**August 25, 2022**

# ISGEC Heavy Engineering Limited: Ratings reaffirmed; outlook revised to Stable

## Summary of rating action

| Instrument* | Previous Rated Amount (Rs. crore) | Current Rated Amount (Rs. crore) | Rating Action |
|---|---|---|---|
| **Long-term Fund-based Working Capital** | 600.00 | 600.00 | [ICRA]AA(Stable); reaffirmed; Outlook revised to Stable from Negative |
| **Short-term – Non-fund Based Working Capital** | 2,755.17 | 2,755.17 | [ICRA]A1+; reaffirmed |
| **Fund-based/Non-fund Based Working Capital** | 1,044.83 | 1,044.83 | [ICRA]AA(Stable)/[ICRA]A1+; reaffirmed; outlook revised to Stable from Negative |
| **Total** | **4,400.00** | **4,400.00** | |

**Instrument details are provided in Annexure-I*

## Rationale

ICRA has considered the consolidated financials of ISGEC Heavy Engineering Limited (IHEL) while assigning the credit ratings.

The revision in the outlook to Stable follows the expected expansion in operating profits along with the reduction in debt from the FY2022 levels, resulting in improved interest coverage and total debt/OPBIDTA in the medium term. The total debt on IHEL's books (consolidated) had significantly increased between FY2018 and FY2022 on account of higher working capital intensity of the engineering, procurement and construction (EPC) operations (NWC/ OI at 28% in FY2022 against 3% in FY2018 for IHEL - standalone), acquisition of CBPI Philippines assets[1]and debt-funded distillery capex at Saraswati Sugar Mills Limited (SSML; rated [ICRA]A-(Stable)/A1).

The working capital intensity of the engineering business increased owing to the shift in the order profile towards Government clients where IHEL does not avail interest-bearing mobilisation advances. Further, the increase in inventory days in the sugar business entailed higher working capital requirements, especially at financial year-end. However, going forward, the working capital intensity of both the engineering and sugar businesses is expected to moderate with IHEL's focus on reducing Government and civil-heavy orders along with the reduction of sugar stock with the operationalisation of the distillery.

The ratings favourably factor in the established position of IHEL as an EPC company and a fabricator for equipment/machinery in the capital goods sector, aided by its long-term technical tie-ups/alliances with several recognised global heavy engineering companies as well as its in-house design and manufacturing capability. This apart, the ratings factor in the well-diversified healthy order book across industry segments, customers and geographies, covering a wide range of product segments. Additionally, the company has a sufficient cushion of non-fund-based limits to address its fresh order requirements over the near to medium term. Further, the absence of cash margin requirements supports the company's financial flexibility.

Further, the Group's operating margins are vulnerable to volatile raw material prices, particularly for fixed-price EPC contracts, given the long order execution period of about 18-24 months. Headwinds in the commodity prices as well as time and cost overrun due to delay in project execution amid covid-19 resulted in a decline in IHEL's operating profit margins (OPM; standalone level) in FY2022 to 4.0% (PY: 6.9%). However, some easing of metal prices aided by IHEL management's strategy of entering 2-3 months forward contract with steel manufacturers to partially mitigate the commodity risk. Further, the policy of

[1] IHEL was under arbitration with Cavite Biofuels Producers Inc or CBPI, Philippines for whom the former was executing a sugar project on EPC basis. As a part of settlement arrived at in October 2019, IHEL acquired 100% equity stake in the entities owning entire assets of the said project.

fully hedging its forex exposures also mitigates the currency fluctuation risks to a large extent. Additionally, the margins in the sugar business remain vulnerable to changes in government policy (which are favourable currently) and agro-climatic conditions.

The Stable outlook on the rating reflects ICRA's opinion that IHEL will continue to benefit from its established position as a leading EPC player and manufacturer of capital goods with a healthy and well-diversified order backlog.

## Key rating drivers and their description

### Credit strengths

**Established position as a leading EPC player and manufacturer for capital goods –** The company has a strong market position in the capital goods segment, which contributes to majority of its revenues and profits. Apart from the in-house capabilities, IHEL has several technology joint ventures (JVs) and strategic technology partnerships with international majors. Moreover, IHEL's long track record of more than 75 years in the industry and its ability to absorb and indigenise technology bolster its market position.

