November 25, 2024

ISGEC Hitachi Zosen Limited: Ratings reaffirmed; outlook for the long term ratings revised to Positive from Stable; rated amount enhanced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long Term - Fund-based – Cash Credit	130.00	100.00	[ICRA]A- (Positive); reaffirmed and outlook revised to Positive from Stable
Long Term - Non-fund based - Others	260.00	100.00	[ICRA]A- (Positive); reaffirmed and outlook revised to Positive from Stable
Long Tern – Fund Based - Term loans	5.00	2.50	[ICRA]A- (Positive); reaffirmed and outlook revised to Positive from Stable
Long Term/ Short Term - Fund-based/Non-fund based - Others	310.00	690.00	[ICRA]A- (Positive)/[ICRA]A2+; reaffirmed and outlook revised to Positive from Stable; rating assigned for enhanced amount
Long Term/ Short Term - Unallocated	-	12.50	[ICRA]A- (Positive)/[ICRA]A2+; assigned
Total	**705.00**	**905.00**	

**Instrument details are provided in Annexure-I*

Rationale

The revision in the outlook to Positive on the long-term ratings of ISGEC Hitachi Zosen Limited (IHZL) factors in ICRA's expectation of increase in scale going forward owing to strong order book position. Medium term demand outlook continues to remain healthy for both the domestic as well as export markets, which should lead to healthy order intake over the medium term. The profitability is also expected to remain comfortable which will translate into healthy cash flow generation. While the IHZL's working capital intensity improved significantly in FY2024 with the receipt of sizeable customer advances, the same is likely to normalise going forward. With increased scale and healthy profitability, the credit metrics and liquidity position is expected to remain comfortable going forward.

ICRA notes the significant improvement in order intake in FY2024 (Rs. 1,008 crore in FY2024 vs Rs. 531/449 crore in FY2022/FY2023), which should lead to expansion in scale of operations over FY2025-FY2026. Further, company's working capital intensity has also improved significantly in FY2024 (NWC/OI stood at 12.9% in FY2024 vs 68.4%/57.5%/35.1% in FY2021/FY2022/FY2023), after witnessing improvement in FY2023 as well, due to realization of debtors from a large project (Numaligarh refinery order) and receipt of sizeable customer advances from new orders awarded by private players like Reliance, Nayara and Technimont. This has resulted in lower utilization of fund-based working capital limits, which has improved the capital structure (nil working capital debt as on Mar-2024 and average working capital limits utilization was Rs. ~60 crore in FY2024 vs Rs. ~140 crore in FY2023. The same is expected to increase going forward, however the overall leverage and coverage metrics are likely to remain comfortable.

The ratings continue to draw comfort from the favourable credit profile of the company's shareholders — Isgec Heavy Engineering Limited (IHEL, rated [ICRA]AA/ Stable/ [ICRA]A1+) and Hitachi Zosen Corporation (HZC) (name changed to Kanadevia w.e.f. Oct , 2024) — as well as their established position in the engineering capital goods space. Further, IHEL shares its brand name with (IHZL). In addition to the technological expertise of its stakeholders that has enabled the company to expand its product offerings, IHZL derives strengths from the continued marketing support from the joint venture partners. Additionally, IHZL benefits from the location of its fabrication unit at Dahej, Gujarat. The proximity of the unit to the port enables efficient logistical management, given the sizeable supplies to global customers.

ICRA continues to positively factor in IHZL's healthy capital structure which improved further in FY2024 with working capital debt reducing to nil as on Mar-2024. IHZL has availed limited long term debt in the past and utilizes its working capital limits moderately. External debt/TNW was 0.82 times as on Mar-2023, which reduced to 0.01 as on Mar-2024 with only Rs. 2.5 crore of term loan outstanding. Similarly, total debt also reduced to Rs 112 crores as on Mar-2024 as compared to Rs 245 crores as on Mar-2023, due to lower lease liability as well as lower WC debt. Consequently, total debt (including lease liability)/TNW declined to 0.7 times (PY: 1.6 times), and total debt/OPBDITA was recorded at 1.8x in FY2024 (PY: 4.0x). Interest coverage also improved to 3.4 times in FY2024 (PY: 2.8x). Going forward, average WC debt is expected to be in the range of Rs. ~50-100 crore for H2FY2025, as execution picks up pace and the advances are utilised. Coverage and capitalization metrices are expected to remain comfortable and improve further over the medium term.

