June 07, 2023

Elecon Engineering Company Limited: Ratings upgraded to [ICRA]AA- (Stable)/[ICRA]A1+ from [ICRA]A+ (Stable)/[ICRA]A1

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term fund-based - Cash credit limits	150.0	100.0	[ICRA]AA- (Stable); upgraded from [ICRA]A+ (Stable)
Short-term non-fund-based limits	350.0	200.0	[ICRA]A1+; upgraded from [ICRA]A1
Total	**500.00**	**300.00**	

**Instrument details are provided in Annexure-I*

Rationale

The ratings upgrade reflects the sustained improvement in the performance of Elecon Engineering Company Limited (EECL), evident from its strong 26% revenue growth in FY2023 coupled with the improved operating margin profile and return metrics and negligible debt levels. The improved financial profile came on the back of the company's established market position with a sizeable market share of around 38% in India, supported by significant manufacturing capacities, an expansive geographic presence (international sales accounting for 29% of revenues in FY2023) and a strong presence in the material handling equipment segment (MHE). 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. 569 crore in the transmission segment and Rs. 145 crore in the MHE segment on a consolidated basis as on March 31, 2023. Further, the order inflow is expected to remain healthy, which provides revenue visibility over the near term.

ICRA notes that EECL's operating profit margin (OPM) expanded to 22.4% in FY2023 (21% in FY2022), strengthening the core ROCE to 27.0% in FY2023 (18.7% in FY2022). Further, company's capital structure remained strong with no external debt, strong net worth position and a healthy liquidity position.

The ratings are, however, constrained by the moderately high working capital intensity with NWC/OI at 21.4% as on March 31, 2023, though it improved from 29.4% as on March 31, 2022. This was primarily on account of high receivables from the MHE segment and the increased inventory levels in the gear division. The working capital cycle is expected to improve, going forward, with the release of retention money and the 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 weakness in economic activity, 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 last few months and are at a multi-year high 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. Earlier, the company used to have an established presence in the material handling equipment segment for products and EPC services with the revenue contribution at 40% in FY2017. This is now restricted only to products and after-sales even as it completes some legacy EPC projects with revenue contribution at 14% in FY2023. 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 benefits from its 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 29% of the consolidated revenues in FY2023. The company is also focused on increasing its presence in South America and Africa — 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. 1,300 crore in FY2023 in the transmission segment with a consolidated order book of Rs. 569 crore as on March 31, 2023. Moreover, the company expects a healthy order inflow for FY2024 which will provide revenue visibility over the near term. The product offerings encompass the standard/catalogue products as well as engineered products in the gear division. Standard products, which account for 48% of the gear division sales in FY2023, 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 FY2024 with healthy demand expected from end-users such as steel, cement, sugar and power (flue gas desulphurisation or FGD projects) sectors.

Additionally, the management has over the years strengthened its team in the international market and expects orders from customers in the US, Europe, South America and Africa. The healthy order book in the transmission segment and favourable demand prospects with recovery in private capex is expected to drive the company's revenue growth over the next few years. The order inflow in the MHE segment has remained modest and with an order book position of Rs. 145.0 crore as of March 2023 and is expected to remain in line, going forward.

Steady improvement in revenue and profitability – The company's revenues have improved to Rs. 1,530 crore in FY2023, a growth of 26%, on the back of healthy order inflow in the transmission division. There was a steady improvement in the operating profit margin (consolidated basis) to 22% in FY2023 from 21% in FY2022, while the core RoCE strengthened to 27% in FY2023 (18.7% in FY2022).

The improvement in ROCE in FY2023 was led by the increase in the scale of operations, resulting in better absorption of fixed expenses and translating into higher operating profits. 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 with the recovery in the capex cycle would allow higher asset sweating and provide scope for further improvement in the return metrices and enable EECL to manage its working capital requirements efficiently.

Healthy capital structure and coverage indicators along with strong liquidity profile – The company's capital structure remained healthy with no external debt and a strong net worth position. The company's NWC/OI, which remained in the range of 35-40% in the last few years, reduced to 21% in FY2023. The company's capital structure remained healthy with a gearing of 0.1 times in FY2023, improving from 0.2 times in FY2022. The coverage indicators also stood comfortable with TD/OPBDITA of 0.2 times (P.Y. 0l.7 times), TOL/TNW of 0.4 times (P.Y. 0.6 times) and interest coverage of 24.9 times (P.Y. 6.7 times) on a consolidated basis as on March 31, 2023. The coverage metrics are expected to remain strong with expectations of healthy revenue growth and the profits being maintained in FY2024 in the backdrop of a reasonable order book and a steady order flow. EECL's liquidity position is expected to remain strong with undrawn line of credit and 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 moderately high with NWC/OI at 21% as on March 31, 2023 even as it improved from 29% as on March 31, 2022. This is primarily on account of high receivables from the MHE segment and the 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 48 days as on March 31, 2023 (compared to inclusive of MHE debtors at 84 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 at present. 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. 295.4 crore in FY2023, and free cash balance and liquid investments of Rs. 228.6 crore on a consolidated level (Rs. 135.0 crore on standalone level) as on March 31, 2023. The fund-based working capital utilisation for EECL (standalone) has remained low at around 20% 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.

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 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 20% 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, founded in 1951 in Mumbai 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 became 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, antena drives and for satellites in the Indian Space programme. Initially, the gears manufactured were used for captive consumption and currently it the leading division of the company.

Key financial indicators (audited)

EECL-Consolidated	FY2022	FY2023
Operating income	1,216.1	1,529.8
PAT	139.1	234.2
OPBDIT/OI	21.0%	22.4%
PAT/OI	11.4%	15.3%
Total outside liabilities/Tangible net worth (times)	0.6	0.4
Total debt/OPBDIT (times)	0.7	0.2
Interest coverage (times)	6.7	24.9

Source: Company, ICRA Research ;PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes, and amortisation; Amounts 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 May xx, 2023 (Rs. crore)	Date & rating in FY2024	Date & rating in FY2023		Date & rating in FY2022	Date & rating in FY2021
					June 07, 2023	Oct 18, 2022	June 21, 2022	-	-
1	Fund-based limits- Cash credit	Long term	100.00	-	[ICRA]AA- (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	-	-
2	Non-fund based limits	Short term	200.00	-	[ICRA]A1+	[ICRA]A1	[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 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	Fund-based limits-Cash credit	-	NA	-	100.00	[ICRA]AA- (Stable)
NA	Non-fund-based limits	-	NA	-	200.00	[ICRA]A1+

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	LTHL Ownership	Consolidation 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

*Source: EECL results FY2023 *Company is in the process of obtaining approval from Reserve Bank of India for its liquidation Note: ICRA has taken a consolidated view of the parent (EECL), its subsidiaries and associates while assigning the ratings.*

ANALYST CONTACTS

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

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

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

Menka Sabnani
+91 79 4027 1562
menka.sabnani@icraindia.com

RELATIONSHIP CONTACT

L. Shivakumar
+91 22 6114 3406
shivakumar@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.

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ICRA Limited

Registered Office

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

Branches