In FY2022, the EPC business contributed 59% to IHEL's gross revenues, ~29% came from manufacturing with the balance from the sugar and ethanol operations. With captive manufacturing and fabrication facilities across key product segments such as presses, boilers, process equipment, IHEL enjoys benefits of synergies with its EPC segment which is characterised by sound designing and execution capabilities

**Healthy and diversified order book –** IHEL continues to have a healthy order book of Rs. 7,736 crore at the consolidated level and Rs. 6,690 crore at the standalone level (order book to OI ratio is ~1.5 times) as on June 30, 2022, which lends healthy medium-term revenue visibility. Further, the consolidated order book is well diversified across industry segments with power contributing 28% of the order book, followed by refineries (17%), sugar (15%), steel, cement and aluminium (14%), chemicals, petrochemicals and fertiliser (6%), railways (5%) and the balance (15%) by other segments. While cyclicality in a single industry would impact IHEL's order and revenue booking, it is not highly exposed to one sector.
Further, the completion of projects within the agreed timelines while maintaining the desired quality parameters is critical to minimise the liabilities arising from project delays and performance issues. The order book, however, is spread across more than 100 individual orders, resulting in modest order concentration. The top 5 and top 10 orders account for ~31% and ~44%, respectively, of the pending order book as on June 30, 2022 on a standalone level.

### Credit challenges

**Growing working capital requirements –** IHEL's working capital requirements steadily rose over FY2018-FY2022 to ~28% from sub-10%, led by high revenue growth in the EPC segment and its changing order profile. While a large order book entails high retention money build-up, many incremental orders do not offer interest-free customer advances, as was common in the past. This, along with varying payment cycles, especially with longer duration EPC contracts, as well as Covid-related disruptions in last two fiscals resulted in higher working capital intensity. IHEL utilised its existing cash and liquid investments and debt to fund these increased requirements.

The company has a sufficient cushion of non-fund-based limits to address its requirements over the medium term as it has also recently enhanced its limits. Further, the absence of cash margin requirements supports the company's financial flexibility. Additionally, IHEL is currently focusing on reducing the civil-heavy order intake in order to lower the related risk of time and cost overruns while reducing the working capital intensity, going forward. The company is now concentrating on engineering/technology intensive orders.

**Operating margins vulnerable to volatile raw material prices, particularly for fixed-price EPC contracts –** The cost of key raw materials for equipment manufacturing such as steel and several other bought-out components make up for IHEL's raw material cost. Given the long order execution period of about 18-24 months, the operating margin remains vulnerable to the volatility in the prices of key raw materials, particularly for private sector contracts that are generally fixed-price in nature.

Headwinds in commodity prices as well as time and cost overruns due to delays in project execution amid Covid-19 resulted in a decline in IHEL's operating profit margins (OPM; standalone level) in FY2022 to 4.0% (PY: 6.9%). Though, the company reported OPM of 5.7% in Q1 FY2023, thus showing some signs of improvement.

IHEL has now started entering into 2-3 months' forward contract with steel manufacturers to partially mitigate the commodity risk. This apart, the company follows a full hedging policy to cover its forex risk. The margins in the sugar business, however, remain vulnerable to the changes in government policy (which are favourable currently) and agro-climatic conditions.

**Moderated debt coverage metrics with increasing debt levels –** IHEL's total consolidated debt increased to Rs. 1,233 crore as on March 31, 2022 (PY: Rs. 983 crore), primarily on account of debt-funded capex at SSML, in addition to meeting the growing working capital requirements of the Group. Higher debt levels have increased the gearing marginally to 0.6 times as on March 31, 2022 (PY: 0.5 times). Further, increased gearing levels coupled with lower OPBIDTA in FY2022 have moderated the coverage metrics with interest cover of 4.4 times (PY: 6.7 times), total debt/OPBIDTA of 4.3 times (PY: 2.9 times) and DSCR of 2.0 times (PY: 5.4 times). However, the coverage and leverage are expected to improve in the medium term from the current levels with the likely reduction in debt levels and better OPBIDTA. Though, weaker-than-expected performance of the subsidiaries can entail funding requirements.

**Intense competition from domestic and international players –** IHEL faces competition from various domestic and international players, which has kept the company's operating margins at modest levels of 4-8% over the last few fiscals.

## Liquidity position: Adequate

IHEL's liquidity profile is adequate with free cash balance and liquid investments of ~Rs. 200 crore (consolidated) as on March 31, 2022 and average cushion of sanctioned limit and drawing power of around Rs. 480 crore (standalone) in FY2022. Further, retained operating cash flows are likely to be comfortable in FY2023 and is expected to improve to healthier levels in FY2024 with better operating margins. ICRA expects IHEL to comfortably meet its debt repayment obligations of ~Rs. 150 crore in FY2023-FY2024. ICRA also notes that IHEL is expected to incur a capex of Rs. 50-80 crore per annum (at consolidated levels) in the medium term, which is expected to be met from internal accruals in addition to a largely debt funded capex of CBPI of ~Rs. 175 crore over FY2023-FY2024.

