication facilities across key product segments such as presses, boilers, process equipment, IHEL enjoys benefits of synergies between its manufacturing and its EPC segment which is characterised by sound designing and execution capabilities.

Healthy and diversified order book – IHEL continues to have a healthy order book of Rs. 8,667 crore at the consolidated level and Rs. 7716 crore at the standalone level as on September 30, 2023, which lends healthy medium-term revenue visibility. Further, the consolidated order book is well diversified across industry segments with refineries contributing 27% of the order book, followed by power (18%), sugar (16%), steel, cement and aluminium (12%), chemicals, petrochemicals and fertiliser (15%), railways (2%) and the balance (10%) by other segments. The diversified orderbook limits vulnerability of IHEL's orders and revenue booking to cyclicality in any single industry capacity expansions.

Further, the completion of projects within the agreed timelines while maintaining the desired quality parameters is critical to minimise the liabilities arising from project delays and performance issues. The order book, however, is spread across more than 300 individual orders, resulting in modest order concentration. The top 5 and top 10 orders account for ~15% and ~25%, respectively, of the pending order book as on June 30, 2023 on a standalone level.

Credit challenges

Working capital intensity continues to remain high – IHEL's working capital requirements steadily rose over FY2018-HFY2024 to ~28-30% from sub-10%, led by high revenue growth in the EPC segment over FY2018-FY2022 and its changing order profile towards PSU orders. While the revenue from project business contribution has moderated over FY2023-H1FY2024, IHEL is yet to witness meaningful improvement in working capital intensity at a standalone level. While a large order book entails high retention money build-up, many incremental orders do not offer interest-free customer advances, as was common in the past. This, along with varying payment cycles, especially with longer duration EPC contracts, as well as Covid-related disruptions over FY2021-FY2022 resulted in higher working capital intensity. IHEL utilised its existing cash and liquid investments and debt to fund these increased requirements.

However, the working capital intensity of the Group improved to 25.4% in FY2023 and further to 21.3% in H1FY2024, even as standalone NWC/OI continues to remain ~28-30%. ICRA notes that consolidated NWC/OI improvement in FY2023 is driven by lower sugar stock for SSML, and lower inventories for IHZL.

The company has a sufficient cushion of non-fund-based limits to address its requirements over the medium term. Further, the absence of cash margin requirements supports the company's financial flexibility. Additionally, IHEL is currently focusing on reducing the civil-heavy order intake in order to lower the related risk of time and cost overruns while reducing the working capital intensity, going forward. The company is now concentrating on engineering/technology intensive orders.

Improvement witnessed in operating margins yet it is subject to volatile raw material prices – The cost of key raw materials for equipment manufacturing such as steel and several other bought-out components make up for IHEL's raw material cost. Given the long order execution period of about 18-24 months, the operating margin remains vulnerable to the volatility in the prices of key raw materials, particularly for private sector contracts that are generally fixed-price in nature. Headwinds in commodity prices as well as time and cost overruns due to delays in project execution amid Covid-19 resulted in a decline in IHEL's operating profit margins (OPM; standalone level) in FY2022 to 4.0% (FY2021: 6.9%). However, OPM improved recovered to ~6.4% in FY2023 and further to ~7.6% in H1FY2024, driven by higher manufacturing and sugar/ethanol contribution to revenues, which have relatively higher profitability. During FY2022, fixed price longer duration orders were under execution and were adversely hit by increase in commodity prices, leading to lower profitability. The proportion of these earlier orders has reduced during FY2023-H1FY2024. Further, the margins in the sugar business remain vulnerable to the changes in government policy (which are favourable currently) and agro-climatic conditions.

