June 21, 2022

Elecon Engineering Company Limited: Ratings assigned

Summary of rating action

Instrument*	Current Rated Amount (Rs. crore)	Rating Action
Fund-based Limits- Cash Credit	175.00	[ICRA]A+ (Stable); assigned
Non-fund Based Limits	325.00	[ICRA]A1; assigned
Total	**500.00**	

**Instrument details are provided in Annexure-1*

Rationale

The ratings assigned factor in the leadership position of Elecon Engineering Company Limited (EECL) in the transmission products segment i.e. gears with a sizeable market share of around 38% in India, supported by significant manufacturing capacities, an expansive geographic presence and an established presence in the material handling equipment segment (MHE). Additionally, EECL has developed a reasonable global footprint in recent years and its revenue mix is fairly diversified across geographies with international sales accounting for 35% of the consolidated revenues in FY2022.

The ratings consider the favourable medium-term demand outlook with increased demand from end-users such as the steel, cement, sugar and power (flue gas desulphurisation or FGD projects) sectors. The order book is also strong at Rs. 410 crore on a standalone basis and at Rs. 605 crore on a consolidated basis as on March 31, 2022. Further, an order inflow guidance of around Rs. 1,000 crore for FY2023 provides revenue visibility over the near term.

The company has enhanced its focus on the replacement market which will support revenue growth. The ratings favourably factor in the steady improvement in the operating profit margin (OPM) to 21% in FY2022 from 11.6% in FY2019 as well as strengthening of the core ROCE to 20.5% in FY2022 (7.6% in FY2019). A favourable revenue mix with a higher share of the manufacturing business and scaling down of the EPC business under the MHE segment improved the working capital cycle and thus, the borrowings. The company's capital structure remained strong with a gearing of 0.1 times as on March 31, 2022, backed by a considerable reduction in debt levels and strong net worth. Expanding operating profits and cash accruals supported healthy debt coverage metrics and a favourable liquidity profile.

The ratings are, however, constrained by the moderately high working capital intensity with NWC/OI at 28.1% as on March 31, 2022, though it improved from 32.9% as on March 31, 2021. This was primarily on account of high receivables from the MHE segment and high inventory levels in the gear division. The working capital cycle is expected to improve going forward with the release of retention money and receivables from the MHE division along with a shorter working capital cycle in the transmission division. Notwithstanding the scaled-down EPC business, any major write-offs in legacy projects would remain a key monitorable.

The ratings are further constrained by the revenues being exposed to the cyclicality in the domestic capex cycle and any economic slowdown, though the company's presence across various industries as well as in the replacement market and its growing exports provides some comfort. The ratings further note the vulnerability of the company's profitability to the variations in the prices of raw materials, which majorly include steel and steel components. Steel prices have increased substantially over the past few months and are at a multi-year highs now amid some moderation seen recently.

The Stable outlook on the long-term rating reflects ICRA's opinion that EECL's revenues and accruals will be supported by its comfortable order book along with expectations of a healthy order inflow in the near to medium term. Also, the company will continue to benefit from its established track record in the transmission and the MHE segments.

Key rating drivers and their description

Credit strengths

Leading player in transmission products segment - EECL is a leading player in the transmission products segment i.e. gears with a sizeable market share of around 38% in India and significant manufacturing capacities. The company had an established presence in the material handling equipment segment for products as well as EPC services in the past with the revenue contribution at 40% in FY2017. However, in recent years, it has restricted its exposure only to the products and after-sales segment even as it completes some legacy EPC projects with revenue contribution at 11% in FY2022. Over the years, the company has widened its product offerings and geographic presence in transmission products through in-house development and acquisitions globally.

The company expects to increase the share of revenue from exports to 50% in the long term. The company benefits from strong design and engineering capabilities, technical collaborations as well as backward-integrated facilities with in-house foundry that has allowed it to enhance its product offerings over the years with increased complexity, reflected in its ability to bag orders for marine gears from the Indian Navy. Additionally, EECL has developed a reasonable global footprint in recent years and its revenue mix is diversified across geographies with international sales accounting for 35% of the consolidated revenues in FY2022. The company is also focused on increasing its presence in the US, South America and Europe — whose revenue contribution is expected to increase going forward.

Favourable medium-term demand outlook; strong order book provides revenue visibility – EECL had received a healthy order inflow of more than Rs. 800 crore in FY2022 in the transmission segment with a standalone order book position of Rs. 410 crore and a consolidated order book of Rs. 605 crore as on March 31, 2022. Moreover, an order inflow guidance of Rs. 1,000 crore for FY2023 provides revenue visibility over the near term. The product offerings encompass the standard/catalogue products as well as engineered products in the gears division. Standard products, which account for 55% of the gear sales, are available off the shelf and have a shorter execution cycle. The execution cycle of engineered products varies between three months and eight months. The order inflow is expected to remain strong in FY2023 with increased demand from end-users such as steel, cement, sugar and power (flue gas desulphurisation or FGD projects) sectors.

