

January 19, 2024

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	1,801.43	1,801.43	[ICRA] BBB+ (Stable)/[ICRA] A2; reaffirmed
Long term/Short term - Unallocated	23.57	23.57	[ICRA] BBB+ (Stable)/[ICRA] A2; reaffirmed
Total	2,000.00	2,000.00	

*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) plans to strengthen national security. Completely owned by the GoI, the company received 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 ratings also consider its healthy order book position of ~Rs. 20,365 crore as on September 30, 2023 with the receipt of a large navy order of ~Rs. 19,048 crore in August 2023, 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 a 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 and FY2023 with an improvement in the operating margins.

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 its working capital requirements. The utilisation of working capital moderated in the recent fiscal 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 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 with other defence PSU and private sector yards for for both competitive as well as nominated orders. 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).

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 auditor comments that the company has applied for a restructuring of these loans 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 the 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 order book position and experience in defence projects – The company had a healthy order book position of ~Rs. 20,365 crore as on September 30, 2023, under the ship building segment, consisting of a large order of Rs. 19,048 crore with a project duration of 7.5-8 years for constructing 05 fleet support ships (FSS) for the Indian Navy which was signed with the Ministry of Defence in August 2023. The other existing orders under this segment include building two diving support vessels (DSVs) and construction of pontoons for the India Navy. Under the refit segment, the company has signed a contract for normal refit of INS Sindhukirti for a duration of 22 months and the order value is Rs. 936 crore. Under the ship repair segment, the company has been getting regular orders on the basis of competitive bidding.

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 has 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– The company has a modest financial profile with its profitability impacted by past delays in project execution, resulting in the imposition of liquidated damages. The financial performance was weak 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 and FY2023 with an improvement in the operating margins. Though the margin improved in FY2023 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 FY2023 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 adversely impact its profitability.

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

High contingent liability; the same is likely to reduce in the current fiscal– The company had high contingent liabilities related to taxes and disputes with customers and suppliers. The contingent liabilities, excluding bank guarantees, are at ~Rs. 2,041 crore as of March 2023 against ~Rs. 1,864 crore in March 2022. Although the management is of the view that the claims are not tenable as they are not in accordance with the contract terms, any potential devolvement of contingent liability remains an event risk which has been partially mitigated owing to reduction in contingent liabilities in the current fiscal. However, many claims have been settled in recent fiscals, moderating its contingent liability upto great extent. One set of arbitration award with respect to Good Earth Maritime has been awarded in favour of HSL which has reduced the contingent liabilities significantly and the other set of award is expected to be announced soon.

Concentration risk due to dependence on defence orders – The company’s current order book and expected orders will be driven by the defence sector, 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 mobilisation advance of ~Rs. 4,000 crore received in YTD FY2024 for the Indian Navy order worth ~Rs. 19,048 crore and sufficient buffer in working capital limits (utilisation of ~6% in Dec 2023). While the company has sizeable capex plans of ~Rs. 500 crore over the next 2 years, the same is expected to be funded through the pending refurbishment & replacement of machineries, the infrastructure (RRMI) fund that the company received in the past, mobilisation advances and existing cash accruals. 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 by converting one of the Government loans to equity.

Rating sensitivities

Positive factors – HSL’s ratings could be upgraded if there is a substantial growth in revenue and profitability, improved liquidity position along with strengthening of the net worth on a substantial basis.

Negative factors – 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. The 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
Parent/Group support	Parent/Group Company: Government of India; the assigned ratings factor 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

Hindustan Shipyard Limited (HSL), incorporated in 1941, operates a shipbuilding facility at Vishakhapatnam, Andhra Pradesh. A Government of India Enterprise, HSL, is currently under the administrative control of the Ministry of Defence (MoD). The company has a diversified business, with three major divisions- ship building, ship repair and retrofit. Prior to the administrative takeover by MoD in 2010, HSL operated primarily as a civil shipyard. After the takeover, HSL also delivered warships for the Indian Navy and Coast Guard in the offshore & inshore patrol vessel segment. HSL also delivers naval warships through its repair and refit activities for both ships and submarines.