While debt metrices improved overall in FY2023 and H1FY2024, they remain elevated vis-à-vis pre-Covid levels – The total debt of the Group has remained stable at Rs 1235 crore as on March 31, 2023 (PY: Rs. 1,233 crore) primarily on account of lower working capital and term debt at SSML (driven by low sugar inventories) and offset by higher debt for the CPBI project. Consequently, due to higher tangible net worth, its gearing improved slightly to 0.39 times as on Mar 31, 2023 (PY: 0.52 times). However, TOL/TNW continues to remain high at ~2 times as on Mar 31, 2023 as well as Sep 30, 2023. Stable gearing levels coupled with higher OPBIDTA has also strengthened the coverage metrics in FY2023 with interest cover of 6.2 times (PY: 4.4 times), total debt/OPBIDTA of 2.7 times (PY: 4.3 times) and DSCR of 1.6 times (PY: 2.0 times). Further, the coverage and leverage are expected to improve in the medium term from the current levels with the likely reduction in debt levels and better OPBIDTA. Overall, while the debt metrices have witnessed improvement in FY2023-H1FY2024, they remain relatively weaker than FY2017 levels.

Total debt declined to Rs 959 crore as on Sep 30, 2023 again due to seasonally lower working capital debt at SSML, IHZL and IHEL (standalone). In H1 FY2024, due to further improvement in profitability, debt/OPBIDTA as well as interest cover have improved and are expected to emerge healthier for the current fiscal.

Intense competition from domestic and international players – IHEL faces competition from various domestic and international players, which has kept the company's operating margins at modest levels of 4-8% over the last few fiscals.

Environmental and Social Risks

Environmental considerations: As per the disclosures made by IHEL, its products and services are designed to achieve better parameters than the legal environment norms set by the Government for emission, water and energy efficiency. Further, some of IHEL's products (air pollution control equipment) are focused on addressing environmental problems. Also, the Group is alert to the possibility of environmental risks due to discharge of waste water and hence it ensures waste water treatment, recycling and reuse. Additionally, IHEL gets periodic energy audits done. Also, there were no pending show cause/legal notices from Central Pollution Control Board (CPCB)/State Pollution Control Board (SPCB) at the end of FY2023. This indicates that IHEL has been able to mitigate the regulatory risks by demonstrating a sound operational track record and ensuring regulatory compliance.

Moreover, with respect to the sugar business, being an agri-commodity, the sugarcane crop depends on climatic conditions, besides being vulnerable to pests and diseases. These factors can affect both the yield per hectare as well as the recovery rates which in turn can affect SSML's profitability.

Social considerations: IHEL's success depends critically on its competent workforce. As per the disclosures made by the company, it has initiated various measures to improve the retention of trained and talented employees in the context of emerging market conditions. Additionally, customer satisfaction remains critical for IHEL's successful operations and it conducts surveys on a regular basis to ensure this. While IHEL remains exposed to the aforementioned social risks, it does not materially affect its credit profile as of now.

Liquidity position: Adequate

IHEL's liquidity profile is adequate with cash balance and investments of Rs. ~387 crore (consolidated) and Rs 223 crore (standalone) as on September 30, 2023 and average cushion in sanctioned limit of Rs. ~300 crore (standalone) in 12 months ended Aug-2023. Further, retained operating cash flows are likely to be comfortable in H2FY2024 and is expected to improve to healthier levels in FY2025 with relatively lower working capital intensity as well as higher profitability. ICRA expects IHEL (standalone) to comfortably meet its debt repayment obligations of ~Rs. 50 crore in H2FY2024. ICRA also notes that IHEL (standalone) is expected to incur a capex of Rs. ~40-50 crore per annum in the medium term, which is expected to be met from internal accruals. No major debt-funded capex is expected at CPBI project or other subsidiaries. Liquidity profiles of key subsidiaries - IHZL and SSML, are also adequate.

Rating sensitivities

Positive factors – Favourable rating action could be taken if the company demonstrates a significant increase in the order book execution while improving the operating profits and cash generation that would strengthen the liquidity and debt coverage metrics on a sustained basis. A specific metric that could lead to an upgrade is net debt/OPBIDTA below 0.8 times.

Negative factors – Negative pressure on the ratings could arise if there is a considerable decline in revenue due to lower order book execution, or reduction in profit margins and cash flow generation, resulting in weakening of liquidity and debt coverage metrics on a sustained basis. Any delays in project ramp-up of operations for CBPI impacting the cash flow generation and resulting in support from IHEL can trigger a negative rating action.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology
Parent/Group support	Not Applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of IHEL. List of companies given in Annexure-2.