The ratings also consider the fact that the company follows a policy of hedging its foreign currency-denominated exposure, which mitigates the currency risks to a large extent. However, the ratings are constrained by the volatility of the company's revenues, given the lumpiness of order booking and the long order manufacturing cycle. Moreover, given the company's presence in niche product segments, its order book remains concentrated towards a few industries, such as oil and gas (refining specifically) and fertilisers, and links IHZL's business prospects to the capacity investment plans of these sectors.

The ratings also remain constrained by competition from both domestic and international players. Moreover, the company's profit margins remain exposed to the fluctuations in the prices of key raw materials, as equipment supply contracts are typically fixed price in nature and IHZL has a long execution cycle. However, the company largely mitigates the raw material price risk by entering into fixed-price contracts with vendors that are back-to-back and within a short duration of the order award for a large proportion of its raw material. However, the company still remains exposed to sharp variations in energy and freight costs, evident from the decline in operating profit margins (OPM) in FY2023, which recovered to some extent in FY2024.

Further, IHZL has been able to gradually improve its overall standalone operations keeping its dependence on JV partners for technology and financial support limited, for project design as well as execution.

Key rating drivers and their description

Credit strengths

Established position of IHZL's shareholders in engineering capital goods – IHEL and HZC, the JV partners in IHZL, are reputed players in the engineering capital good space. IHEL has product offerings for capital goods, including boilers, presses, pressure vessels, among others and caters to clients across 90 countries. Japan-based HZC is a global player across various business verticals, including industrial plants, environmental systems, process equipment and precision machinery. Both the entities have a strong market position in their respective geographies with a long track record of execution and client relationship. Further, some of IHZL's facilities are backed by IHEL's corporate guarantee.

Operational synergies with JV partners – Given the niche segments IHZL operates in as well as the need for licences for critical process equipment like reactors, convertors, among others, its business generation is led by its JV. Notably, these JV partners also have significant involvement in the operations, evident from the technical personnel stationed at the projects. Thus, the company benefits from the operational synergies and client relationships of its shareholders. IHZL either receives direct orders facilitated by the JV partners or undertakes job work for their orders.

Healthy order book indicates adequate revenue visibility – IHZL's order book stood at Rs. 1048 crore as on March 31, 2024 (Rs 506 crore as on March 31, 2023), lending healthy revenue visibility over the medium term. The order bookings increased significantly by 124% YoY to Rs. 1008 crore in FY2024 (Rs. 449 crore in FY2023), driven by large orders from Reliance Solar, Nayara Energy and Technimont. While the pace of order inflow is expected to moderate going forward, company's execution is expected to be higher over FY2025-FY2027 as compared to earlier years. Medium term demand outlook continues to remain healthy for both the domestic as well as export markets, which should lead to healthy order intake over the medium term.

Healthy capital structure and debt coverage metrics – IHZL has a healthy capital structure which improved further in FY2024 with WC debt reducing to nil as on Mar-2024 (average utilization for FY2024 being Rs. ~60 crore vs Rs. ~140 crore in FY2023). IHZL has availed limited long term debt in the past and utilizes its working capital limits moderately. External debt/TNW was 0.82 times as on March 31, 2023, which reduced to 0.01 as on Mar-2024 with only Rs. 2.5 crore of term loan outstanding.

Similarly, total debt also reduced to Rs 112 crores as on Mar-2024 as compared to Rs 245 crores as on Mar-23, due to lower lease liability as well as nil WC debt. Lease liability outstanding as on Mar 31, 2024 stood at Rs 110 crore (PY: Rs 119 crore). Consequently, total debt (including lease liability)/TNW declined to 0.7 times (PY: 1.6 times), and total debt/OPBDITA was recorded at 1.8x in FY2024 (PY: 4.0x). Total interest cost declined from Rs 22.2 crore in FY2023 to Rs 18.2 crore in FY2024. Hence, interest coverage also improved to 3.4 times in FY2024 (PY: 2.8x).

Going forward, average WC debt is expected to be in the range of Rs ~50-100 crore for H2FY2025, as execution picks up pace. Coverage and capitalization metrices are expected to remain healthy and improve further over the medium term.

