September 12, 2017

ISGEC Heavy Engineering Limited

Summary of rated instruments

Instrument*	Rated Amount (Rs. crore)	Rating Action
Fund-based	300.0	[ICRA]AA(Stable); reaffirmed
Non-fund based	98.90	[ICRA]AA(Stable); reaffirmed
Non-fund based	2451.10	[ICRA]A1+; reaffirmed
Fund-based / Non-fund based	150.0	[ICRA]AA(Stable)/[ICRA]A1+; reaffirmed
Proposed	300.0	[ICRA]AA(Stable); reaffirmed
Total	**3300.0**	

*Instrument details are provided in Annexure-1

Rating action

ICRA has reaffirmed the rating on the long term scale for Rs 300.0 crore[1] fund based facilities, Rs 98.90 crore non fund based facilities and Rs 300.0 crore proposed limits of ISGEC Heavy Engineering Ltd (IHEL) at [ICRA]AA(pronounced ICRA double A). ICRA has also reaffirmed the rating on the short term scale for Rs 2451.10 crore non fund based limits of IHEL at [ICRA]A1+(pronounced ICRA A one plus)[2]. ICRA has also reaffirmed the rating on the long term and short term scale for Rs 150.0 crore fund based / non fund based limits of IHEL at [ICRA]AA/ [ICRA]A1+. The outlook on the long-term rating is 'stable'.

Rationale

The rating action positively factors in the track record of promoters and established position of IHEL as an EPC/fabricator for various equipments/machinery in the capital goods sector both in India and in the overseas markets. The ratings also factor in the stability in operations which arises due to the defensible market position of IHEL, especially in India, in a number of divisions such as boilers, presses, sugar plant machinery and process equipment aided by long term technical tie ups/alliances with a number of recognized global heavy engineering companies as well as IHEL's in-house design and manufacturing capability. The strong market position enables IHEL to keep its working capital requirements negligible given they receive adequate customer advances and have a shorter receivables cycle. Further, ICRA acknowledges the prudent risk management techniques followed by IHEL such as hedging of entire forex exposure (forex risk), back to back arrangement with vendors as well as satisfactory assessment of various other risks such as political, environmental, commercial, legal etc. before taking up a project. Apart from this, the rating reaffirmation factors in the strong diversification of IHEL's revenue stream across a number of end markets, geographies and clients and a strong order book which offers revenue visibility in the medium term. The strong business position is reflected in the robust financial profile. IHEL has a negative net debt position, interest coverage ratio of 12.5x and NCA/total debt of 212% in FY2017 apart from unutilized bank lines. IHEL's short term liquidity is supported by more than Rs 800 crore of liquid investments and cash and bank on top of a negative working capital requirement aided by adequate customer advances.

Nevertheless, the assigned ratings continue to factor in the competitive pressures from other engineering equipment manufacturers and vulnerability of the company's revenues to cyclical trends in some consuming industries, which may affect future order inflows. The same has been demonstrated by ~22%

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[1] *100 lakh = 1 crore = 10 million*

[2] *For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications*

reduction in revenue in FY2017 as compared to FY2016 which was attributed largely to a lower opening order book in FY2017. The assigned ratings also take into consideration the business risks arising out of company's exposure to raw material price fluctuations for the products manufactured in-house, though ICRA notes that the percentage of the same in overall mix is low. Further, the profitability of Saraswati Sugar Mills Ltd, a 100% subsidiary of IHEL which is into sugar manufacturing, is likely to remain exposed to cyclicality in the sugar industry, necessitating financial support from the parent entity in downturns.