About the company

ISGEC Heavy Engineering Limited (IHEL), a public company under the ISGEC Group, manufactures heavy engineering equipment and provides related EPC/turnkey services. The company was established in 1946 by the Puri family and was initially named Saraswati Industrial Syndicate Limited. The initial activity was the manufacture of spares for sugar mills to complement the Group's sugar mills operations. Over a period of time, the company diversified into a range of engineering products and projects, including process equipment, sugar plants and distilleries, air pollution control equipment, industrial boilers, power projects, bulk material handling, industrial water waste treatment and liquefiable gas containers. Apart from in-house capabilities, IHEL has a number of technology joint ventures (JVs) and strategic technology partnerships with global EPC players such as Hitachi Zosen Corp., Foster Wheeler North America Corp., AP&T, BabcockPower USA, Riley Power USA etc., which enables it to command a leadership market position across many product categories.

Key financial indicators (audited)

IHEL Consolidated	FY2022	FY2023	H1 FY2024
Operating income	5,477	6,399	2,859
PAT	115	205	116
OPBDIT/OI	5.3%	7.1%	8.3%
PAT/OI	2.1%	3.2%	4.1%
Total outside liabilities/Tangible net worth (times)	2.1	1.9	2.0
Total debt/OPBDIT (times)	4.3	2.7	2.0
Interest coverage (times)	4.4	6.2	6.0

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 (FY2024)					Chronology of rating history for the past 3 years			
		Type	Amount rated (Rs. crore)	Amount outstanding as of Sep 30, 2023 (Rs. crore)	Date & rating in FY2024		Date & rating in FY2023		Date & rating in FY2022	Date & rating in FY2021
					Dec 19, 2023	Nov 23, 2023	Nov 28, 2022	Aug 25, 2022	May 25, 2021	-
1	**Fund-based Working Capital**	Long term	600.00	-	**[ICRA]AA (Stable)**	**[ICRA]AA (Stable)**	**[ICRA]AA (Stable)**	**[ICRA]AA (Stable)**	**[ICRA]AA (Negative)**	-
2	**Non fund based Working Capital**	Short term	3,800.17	-	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	-
3	**Fund based / Non fund based Working Capital**	Long term/ Short term	1,099.83	-	**[ICRA]AA (Stable)/ [ICRA]A1+**	**[ICRA]AA (Stable)/ [ICRA]A1+**	**[ICRA]AA (Stable)/ [ICRA]A1+**	**[ICRA]AA (Stable)/ [ICRA]A1+**	**[ICRA]AA (Negative)/ [ICRA]A1+**	-
4	**Long-term Fund-based Term Loan**	Long term	50.00	50.00	**[ICRA]AA (Stable)**	-	-	-	-	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term Fund-based Working Capital	Simple
Short-term – Non fund based Working Capital	Very Simple
Long-term/Short-term - Fund based / Non fund based Working Capital	Simple
Long-term Fund-based Term Loan	Simple

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: [Click Here]

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Long-term Fund-based Working Capital	NA	NA	NA	600.00	[ICRA]AA (Stable)
NA	Short-term – Non fund based Working Capital	NA	NA	NA	3,800.17	[ICRA]A1+
NA	Long-term/Short-term - Fund based / Non fund based Working Capital	NA	NA	NA	1,099.83	[ICRA]AA (Stable)/ [ICRA]A1+
NA	Long-term Fund-based Term Loan	FY2021	NA	Q4FY2024	50.00	[ICRA]AA (Stable)

Source: Company

Please click here to view details of lender-wise facilities rated by ICRA

Annexure II: List of entities considered for consolidated analysis

Company Name	IHEL Ownership	Consolidation Approach
ISGEC Heavy Engineering Limited	100.00%	Full Consolidation
ISGEC Covema Ltd.	100.00%	Full Consolidation
ISGEC Exports Ltd.	100.00%	Full Consolidation
Saraswati Sugar Mills Ltd.	100.00%	Full Consolidation
ISGEC Engineering & Projects Ltd.	100.00%	Full Consolidation
Free Look Software Private Ltd.	100.00%	Full Consolidation
ISGEC Hitachi Zosen Ltd.	51.00%	Full Consolidation
ISGEC SFW Boilers Private Ltd.	51.00%	Full Consolidation
ISGEC Titan Metal Fabricators Private Ltd.	51.00%	Full Consolidation
ISGEC Redecam Enviro Solutions Private Ltd.	51.00%	Full Consolidation
Eagle Press & Equipment Co. Limited*	100.00%	Full Consolidation
ISGEC Investments Pte Ltd.*	100.00%	Full Consolidation

**Including their subsidiaries; ISGEC Investment Pte Ltd owns CBPI assets*

***Source:** IHEL*

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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.

