January 19, 2023

Dhansar Engineering Co. Private Limited: Ratings downgraded to [ICRA]BBB-/[ICRA]A3; outlook revised to Stable from Negative

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Cash Credit	52.00	52.00	[ICRA]BBB-; Downgraded from [ICRA]BBB; outlook revised to Stable from Negative
Bank Guarantee	111.53	160.59	[ICRA]BBB-; Downgraded from [ICRA]BBB; outlook revised to Stable from Negative
Term Loans	160.59	111.53	[ICRA]BBB-; Downgraded from [ICRA]BBB; outlook revised to Stable from Negative
Letter of Credit	(5.00)**	(5.00)**	[ICRA]A3; Downgraded from [ICRA]A3+
Total	**324.12**	**324.12**	

**Instrument details are provided in Annexure-I **Sublimit of bank guarantee limits*

Rationale

For arriving at the ratings, ICRA continues to consolidate the business and financial risk profiles of Dhansar Engineering Co. Private Limited (DECO) and Dhansar Equipment Private Limited (DEPL, hereafter collectively referred to as the Group) owing to the common management, business linkages and corporate guarantee extended by DECO towards DEPL's entire external borrowings.

The ratings downgrade reflects the impact of elevated borrowing levels with short repayment tenure on the Group's debt service coverage ratio (DSCR). The consolidated debt levels initially rose sharply to fund the execution of a large-sized contract coal mining project at Bina, Uttar Pradesh, awarded by Northern Coalfields Limited (NCL) in prior fiscals. Such debt-funded capex plans for supporting other ongoing/upcoming projects in DECO have continued, leading to the pace of deleveraging in FY2023 being much slower than what ICRA had anticipated. This, along with the lumpy nature of scheduled repayments, is expected to keep the Group's DSCR at a depressed level of 1.0-1.2 times in FY2023 and FY2024, potentially exposing the company to refinancing risks. Such risks associated with cash flow timing mismatches are however, mitigated to an extent by the Group's established relationships with banks, reflected in its ability to raise funds at competitive rates. The ratings also consider sizeable non-core investments into the associated entities and other corporates, including the inter-corporate deposits (ICDs) and the Group's investment in market instruments through portfolio management services (PMS) and direct investment in mutual funds and equity instruments, which are estimated to have increased to around Rs. 190 crore as on October 31, 2022, from around Rs. 82 crore as of end-March, 2021. The sizeable quantum of the non-core investments relative to the size of the balance sheet adversely impacts the liquidity profile of the Group, which in turn leads to a greater reliance on external debt for meeting capex requirements.

The ratings also remain constrained by the tender-based nature of the contract mining business, which limits the scope for margin improvement to a large extent. The ratings also consider the high project concentration risks with the top-three projects constituting 58% of the outstanding orders as on October 31, 2022. Besides, the Group is exposed to project execution risks as 77% of its order book was in the nascent stages of execution as on October 31, 2022 (less than 25% execution). Any slowdown in the execution of these major projects would adversely impact the Group's revenue stream in the near term.

The ratings are, however, supported by DECO's established track record in the contract mining business, its ability to report profitable operations across business cycles, and the company's healthy revenue visibility over the medium term, given its robust unexecuted order book of around Rs. 5,035 crore as on October 31, 2022, which is almost 6.9 times of the operating income in FY2022. The ratings also factor in DECO's reputed client profile, leading not only to low counterparty risk, but also repeat businesses from such customers, thereby ensuring a healthy order inflow.

The Stable outlook on the long-term rating reflects ICRA's opinion that the Group will continue to benefit from its established track record in the contract mining business, and a strong client profile which is expected to keep earnings at a healthy level, going forward.

Key rating drivers and their description

Credit strengths

Established track record in the contract mining business – DECO has been in the business of contract mining since 2003 and is involved in the mining of coal, iron ore, bauxite, zinc, stone and chromite ore. DECO's services also include site levelling and grading, drilling, removal of overburden, extraction of mineral, and its transportation to railway siding. The company has a demonstrated project execution capability, backed by a fleet of over 650 heavy earthmoving vehicles and experienced personnel.