## Rating sensitivities

**Positive factors –** Favourable rating action could be taken if the company demonstrates a significant increase in the order book execution while improving the operating profits and cash generation that would strengthen the liquidity and debt coverage metrics on a sustained basis. A specific metric that could lead to an upgrade is net debt/OPBIDTA below 0.8 times.

**Negative factors –** Negative pressure on the ratings could arise if there is a considerable decline in revenue due to lower order book execution, or reduction in profit margins and cash flow generation, resulting in weakening of liquidity and debt coverage metrics on a sustained basis. Any delays in project execution/ramp-up of operations for CBPI impacting the cash flow generation and resulting in support from IHEL can trigger a negative rating action.

## 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 considered the consolidated financials of IHEL. List of companies given in Annexure-2. |

## About the company

ISGEC Heavy Engineering Limited (IHEL), a public company under the ISGEC Group, manufactures heavy engineering equipment and provides related EPC/turnkey services. The company was established in 1946 by the Puri family and was initially named Saraswati Industrial Syndicate Limited. The initial activity was the manufacture of spares for sugar mills to complement the Group's sugar mills operations. Over a period of time, the company diversified into a range of engineering products and projects, including process equipment, sugar plants and distilleries, air pollution control equipment, industrial boilers, power projects, bulk material handling, industrial water waste treatment and liquefiable gas containers. Apart from in-house capabilities, IHEL has a number of technology joint ventures (JVs) and strategic technology partnerships with global EPC players such as Hitachi Zosen Corp., Foster Wheeler North America Corp., AP&T, BabcockPower USA, Riley Power USA etc., which enables it to command a leadership market position across many product categories.

### Key financial indicators (audited)

| IHEL Consolidated | FY2021 | FY2022 |
|---|---|---|
| **Operating income** | 5,308 | 5,477 |
| **PAT** | 253 | 115 |
| **OPBDIT/OI** | 6.3% | 5.3% |
| **PAT/OI** | 4.8% | 2.1% |
| **Total outside liabilities/Tangible net worth (times)** | 2.1 | 2.1 |
| **Total debt/OPBDIT (times)** | 2.9 | 4.3 |
| **Interest coverage (times)** | 6.7 | 4.4 |

*PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount 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 (FY2023) | | | | Chronology of rating history for the past 3 years | | |
|---|---|---|---|---|---|---|---|---|
| | | Type | Amount rated (Rs. crore) | Amount outstanding as of Mar 31, 2022 (Rs. crore) | Date & rating in FY2023 | Date & rating in FY2022 | Date & rating in FY2021 | Date & rating in FY2020 |
| | | | | | Aug 25, 2022 | May 25, 2021 | - | Feb 19, 2020 |
| 1 | **Fund-based Working Capital** | Long term | 600.00 | - | **[ICRA]AA (Stable)** | **[ICRA]AA (Negative)** | - | **[ICRA]AA (Stable)** |
| 2 | **Non fund based Working Capital** | Short term | 2755.17 | - | **[ICRA]A1+** | **[ICRA]A1+** | - | **[ICRA]A1+** |
| 3 | **Fund based / Non fund based Working Capital** | Long term/ Short term | 1044.83 | - | **[ICRA]AA (Stable)/ [ICRA]A1+** | **[ICRA]AA (Negative)/ [ICRA]A1+** | - | **[ICRA]AA (Stable)/ [ICRA]A1+** |
| 4 | **Long-term – Non fund based Working Capital** | Long term | 0.00 | - | - | - | - | **[ICRA]AA (Stable)** |
| 5 | **Long-term unallocated limits** | Long term/ Short term | 0.00 | - | - | - | - | **[ICRA]AA (Stable)/ [ICRA]A1+** |

## Complexity level of the rated instruments

| Instrument | Complexity Indicator |
|---|---|
| Long-term Fund-based Working Capital | Simple |
| Short-term – Non fund based Working Capital | Very simple |
| Fund based / Non fund based Working Capital | 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: www.icra.in

## 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 Working Capital | NA | NA | NA | 600.00 | [ICRA]AA (Stable) |
| NA | Short-term – Non fund based Working Capital | NA | NA | NA | 2755.17 | [ICRA]A1+ |
| NA | Fund based / Non fund based Working Capital | NA | NA | NA | 1044.83 | [ICRA]AA (Stable)/ [ICRA]A1+ |