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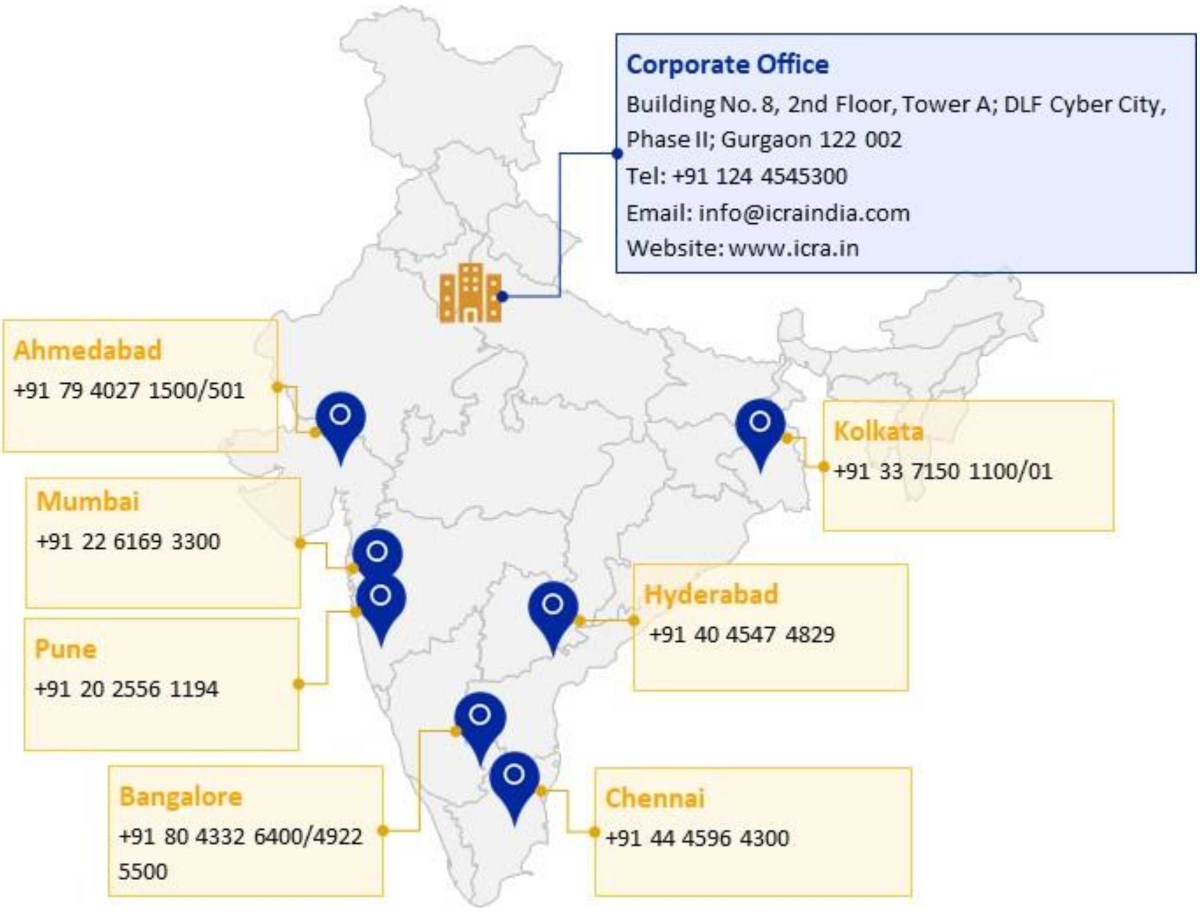

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