Besides the supplies to projects, the management has enhanced focus on the replacement market, which accounts for 20% of the total revenue and is expected to increase going forward. Additionally, the management has over the years strengthened its team in developed markets as well as supplied initial batches and expects repeat orders from customers in North America. The healthy order book in the transmission segment and favourable demand prospects with the recovery in private capex are expected to drive the company's revenue growth over the next few years. The order inflow in the MHE segment has remained modest at around Rs. 162.4 crore and order book position at Rs. 127.0 crore (March 2022) and is expected to remain in line going forward.

Steady improvement in profitability and earnings profile with focus on manufacturing operations - The company's revenues have remained range-bound at around Rs. 1,100-1,200 crore in the last five years. A favourable revenue mix with a higher share of the manufacturing business (89% gears in FY2022 against around 60% in FY2017), supplies of technically complex products (naval gears) as well as a scaled-down EPC business under the MHE segment have enabled the release of long standing dues and partial retention money that improved the return metrics. Despite the spike in raw material prices, provisions and write offs, the company's operating profit margin (consolidated basis) improved to 21% in FY2022 from 11.6% in FY2019, while the core RoCE strengthened to 20.5% in FY2022 (7.6% in FY2019).

The improvement in ROCE in FY2022 was led by a favourable revenue mix and reduced costs pertaining to the MHE business, translating into better operating profits (standalone as well as consolidated wherein the profitability from subsidiaries also improved in FY2022). The working capital requirements also contracted with the scaling down of the MHE business which reduced the debt levels. A healthy order book position and favourable order intake prospects benefiting from a recovery in the capex cycle would allow higher asset sweating and provide scope for further improvement in the return metrices while managing the working capital requirements efficiently.

Healthy capital structure and coverage indicators along with strong liquidity profile - With the company transitioning its business operations from being a manufacturer as well as an EPC company to a manufacturer of transmission and material handling equipment, the total outside liabilities reduced to around Rs. 500 crore in March 2022 from over Rs. 1,200 crore in March 2018. The considerable reduction in the debt levels following the repayment of term loans, lower working capital borrowings and a strong net worth position have supported the company's capital structure. During 2017-2020, the company's borrowings remained substantially high on account of the stretched liquidity position due to the projects division in the MHE segment and the execution of high-value order from the Indian Navy. However, with the closure of the projects division in the MHE segment as well as completion of the Navy order, EECL's working capital intensity improved and reduced the borrowings. The company's NWC/OI, which remained in the range of 35-40% in the last few years, reduced to 28% in FY2022. The company's capital structure remained healthy with a gearing of 0.1 times in FY2022, improving from 0.3 times in FY2021. The coverage indicators also stood comfortable with TD/OPBDITA of 0.4 times (P.Y. 1.5 times), TOL/TNW of 0.6 times (P.Y. 1.2 times) and interest coverage of 6.7 times (P.Y. 3.1 times) on consolidated basis as on March 31, 2022. The coverage metrics further improved with expectations of a healthy revenue growth and profits being maintained in FY2023 in the backdrop of a reasonable order book and a steady order flow despite the headwinds from elevated raw material prices. EECL's liquidity position is expected to remain strong with undrawn line of credit, sizeable, unencumbered cash balance and receipt of customer advances.

Credit challenges

Moderately high working capital intensive nature of operations- EECL's working capital intensity remained high with NWC/OI at 28.1% as on March 31, 2022 even as it improved from 32.9% as on March 31, 2021. This is primarily on account of high receivables from the MHE segment and high inventory levels in the gear division owing to various types of standard product inventory maintained by the company. For majority of the receivables in the MHE segment, the company has taken the recourse of arbitration following delays in payments. The debtor days for EECL, excluding the MHE division's receivables, stood at around 60 days as on March 31, 2022 (compared to inclusive of MHE debtors at 127 days). This mainly transpires from a shorter recovery cycle of the transmission division. Going forward, the company's working capital cycle is expected to improve with the release of payments from the MHE division along with a shorter working capital cycle in the transmission division.

Revenues vulnerable to cyclicality in end-user industries – EECL's revenues are exposed to the cyclicality in the domestic capex cycle and any economic slowdown could impact its revenues as witnessed in the past. However, presence across multiple segments as well as the international market (mostly replacement market) and increased focus on the replacement market in India mitigates the risk to an extent.

Margins susceptible to fluctuations in raw material prices – The company's margins are susceptible to the fluctuations in raw material prices due to a lag of two to three months in manufacturing lead time, especially for engineered products. Its major raw materials include steel and steel components, the prices of which have increased substantially over the past few months and are at a multi-year high currently. Nonetheless, EECL's ability to pass through the increase in raw material prices in new orders and advance the procurement of raw material for existing orders mitigates the risk to an extent. Further, ICRA notes the rising competition faced by the company from domestic and foreign players, limiting its pricing flexibility to an extent.

Liquidity position: Strong

EECL has a strong liquidity profile, reflected in its healthy cash flow from operations of Rs. 189.6 crore in FY2022, and free cash balance of Rs. 76.41 crore on a consolidated level (Rs. 6.18 crore on standalone level) as on March 31, 2022. The fund-based working capital utilisation for EECL (standalone) has remained moderate at around 60% for the past 12 months, providing adequate cushion. Further, the company has Rs. 150-crore capex plans for the FY2023 to FY2025 period, which will be funded through internal accruals and surplus cash, yet the liquidity position is expected to remain comfortable. The management has guided for prepayment of long-term loans of Rs. 25.8 crore till September 2022, which can be comfortably met from cash accruals.