*Source: Company*

## Annexure II: List of entities considered for consolidated analysis

| Company Name | IHEL Ownership | Consolidation Approach |
|---|---|---|
| **ISGEC Heavy Engineering Limited** | 100.00% | Full Consolidation |
| **ISGEC Covema Ltd.** | 100.00% | Full Consolidation |
| **ISGEC Exports Ltd.** | 100.00% | Full Consolidation |
| **Saraswati Sugar Mills Ltd.** | 100.00% | Full Consolidation |
| **ISGEC Engineering & Projects Ltd.** | 100.00% | Full Consolidation |
| **Free Look Software Private Ltd.** | 100.00% | Full Consolidation |
| **ISGEC Hitachi Zosen Ltd.** | 51.00% | Full Consolidation |
| **ISGEC SFW Boilers Private Ltd.** | 51.00% | Full Consolidation |
| **ISGEC Titan Metal Fabricators Private Ltd.** | 51.00% | Full Consolidation |
| **ISGEC Redecam Enviro Solutions Private Ltd.** | 51.00% | Full Consolidation |
| **Eagle Press & Equipment Co. Limited*** | 100.00% | Full Consolidation |
| **ISGEC Investments Pte Ltd.*** | 100.00% | Full Consolidation |

**Including their subsidiaries; ISGEC Investment Pte Ltd owns CBPI assets*

***Source:** IHEL*

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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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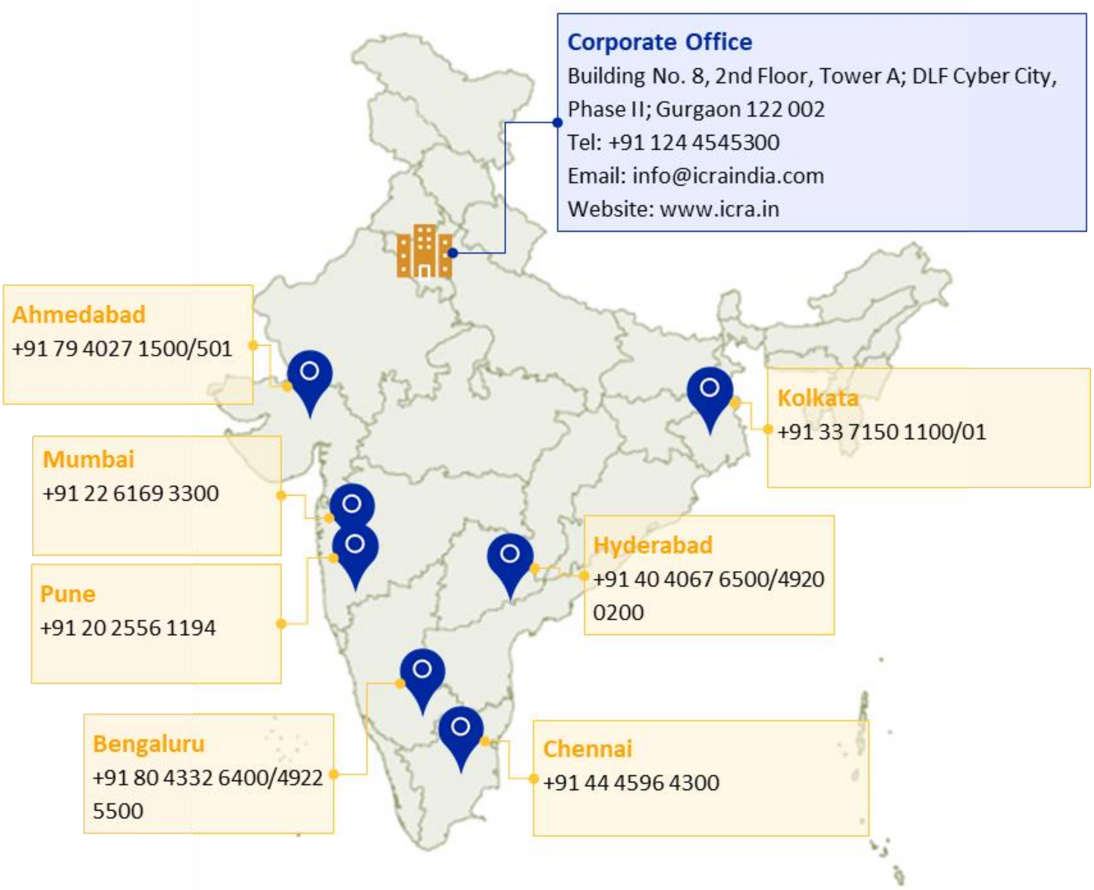



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