Reputed client profile, leading to low counterparty risk – DECO has a reputed client base, which includes Hindustan Zinc Limited, Tata Steel Mining Limited, Odisha Mining Corporation Limited, Bharat Coking Coal Limited, and Haryana State Industrial and Infrastructure Development Corporation Limited, among others. The counterparty risk is also reduced to a large extent owing to a reputable client base. Moreover, ICRA derives comfort from the company's track record of contract renewals with existing clients, which demonstrates strong project execution capabilities. This includes the renewal of annual mining contracts with Odisha Mining Corporation's for Overburden & Chrome.

Healthy order book position provides medium-term revenue visibility – Revenue visibility remains strong in the medium term, on account of healthy order book of about Rs. 5,035 crore as on October 31, 2022. The trailing book-to-bill ratio considering the current order book as on October 31, 2022, was 6.9 times based on the operating income for FY2022. At present, there are no delays in the execution of the orders as per the management, which provides additional comfort.

Ability to report profitable operations across business cycles – DECO has showcased stability in its operating performance with maintenance of healthy operating income, coupled with above 10% margins consistently across the years, despite volatility in the market conditions. The margin dipped slightly below 10% in FY2022 as a one-off due to higher sub-contracting of work (around Rs. 484 crore). In FY2020, the scale dipped in comparison with the previous year; however, the absolute OPDITA improved leading to no adverse impact on the business for the company. For FY2023, the performance is expected to remain healthy with the Group generating revenue of Rs. 580 crore with EBITDA margin of around 15% in the seven-month period ending as on October 31, 2022.

Credit challenges

Exposure to refinancing risks given the high debt levels with lumpy debt service requirements, leading to DSCR remaining subdued – The HEMM loans taken by DECO are of a shorter tenure of three to four years compared to the life of the asset (around eight years), which make the annual repayments very sizeable. This, coupled with the tightly matched accruals and lack of liquid funds with the Group, leads to a strain on the company's debt service ability, measured by the DSCR, which is expected to hover at around 1.0-1.2 times over the medium term. However, DECO has been continuously replenishing its older fleet (before end-of-life) with debt-funded purchase of new fleet, which are more advanced with superior efficiency levels. Apart from the company's healthy financial flexibility to raise funds, the proceeds from these assets' sales in the secondary market also help support timely debt servicing.

Significant non-core investments adversely impact the liquidity profile and increase dependence on external debt – The Group has non-core investments into the associated entities and other corporates including ICDs, and the Group's investment in market instruments through PMS and direct investment in mutual funds and equity instruments, which are estimated to have increased to around Rs. 190 crore as of October 31, 2022, from around Rs. 82 crore as of end-March, 2021. The sizeable quantum of the non-core investments relative to the size of the balance sheet adversely impacts the liquidity profile of the Group, in turn leading to a greater reliance on external debt for the operating capex requirements.

Exposure to regulatory risks arising out of presence in the mining industry – DECO's exposure to regulatory risks remains high as it mainly derives revenues from mining. Mining operations remain exposed to the regulatory risk, which can lead to potential disruptions in operations in case of any violation of statutory norms by the lessee. Moreover, the mining belts are prone to law-and-order problems, which may result in unforeseen delays in project execution. While the entire responsibility of getting regulatory clearances lies with the mining leaseholder, it may impact the revenues of contract miners, like DECO, if the projects get delayed.

Exposed to significant client concentration and project execution risks – There is a high project concentration risk, with the top-three projects contributing 69% to the outstanding orders as on October 31, 2022. Therefore, any slowdown in the execution of these major projects or disturbances in the region of operations could affect the company's revenues. Historically, DECO derives more than 75% of its revenues from a handful of clients like BCCL, Tata Steel Mining Ltd, OMC, exposing the company to significant client concentration risks. The company also remains exposed to project execution risks with 77% of the order book as on October 31, 2022, in the nascent stages of execution (less than 25% execution).

Tender-based contracts limit scope for margin improvement – DECO procures orders through tenders. Entities that meet the technical qualification criteria qualify for financial bidding, and subsequently the contract is awarded to the lowest (L1) bidder. Due to such tender-based order procurement, the company faces stiff competition. Additionally, given DECO's high share of sub-contracted orders, its operating margins and business return indicators remain weaker than many peer contract miners.