Credit challenges

Exposure to input price risks – The profitability of the company remains exposed to the fluctuations in the prices of key raw materials, given that the equipment-supply contracts it enters into are typically fixed price in nature. However, as the manufacturing cycle is long, the company largely mitigates the raw material price risk by entering into fixed-price contracts for a large proportion of its bought-out raw material for which negotiations with vendors start during the pre-bid period. However, the company still remains exposed to sharp variations in energy and freight costs, evident from the decline in OPM in FY2023. IHZL's OPM declined sharply to 10.3% in FY2023 from 17.0% in FY2022 due to the impact of higher energy and freight costs, and to some extent higher raw material prices. OPM recovered to some extent in FY2024 to 12.9%, with higher prices factored in the new orders being booked.

Volatility in revenues and operating profitability, along with long working capital cycle – The company's revenues have been volatile in the last seven years because of lumpy order bookings, longer order execution timelines of 15–18 months and project completion-based revenue recognition. However, IHZL has adopted of the percentage of completion method (POCM) of accounting for the orders that have commenced execution post Mar 31, 2023, which will lead to relatively low revenue variability, going forward.

IHZL's revenues in FY2024 stood at Rs. 477.4 crore, witnessing a decline of 20% YoY. However, the same was in line with expectations, largely due to the delivery of pending orders of Rs. ~90 crore in FY2023. These orders were ready since Q4 FY2022, and had been recognised as part of the finished goods inventories as on March 31, 2022. Hence, revenue recognition on dispatch pertaining to those orders shifted from FY2022 to FY2023, leading to a high base for FY2024. Adjusting for that revenue decline would have been ~6-7% YoY in FY2024. Order inflow was also weaker YoY in FY2023 at Rs. 443 crore, which contributed to revenue decline in FY2024. With order inflows more than doubling in FY2024 to Rs. 1008 crore, driven by 2 large orders from Reliance and Nayara, order backlog has reached record high level of Rs. 1048 crore as on Mar-2024. For FY2025, inflow is expected at Rs. ~550-600 crore. Consequently, revenues are expected to increase significantly in FY2025 to ~25%-35% to Rs. 600-650 crore

Exposure to demand cyclicality in end-user industries and competitive pressures – IHZL manufacturers niche products for specific industries, namely fertilisers, oil refineries and petrochemicals. Hence, its order booking remains exposed to the capital expenditure cycle in these industries, adding to the lumpiness. As on June 30, 2023, around 37% of the company's orders were from the oil refinery sector, followed by 56% from the fertiliser segment and the balance 6% from the chemical segment. It also remains exposed to competition from established players. However, this is partly mitigated by the strong market position and the established relations of its JV partners, leading to business generation.

Liquidity position: Adequate

Despite the long working capital cycle, IHZL has a satisfactory working capital management policy, where the project execution begins only after the receipt of customer advances. The company had moderate unutilised fund-based limits with an average cushion in sanctioned limits (limited to drawing power) of around Rs. ~117 crore in the 18 months over FY2024-H1FY2025. Cushion in drawing power is estimated to be at a similar level in FY2025 or higher. The utilisation of limits has remained less than Rs. 55 crore during H1FY2025, with the average utilisation being Rs. ~26 crore

Over the past one year, fund-based WC limits have been enhanced by Rs. ~235 crore to Rs. 440 crore, with IHZL enjoying sufficient cushion in DP. Additionally, there are non-fund based limits as well which are partially convertible into fund based limits basis DP availability. The presence of promoters with a strong credit profile indicates financial flexibility. Further, with limited term loan repayment commitments and only routine capex to be incurred over the medium term, the liquidity remains adequate.

Rating sensitivities

Positive factors – ICRA could upgrade the rating if the company demonstrates a considerable and sustained improvement in scale, led by a healthy order book build-up and execution with the improvement in profitability. Further, the rating could be upgraded if the credit profile of IHZL's parent, IHEL, strengthens.

Negative factors – Pressure on the ratings could arise in there is a reduction in revenues and profits and cash flow generation. Further, sustained elongation of working capital cycle leading to weakening of the liquidity profile, or deterioration in the credit profile of IHZL's parent IHEL, or weakening of linkages with the parent can also lead to a rating revision. Deterioration in interest coverage below 3 times on a sustained basis could also lead to downward revision in outlook or ratings.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology
Parent/Group support	Parent/Group Company: ISGEC Heavy Engineering Ltd The rating assigned to IHZL factors in the high likelihood of its parent, IHEL [rated [ICRA]AA (Stable)], extending financial support to it because of the close business linkages between them. ICRA also expects IHEL to be willing to extend financial support to IHZL out of its need to protect its reputation from the consequences of a group entity's distress. There also exists a consistent track record of IHEL having extended corporate guarantees to IHZL's lenders for its facilities
Consolidation/Standalone	Standalone