Key rating drivers

Credit strengths

- **Long experience of promoters of IHEL -** IHEL was established in 1946 by Puri family and was initially engaged in the manufacture of spares for sugar mills to complement the group's sugar mills operations. In the course of its history, the company diversified into a range of engineering products such as boilers, process equipments, castings etc. IHEL has manufacturing facilities in Yamunanagar (Haryana), Muzaffarnagar (Uttar Pradesh), Dahej (Gujarat) and Bawal (New Delhi) and also has design and engineering capabilities. It largely undertakes Engineering Procurement and Construction (EPC) of boilers, sugar machinery and power plants with manufacturing of process equipment, presses and castings also contributing a small portion to the top line.
- **Market position aided by technical tie ups/alliances -** Apart from in-house capabilities, IHEL has a number of technology JVs and strategic technology partnerships with global EPC players such as Hitachi Zosen Corp, Amec Foster Wheeler North America Corp., Belleli, Italy etc which enables it to command leadership market position across many product categories such as boilers, presses, process equipment etc. IHEL's long experience in the industry, technical tie-ups with international majors and ability to absorb and indigenize technology results in strong brand recall for its products. Entry barriers for new entrants are high because of requirement of strong track record, technical competence and pre-qualification status.
- **The order book is adequate and well diversified** – IHEL has a satisfactory order book which is increasingly focussed towards international business in regions such as Central America, Africa, the Middle East and South East Asia. While some of consuming industries are cyclical in nature (notably sugar and steel) which results in risk to IHEL's business growth, however, owing to a diverse mix of client's base, the risk is mitigated to some extent. Further, most of the consumer companies are private sector industrial customers which reduces the risk of exposure of the order book to few lumpy orders. The company's order book has, thus, remained well diversified both geographically and in terms of exposure to industries catered to.
- **Risk mitigation processes are robust** – IHEL sources its raw material and a sizable portion of equipments from external vendors/suppliers. For any order received by the company, it enters into back to back order for supply of key equipments on similar commercial and technical terms. However, for the products manufactured in house by the company, raw materials, such as steel, is largely procured from open markets at spot rates which makes the company vulnerable to raw material price fluctuations, since most of its contracts are on a fixed price basis. Apart from raw material risk, IHEL takes vanilla forward covers on most of its forex exposures to manage the currency risk. These covers are taken within a short period from date of receiving new order. IHEL also undertakes risk assessment studies before bidding for any project.
- **Strong profitability and healthy capital structure –** IHEL's operating profitability and working capital intensity has improved over the last few years which has positively impacted its liquidity profile and capital structure. Short term liquidity is supported by more than Rs 800 crore of liquid mutual fund and FD investments and cash and bank and a negative working capital requirement.

Credit weaknesses

- **Intense competition from domestic and international players** – Given the competitive nature of domestic and international market, order booking is expected to remain challenging. The same is further amplified by the overall weak market scenario. However, that said, IHEL has demonstrated a solid track record of booking orders despite a difficult external environment.
- **Possible support extended to Saraswati Sugar Mills Ltd (SSML)** – SSML is a 100% subsidiary of IHEL and is non-integrated sugar mill based in Yamunanagar, Haryana and having an operating capacity of 9,600 TCD. Despite strong recent performance, SSML is likely to remain exposed to cyclicality in the sugar industry, which could necessitate financial support from the parent entity in downturns.

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

Links to applicable criteria:
Corporate Credit Rating Methodology

About the company
ISGEC Heavy Engineering Limited (formerly Saraswati Industrial Syndicate Limited), a public company under the ISGEC Group, is engaged in the manufacturing of Heavy Engineering equipments and providing related EPC/ turnkey services. Its product portfolio comprises pressure vessels, heat exchangers, mechanical and hydraulic presses, iron and alloy steel castings, boilers, power plant, sugar machinery and air pollution control equipments. The company was established in 1946 by the Puri family. Their initial business activity was manufacturing of spares for sugar mills to complement its sugar mills operations. In the course of its history, the company diversified into a range of engineering products, and in 1964 it established a joint venture with John Thompson of the UK to form "ISGEC John Thompson" to manufacture boilers. In 1981, it acquired majority shares in UP Steels. Both these companies were subsequently amalgamated into ISGEC Heavy Engineering Limited.

The company also has technical collaborations with Amec Foster Wheeler of USA for technology related to manufacturing of CFBC Boilers upto 99.9 MW and for Pulverized Coal Fired Subcritical (60 MW to 1000 MW) and Supercritical (550 MW to 1000 MW) Boilers. During FY 2011-12, IHEL completed a capacity expansion for manufacturing of pressure parts required for Boilers.

IHEL incorporated a Joint Venture 'ISGEC Hitachi Zosen Limited' along with Hitachi Zosen Corporation, Japan in March 2012. The JV is engaged in the manufacturing of specialized & critical process equipments and caters to the requirements of oil refining, fertilizer & petrochemical industries.

