February 16, 2024

Finolex J-Power Systems Limited: Ratings reaffirmed; outlook revised to Negative; rated amount enhanced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long term - Fund based - Working capital limits	145.00	195.00	[ICRA]BBB-(Negative); reaffirmed/assigned for enhanced amount and outlook revised to Negative from Stable
Long-term – Fund based – Term loan	7.84	2.25	[ICRA]BBB-(Negative); reaffirmed and outlook revised to Negative from Stable
Short term - Non-fund based	70.00	70.00	[ICRA]A3; reaffirmed
Long term/Short term - Unallocated limits	3.70	0.00	-
Total	**226.54**	**267.25**	

**Instrument details are provided in Annexure-I*

Rationale

The outlook has been revised to Negative as ICRA expects Finolex J-Power Systems Limited's (FJPS) financial profile to continue to be under pressure due to the slow ramping up of revenues, resulting in losses and delays in achieving break-even. The working capital position also remains stretched, leading to elevated borrowing levels and weakening the debt metrics and liquidity profile.

However, FJPS has a strong parentage and benefits from the operational synergies with its parent entities – Japan-based J-Power Systems Corporation (JPS) and Finolex Cables Limited (FCL) – by leveraging their technical strengths and market presence. JPS is a wholly-owned subsidiary of Sumitomo Electric Industries, or SEI, rated A2 (Negative) by Moody's Investors Services. The parent entities have demonstrated a track record of financial support to FJPS in the form of regular equity infusion, besides extending corporate guarantees for its bank facilities.

The company manufactures underground cables for the extra-high voltage (EHV) segment and implements turnkey projects for various utilities. The company operates in a niche segment and manufactures cables that have specific requirement in terms of quality, technical parameters and high gestation period.

The ratings consider the favourable medium-term demand prospects from various end-user sectors, especially state utilities, metro rail corporations and private players that have captive power plants. The company reported a healthy order book position of Rs. 260 crore as of December 2023 with around Rs. 120-150 crore of orders in the pipeline, providing strong medium-term revenue visibility. The company's capital structure remains comfortable with a gearing of 1.2 times as on September 30, 2023, supported by equity infusion by the parent companies on a regular basis, notwithstanding the cash losses in the previous years.

The ratings, however, are constrained by FJPS's weak financial profile with revenues remaining in the range of Rs. 50-120 crore in the last five years. The revenue was affected by the weak order book position on account of the high gestation period, lumpy order flows and hurdles in execution. The current year's performance has remained weak for 6M FY2024 and the company was unable to break even on account of the delays in receiving and executing orders.

FJPS reported losses at the operating and cash level and weak coverage indicators in the last five years and needed regular liquidity support from its parent entities. Therefore, timely support from the parent group remains the key rating monitorable. Nevertheless, an improved order book position provides revenue visibility in the near to medium term that would also enable the company to scale up its operations.

The ratings consider the vulnerability of FJPS's profitability to raw material price variations, where the execution timeline may be longer. Considering the project nature of the business, the company's revenues exhibit lumpiness with an elongated working capital cycle due to the long execution period of projects, milestone-based payments and the retention money requirement. FJPS faces competition from a few large and established players in the cable industry.

Key rating drivers and their description

Credit strengths

Strong operational synergies with parents and track record of financial support - FJPS, being a 51:49 joint venture of Japan-based J-Power Systems Corporation (JPS) and Pune-based Finolex Cables Limited (FCL), receives financial support in the form of regular equity infusion as well as corporate guarantees for its bank facilities. The parent companies have infused Rs. 231.5 crore in the last six years till FY2023. No equity infusion is expected in FY2024. Apart from the financial support, the company enjoys technical support from J-Power Systems Corporation and execution support from Finolex Cables Limited. Further, the parent companies provide co-guarantee for certain projects under execution.

Presence in niche segment along with strong demand prospects - The company manufactures underground cables in the EHV segment. EHV is a niche segment and is less competitive than overhead cables due to the specific requirements in terms of quality, technical parameters and time of execution. Further, the gestation period remains high in this segment with 5-8 years to get the concrete orders and 1-1.5 years to get the cable approved for certain quality parameters, which is also known as the pre-qualification (PQ) test, a rigorous long duration test. The high gestation period makes the business capital-intensive, which acts as an entry barrier for new players. The demand prospects in this segment remains strong with large tenders expected from various state utilities, especially in the cyclone-driven areas for converting overhead cables to underground cables in the next few years. Besides the continued need to expand the transmission and distribution network with the growing power demand, the Revamped Distribution Sector Scheme (RDSS) of the Government of India supports the demand prospects of the cable industry.

Order book position provides healthy revenue visibility - FJPS's order book stood at ~Rs. 260 crore as on December 30, 2023, along with an L1 pipeline of over Rs. 120-150 crore, providing strong medium-term revenue visibility. At present, the company is witnessing healthy demand from various end-user sectors, especially state utilities, metro rail corporations and private players with captive power plants. However, the completion of the projects within the agreed timelines, while maintaining the desired quality parameters, is critical to minimise the liabilities arising from project delays and performance issues.

Comfortable capital structure - The capital structure of the company remained comfortable with gearing of 1.3 times as on September 30, 2023, supported by equity infusion by the parent companies on a regular basis. The parent companies have infused Rs. 231.5 crore in the last six years till FY2023. No equity infusion is expected in FY2024.