Liquidity position: Adequate

The Group has lumpy principal repayment obligations of around Rs. 103 crore in FY2023 and around Rs. 109 crore in FY2024 for the outstanding debt, against which the cash accruals in the respective years are expected to remain tightly matched. However, the working capital utilisation levels have remained at low levels, averaging around 43% over the 12-month period ending November 2022, leading to a modest headroom in the working capital limits. While the consolidated free cash flows are estimated to be lower than the debt repayment obligations in FY2023, however, the deficit has been bridged through additional borrowings of over Rs. 100 crore that has been raised during the current fiscal so far, accentuating the refinancing risks. Therefore, the liquidity profile has been assessed as **Adequate**.

Rating sensitivities

Positive factors – The ratings may be upgraded if DECO is able to improve its profitability and reduce its borrowing levels, leading to an improvement in the liquidity and debt coverage metrics. Specific metric for rating upgrade would be improvement of DSCR above 1.4 times on a sustained basis.

Negative factors – Pressure on DECO's ratings could arise if there are delays in execution of newly awarded projects, a stretch in the working capital cycle and/or a significant increase in debt levels, leading to a deterioration in the coverage metrics and liquidity position. Additionally, any significant increase in investments in associate entities or other corporates will be a credit negative.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating Methodology for Mining Entities Rating Approach-Consolidation
Parent/Group support	Not Applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has consolidated the business and financial risk profiles of DECO and DEPL owing to the common management, business linkages and corporate guarantee extended by DECO towards DEPL's entire external borrowings.

About the company

Dhanbad-based Dhansar Engineering Co. Private Limited (DECO) is a leading contract miner from eastern India, with an experience of over a decade in the mining business. The company is involved in the mining of coal, iron ore, bauxite, and chromite ore, and its range of services include site levelling and grading, drilling, removal of overburden, extraction of minerals, and its transportation to railway siding.

Key financial indicators (audited)

DECO	Standalone		Consolidated** (DECO+DEPL)	
	FY2021	FY2022	FY2021	FY2022
Operating income	581.2	728.8	607.4	797.7
PAT	24.2	14.2	36.1	11.2
OPBDIT/OI	13.4%	9.7%	17.0%	14.8%
PAT/OI	4.2%	1.9%	5.9%	1.4%
Total outside liabilities/Tangible net worth (times)	1.5	1.5	1.9	1.7
Total debt/OPBDITA (times)	2.7	3.1	3.0	2.5
Interest coverage (times)	4.0	3.1	4.9	3.9

*PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; **Consolidation done by ICRA based on elimination of important inter-group transactions based on public disclosures*

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 Oct 31, 2022 (Rs. crore)	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021	Date & rating in FY2020
					Jan 19, 2023	Jan 13, 2022	Oct 6, 2020	Jul 15, 2019
1	Cash Credit	Long Term	52.00	-	[ICRA]BBB- (Stable)	[ICRA]BBB (Negative)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)
2	Term Loans	Long Term	111.53	111.53	[ICRA]BBB- (Stable)	[ICRA]BBB (Negative)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)
3	Bank Guarantee	Long Term	160.59	-	[ICRA]BBB- (Stable)	[ICRA]BBB (Negative)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)
4	Letter of Credit	Short Term	(5.00)**	-	[ICRA]A3	[ICRA]A3+	[ICRA]A2	[ICRA]A2

***Sublimit of bank guarantee limits*

Complexity level of the rated instruments

Instrument	Complexity Indicator
Cash Credit	Simple
Bank Guarantee	Very Simple
Term Loans	Simple
Letter of Credit	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	Cash Credit	NA	NA	NA	52.00	[ICRA]BBB- (Stable)
NA	Term Loans	FY2020	NA	FY2025	111.53	[ICRA]BBB- (Stable)
NA	Bank Guarantee	NA	NA	NA	160.59	[ICRA]BBB- (Stable)
NA	Letter of Credit	NA	NA	NA	(5.00)**	[ICRA]A3

*Source: Company; **Sublimit of bank guarantee limits*

Annexure II: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Dhansar Equipment Private Limited	-	Full Consolidation

Source: *Company*

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About ICRA Limited:

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