The company bought technical drawings and the brand Morando for manufacturing of Vertical Turning Lathes (VTL) during FY2012. IHEL also acquired the technology to manufacture Electrostatic Precipitators (ESP) from Envirotherm GmbH, Germany, and signed technology agreements with M/s Belleli, Italy for the manufacturing of Breech Lock Exchangers and with Foster Wheeler, USA for the supply of design for Feed Water Heaters and Surface Condensers in the same financial year.

During FY2013, the company's machine building division developed presses suitable for non-automobile applications such as white goods, tiles, etc. Further, the company's steel casting unit developed the capability of manufacturing crushing shell castings for the mining & mineral processing industry.

In FY2014, the boiler division of IHEL has ventured into new products including Heat recovery steam generators, Waste heat recovery boilers and Pin hole grate boilers. The division has also ventured into Repair and maintenance business for the first time. The company has commissioned first domestic order for Pulverized coal fired boiler. It has also commissioned a number of Electrostatic precipitators in accordance with the technology acquired from Envirotherm Gmbh, Germany.

In FY2017, IHEL entered into various technology agreements for air pollution control equipments such as those with Fuel Tech, USA, Redecam, Italy and Babcock Power Environmental, USA.

Key Financial Indicators (Audited)

	FY2016	FY2017
Operating Income (Rs. crore)	3873	3032
PAT (Rs. crore)	190	189
OPBDIT/ OI (%)	7.9%	8.5%
RoCE (%)	26.1%	23.2%
Total Debt/ TNW (times)	0.33x	0.10x
Total Debt/ OPBDIT (times)	1.02x	0.42x
Interest coverage (times)	15.44x	12.46x
NWC/ OI (%)	-4.6%	-8.7%

OI: Operating Income; PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; ROCE: PBIT/Avg (Total Debt + Tangible Net-Worth + Deferred Tax Liability - Capital Work - in Progress);
NWC: Net Working Capital

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating history for last three years:

Table:

<table>
<tr><th rowspan="3">S. No.</th><th rowspan="3">Instrument</th><th colspan="4">Current Rating (FY2018)</th><th colspan="4">Chronology of Rating History for the past 3 years</th></tr>
<tr><th rowspan="2">Type</th><th rowspan="2">Amount Rated (Rs. crore)</th><th rowspan="2">Amount O/s (Rs Crore)</th><th>Date & Rating</th><th colspan="2">Date & Rating in FY2017</th><th>Date & Rating in FY2016</th><th>Date & Rating in FY2015</th></tr>
<tr><th>Sep 2017</th><th>Sep 2016</th><th>May 2016</th><th>Jun 2015</th><th></th></tr>
<tr><td>1</td><td>PC/PCFC/ Letter of Credit</td><td>Long Term</td><td>300.0</td><td></td><td>[ICRA]AA (Stable)</td><td colspan="2">[ICRA]AA (Stable)</td><td>[ICRA]AA (Stable)</td><td></td></tr>
<tr><td>2</td><td>BG/LC</td><td>Short Term</td><td>2451.10</td><td></td><td>[ICRA]A1+</td><td colspan="2">[ICRA]A1+</td><td>[ICRA]A1+</td><td></td></tr>
<tr><td>3</td><td>BG/LC</td><td>Long Term</td><td>98.90</td><td></td><td>[ICRA]AA (Stable)</td><td colspan="2">[ICRA]AA (Stable)</td><td>[ICRA]A1+</td><td></td></tr>
<tr><td>4</td><td>PC/PCFC/ Letter of Credit/BG/ LC</td><td>Long Term/ Short Term</td><td>150.0</td><td></td><td>[ICRA]AA (Stable)/ [ICRA]A1+</td><td colspan="2"></td><td></td><td></td></tr>
<tr><td>5</td><td>Proposed</td><td>Long Term</td><td>300.0</td><td></td><td>[ICRA]AA (Stable)</td><td colspan="2">[ICRA]AA (Stable)</td><td>[ICRA]AA (Stable)</td><td></td></tr>
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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

Instrument	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
PC/PCFC/ Letter of Credit	-	-	-	300.0	[ICRA]AA(Stable)
BG/LC	-	-	-	2451.10	[ICRA]A1+
BG/LC	-	-	-	98.90	[ICRA]AA(Stable)
PC/PCFC/ Letter of Credit/BG/LC	-	-	-	150.0	[ICRA]AA(Stable)/ [ICRA]A1+
Proposed	-	-	-	300.0	[ICRA]AA(Stable)

Source: IHEL

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Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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