Credit challenges

Weak financial risk profile with losses at operating level - The financial profile is characterised by weak operating income and losses at the operating level due to the slow speed of execution and collection. The coverage indicators also remained weak due to the losses at the operating level. Further, for FY2023, the company has achieved lower sales, mainly due to external factors such as changes in the Tamil Nadu government's policy and other challenges such as delays in getting permission from the Government etc. Local political factors in the state of the company's largest customer impacted the project execution. However, FJPS recorded a turnover of Rs. 62 crore in H1 FY2024 and expects to achieve a total turnover of Rs. 90-95 crore by December 2023 and sales of Rs. 35-40 crore are expected in the last quarter of FY2024. The order book position as of December

2023 was Rs. 260 crore, while orders worth Rs. 120-150 crore are in pipeline which will be received by March 2024, providing comfortable revenue visibility in the near to medium term.

High working capital intensity in EPC business - The working capital intensity remains inherently high in the EPC business due to the long execution period of projects, milestone-based payments and the retention money requirement. As a result, the company's overall debtor days remained high at around 181 days in FY2023. The debtor days are on the higher side as the receivables include retention money of projects and contract assets. The working capital position is, however, supported to some extent by the creditor days. A high working capital intensity is further evident from the net working capital/operating income of 121.0% in FY2023. This also led to full utilisation of the working capital limits, thus exerting pressure on liquidity.

Competition from large established players - Though the company works in a niche segment and manufactures cables in the higher KV range of 66KV to 500 KV, it faces competition from a few large and established players. For 220KV, the company faces major competition from KEI Industries Limited, LS Cable and Systems and Universal Cables. For 400-KV cables, the company faces competition from Universal Cables. Nevertheless, the company has created its own niche in this segment with specialisation in EHV cables along with a state-of-the-art facility for VCV line which provides better quality output.

Margins vulnerable to volatile raw material prices - Aluminum and copper, the key raw materials for cable manufacturing, form a major part of the raw material cost. Given the long order execution period of 12-24 months, the operating margin remains vulnerable to the volatility in the prices of key raw materials. Nonetheless, the risk is mitigated as price variation clauses are now there in all categories of projects.

Liquidity position: Stretched

FJPS's liquidity is stretched, reflected in the high utilisation of the working capital limit in the last 12 months. The liquidity of the company is supported by the equity infusion by parent companies and enhancement of working capital limits, as and when required. Timely fund infusion by the parent companies to support its liquidity position remains the key rating monitorable.

Rating sensitivities

Positive factors – The outlook can be revised to Stable if FJPS demonstrates an improvement in its revenues, profits and coverage metrics, while enhancing its liquidity position.

Negative factors – ICRA could downgrade FJPS's ratings if any further delay in the execution of orders in hand reduces the turnover and profitability. Additionally, any weakening of the liquidity position or a stretch in the receivable position could have a negative impact on the ratings. This apart, ICRA could downgrade FJPS's ratings if there is a major deterioration in the parent company's credit profile, or weakening of linkage with the parent company, or change in the support philosophy.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology
Parent/Group support	Operational and financial support from being a part of Sumitomo Electric Industries Ltd., the ultimate parent
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the standalone financials of FJPS

About the company

Finolex J Power System Limited (FJPS) is a 51:49 joint venture between Japan-based J-Power Systems Corporation (JPS) and Pune-based Finolex Cables Limited (FCL). FJPS was formed to manufacture and sell high-voltage and extra-high voltage (EHV) power cables (underground cables), ranging from 66kV to 500kV grade, and other power accessories and provide turnkey solution cables to the Asian market. However, as of now, the company is working towards catering to the Indian market and will focus on the Asian market later.

Key financial indicators (audited)

	FY2022	FY2023	H1FY2024*
Operating income	86.3	126.0	63.7
PAT	-27.2	-28.2	-8.2
OPBDIT/OI	-10.3%	-4.1%	8.0%
PAT/OI	-31.6%	-22.4%	-12.8%
Total outside liabilities/Tangible net worth (times)	0.7	1.0	1.4
Total debt/OPBDIT (times)	-9.3	-25.2	17.8
Interest coverage (times)	-0.9	-0.4	0.6

*Source: Company, ICRA Research; * Provisional numbers; 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	Current rating (FY2024)				Chronology of rating history for the past 3 years			
		Type	Amount rated (Rs. crore)	Amount outstanding as on Dec 31, 2023 (Rs. crore)	Date & rating in FY2024	Date & rating in FY2023		Date & rating in FY2022	Date & rating in FY2021
					Feb 16, 2024	Mar 06, 2023	Nov 01, 2022	-	-
1	**Fund-based working capital limits**	Long-term	195.00	-	**[ICRA]BBB- (Negative)**	**[ICRA]BBB- (Stable)**	**[ICRA]BBB- (Stable)**	-	-
2	**Term loans**	Long-term	2.25	2.25	**[ICRA]BBB- (Negative)**	**[ICRA]BBB- (Stable)**	**[ICRA]BBB- (Stable)**	-	-
3	**Non-fund based**	Short term	70.00	-	**[ICRA]A3**	**[ICRA]A3**	**[ICRA]A3**	-	-
4	**Unallocated**	Long-term and short term	-	-	-	**[ICRA]BBB- (Stable)/ [ICRA]A3**	**[ICRA]BBB- (Stable)/ [ICRA]A3**	-	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long term- Fund based - Working capital limits	Simple
Long-term – Term loan	Simple
Short term- Non-fund based	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	**Long term - Fund based - Working capital limits**	NA	NA	NA	195.00	[ICRA]BBB-(Negative)
NA	**Long-term – Term loan**	FY2022	NA	FY2025	2.25	[ICRA]BBB-(Negative)
NA	**Short term - Non-fund based**	NA	NA	NA	70.00	[ICRA]A3

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:

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