Key financial indicators (audited)

HSL Standalone	FY2022	FY2023
Operating income	727.8	1,072.9
PAT	50.8	81.2
OPBDIT/OI	5.3%	8.4%
PAT/OI	7.0%	7.6%
Total outside liabilities/Tangible net worth (times)	(3.4)	(3.9)
Total debt/OPBDIT (times)	15.6	6.0
Interest coverage (times)	1.7	4.7

Source: Company, ICRA Research; All ratios as per ICRA's calculations; Amount in Rs. crore; 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	Type	Current rating (FY2024)		Chronology of rating history for the past 3 years				
		Amount rated (Rs. crore)	Amount outstanding as on Sep 30, 2023 (Rs. crore)	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021	
				Jan 19, 2024	Oct 06, 2022	Sep 02, 2021	Jun 12, 2020	
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	1,801.43	--	[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: [Click Here](#)

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

[Please click here to view details of lender-wise facilities rated by ICRA](#)

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

ANALYST CONTACTS

Girishkumar Kadam
+91 022-6114 3441
girishkumar@icraindia.com

Prashant Vasisht
+91 12 4454 5322
prashant.vasisht@icraindia.com

Kushal Kumar
+91 040-69396408
kushal.kumar@icraindia.com

Deep Shailesh Vakil
+91 022-6169 3352
deep.vakil@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

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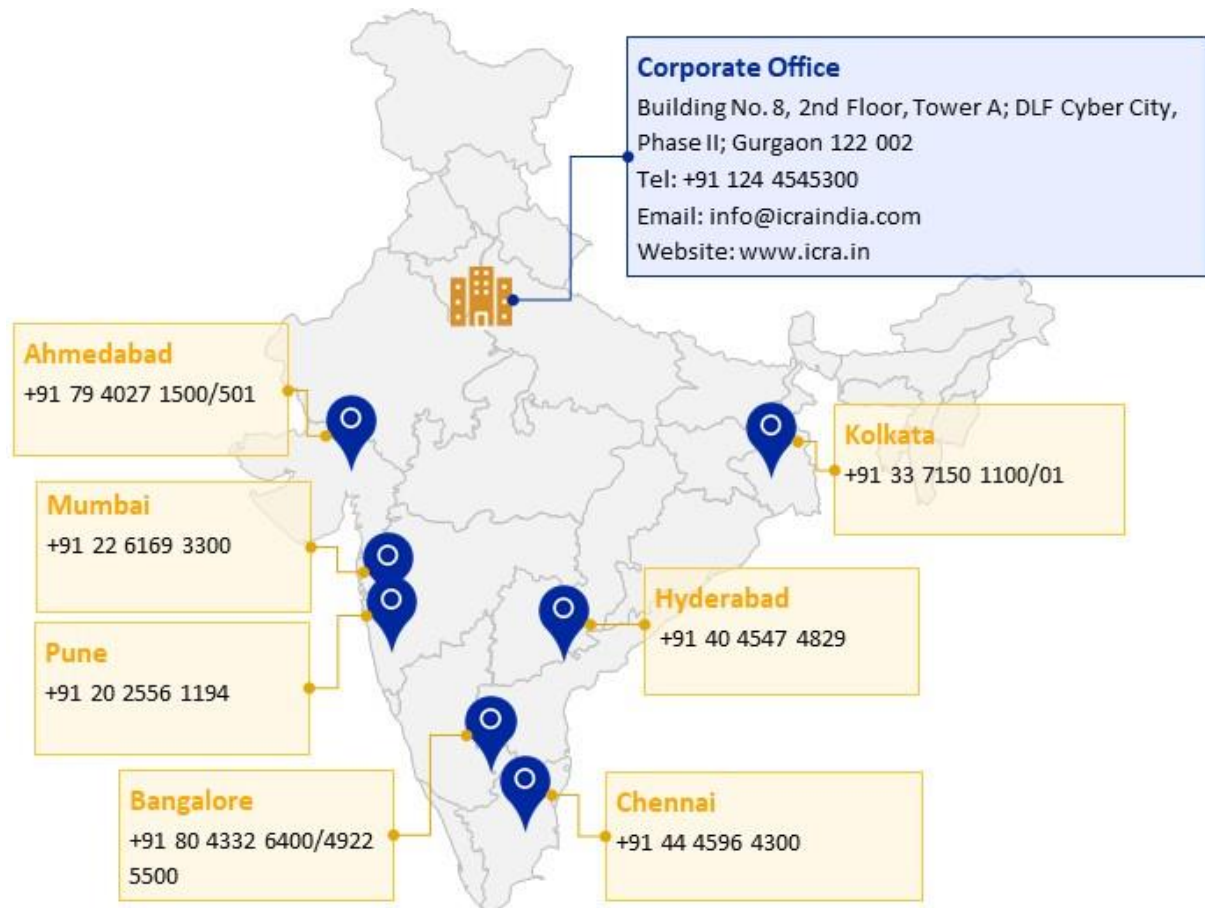
Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001

Tel: +91 11 23357940-45



Branches



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