Rating sensitivities

Positive factors – ICRA could upgrade EECL's ratings if it demonstrates a significant growth in its scale of operations and profitability as well as shortening of the working capital cycle that would allow a sustained improvement in the debt protection metrics and liquidity profile.

Negative factors – Pressure on the company's ratings could arise if it witnesses a sharp deterioration in its revenues and profitability or if its coverage metrics weaken. Further, any deterioration in the working capital cycle that weakens the liquidity position or coverage metrics may trigger a downward rating action. Further, the ratings may be downgraded if the ROCE is lower than 18% on a sustained basis.

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 taken a consolidated view of EECL and its wholly-owned subsidiaries, Radicon Transmission UK Limited (including its wholly owned step-down subsidiaries), Elecon Singapore Pte. Limited, Elecon Middle East FZE as well as associate companies Emico (Elecon) India Limited, Elecon Eng. (Suzhou) Co. Limited, Elecon Australia Pty. Limited and Elecon Africa Pty. Limited.

About the company

Elecon Engineering Company Limited (EECL) is a listed company which was founded in 1951 in Bombay to manufacture elevators and conveyors. It was incorporated as a private limited company in 1960. After the formation of a separate Gujarat state in May 1960, ELECON shifted its base to Vallabh Vidyanagar, and become a public limited company in 1962. In 1976, the company set up a gear division to manufacture products like worm gears, helical gears, spiral bevel helical gears and different types of couplings for application in steel mills, high-speed turbines, sugar mills, marine vessels, coast guard ships, plastic extrusions, antenna drives and satellites for the Indian Space Programme. Initially, the gears manufactured were used for captive consumption and currently it is the leading division of the company. The company also manufactures material handling equipment and is now mainly into the supply of products and after-sales services. ICRA has consolidated the operational and financial profiles of EECL, its subsidiaries and joint ventures for the analysis.

Key financial indicators

EECL-Consolidated	FY2020 (Audited)	FY2021 (Audited)	FY2022 (Audited)
Operating Income (Rs. crore)	1,091.1	1,050.8	1,207.8
PAT (Rs. crore)	88.1	55.8	139.1
OPBDIT/OI (%)	13.4%	18.0%	21.2%
RoCE (%)	7.2%	11.2%	17.3%
Total Outside Liabilities/Tangible Net Worth (times)	1.5	1.2	0.6
Total Debt/OPBDIT (times)	3.7	2.0	0.7
Interest Coverage (times)	1.9	3.1	6.7
DSCR (times)	1.5	2.0	2.4

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2023)				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
					June 21, 2022			
1	Fund-based limits- Cash Credit	Long Term	175.00	-	[ICRA]A+ (Stable)	-	-	-
2	Non-fund-based limits	Short Term	325.00	-	[ICRA]A1	-	-	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Fund-based limits- Cash Credit	Simple
Non-fund-based limits	Very 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, is available on ICRA's 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	Fund-based limits-Cash Credit	--	NA	--	175.00	[ICRA]A+ (Stable)
NA	Non-fund-based limits	--	NA	--	325.00	[ICRA]A1

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

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership (Mar 31, 2022)	Consolidated Approach
Radicon Transmission UK Limited (including its following wholly owned step-down subsidiaries)	100.00%	Full Consolidation
- Benzlers Systems AB	100.00%	Full Consolidation
- AB Benzlers	100.00%	Full Consolidation
- Radicon Drive Systems Inc.	100.00%	Full Consolidation
- Benzler Transmission AS.	100.00%	Full Consolidation
- Benzler TBA B.V.	100.00%	Full Consolidation
- Benzler Antriebstechnik GmBH	100.00%	Full Consolidation
- OY Benzler AB	100.00%	Full Consolidation
- Benzlers Italia s.r.l	100.00%	Full Consolidation
Elecon Singapore Pte. Limited	100.00%	Full Consolidation
Elecon Middle East FZE	100.00%	Full Consolidation
Eimco (Eiecon) India Limited	16.62%	Equity Method
Elecon Eng. (Suzhou) Co. Limited*	50.00%	Equity Method
Elecon Africa Pty. Limited*	50.00%	Equity Method
Elecon Australia Pty. Limited*	50.00%	Equity Method

*Company is in the process of obtaining approval from Reserve Bank of India for their liquidation

ANALYST CONTACTS

Sabyasachi Majumdar
+91 124 4545 304
sabyasachi@icraindia.com

Girishkumar Kadam
+91 22 6114 3441
girishkumar@icraindia.com

Anupama Arora
+ 91 124 4545 303
anupama@icraindia.com

Menka Sabnani
+91 79 4027 1562
menka.sabnani@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

About ICRA Limited:

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.

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.

For more information, visit www.icra.in

ICRA Limited

Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001
Tel: +91 11 23357940-45

Branches