About the company

IHZL, incorporated in March 2012, is a 51:49 JV between IHEL of India and HZC of Japan. The JV is involved in the manufacturing of specialised and critical process equipment for the oil refining, fertiliser and petrochemical industries. IHZL benefits from the technological capability and customer base of its shareholding entities, IHEL and HZC, which are also responsible for the bidding/marketing function of the company. Collaboration with HZC has given it access to licensed technology to build the critical process equipment. The JV has a fabrication facility based in Dahej, Gujarat.

Key financial indicators (audited)

Standalone	FY2023	FY2024
Operating income	596.4	477.4
PAT	8.3	15.3
OPBDIT/OI	10.3%	12.9%
PAT/OI	1.4%	3.2%
Total outside liabilities/Tangible net worth (times)	3.0	3.2
Total debt/OPBDIT (times)	4.0	1.8
Interest coverage (times)	2.8	3.4

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

	Current (FY2025)				Chronology of rating history for the past 3 years					
			FY2025		FY2024		FY2023		FY2022	
Instrument	**Type**	**Amount Rated (Rs Crore)**	**Date**	**Rating**	**Date**	**Rating**	**Date**	**Rating**	**Date**	**Rating**
Cash Credit	Long-term	100.00	Nov 25, 2024	[ICRA]A-(Positive)	Oct 04, 2023	[ICRA]A-(Stable)	Aug 30, 2022	[ICRA]A-(Stable)	Jun 15, 2021	[ICRA]AA (CE) (Negative)
Non-fund based - Others	Long-term	100.00	Nov 25, 2024	[ICRA]A-(Positive)	Oct 04, 2023	[ICRA]A-(Stable)	Aug 30, 2022	[ICRA]A-(Stable)	Jun 15, 2021	[ICRA]AA (CE) (Negative)
Term loans	Long-term	2.50	Nov 25, 2024	[ICRA]A-(Positive)	Oct 04, 2023	[ICRA]A-(Stable)	Aug 30, 2022	[ICRA]A-(Stable)	Jun 15, 2021	[ICRA]BBB+ (Stable)
Fund-based/Non-fund based - Others	Long-term/ Short-term	690.00	Nov 25, 2024	[ICRA]A-(Positive)/ [ICRA]A2+	Oct 04, 2023	[ICRA]A-(Stable)/ [ICRA]A2+	Aug 30, 2022	[ICRA]A-(Stable)/ [ICRA]A2+	-	-
Unallocated	Long-term/ Short-term	12.50	Nov 25, 2024	[ICRA]A-(Positive)/ [ICRA]A2+	Oct 04, 2023	-	-	-	-	-
Unallocated	Long-term	-	Nov 25, 2024	-	Oct 04, 2023	-	Aug 30, 2022	[ICRA]A-(Stable)	Jun 15, 2021	[ICRA]BBB+ (Stable)
Fund-based	Long-term	-	Nov 25, 2024	-	Oct 04, 2023	-	Aug 30, 2022	[ICRA]A-(Stable)	Jun 15, 2021	[ICRA]AA-(CE) (Negative)
Non-fund based	Long-term	-	Nov 25, 2024	-	Oct 04, 2023	-	Aug 30, 2022	[ICRA]A-(Stable)	Jun 15, 2021	[ICRA]AA-(CE) (Negative)

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long Term - Fund-based – Cash Credit	Simple
Long Term - Non-fund based - Others	Very Simple
Long Tern – Fund Based - Term loans	Simple
Long Term/ Short Term - Fund-based/Non-fund based - Others	Simple
Long Term/ Short Term - 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	Long Term - Fund-based – Cash Credit	NA	NA	NA	100.00	[ICRA]A- (Positive)
NA	Long Term - Non-fund based - Others	NA	NA	NA	100.00	[ICRA]A (Positive)
NA	Long Tern – Fund Based - Term loans	July 2019	8.20%-9.35%	FY2025	2.50	[ICRA]A (Positive)
NA	Long Term/ Short Term - Fund-based/Non-fund based - Others	NA	NA	NA	690.00	[ICRA]A-(Positive)/[ICRA]A2+
NA	Long Term/ Short Term - Unallocated	NA	NA	NA	12.50	[ICRA]A-(Positive)/[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

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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.

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