October 21, 2019

Aequs Private Limited: Ratings downgraded to [ICRA]BB+/[ICRA]A4+; Outlook remains Negative

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund Based – Term Loan	4.00	4.00	[ICRA]BB+(Negative); downgraded from [ICRA]BBB-(Negative)
Fund Based – Working Capital Facilities	14.50	14.50	[ICRA]A4+; downgraded from [ICRA]A3
Non-fund Based Facilities	0.50	0.50	[ICRA]A4+; downgraded from [ICRA]A3
Total	**19.00**	**19.00**	

**Instrument details are provided in Annexure-1*

Rationale

For arriving at the ratings, ICRA has taken a consolidated view of Aequs Private Limited (APL) along with all its subsidiaries and joint ventures (JVs) as all the companies have operational linkages. APL, together with its subsidiaries, will be referred to as 'the Group' in this document.

The rating downgrade follows the continued weak financial performance of the Group over the last three years leading to sizable cumulative net losses. The Group's margins continue to be impacted by its high-cost operations in France and the US even while its Indian operations continue to generate healthy margins. Despite regular equity infusions from the promoters, the company's capitalisation and coverage indicators remain weak on account of high dependence on debt funding for both capex and working capital requirements. ICRA has also factored in the high working capital utilisation levels, stretched liquidity position and high refinancing dependence. The Group's net margins also remain vulnerable to exchange rate fluctuations as it derives substantial revenues from export markets and most of its debt is in foreign currency.

The Group recently formed a decentralised team to focus on profitability and to turn around its French operations. This is expected to improve the company's overseas margins going forward. Further, small and non-strategic customers have been let go of to increase the overall business viability. Moreover, the Group has adopted cost optimisation measures to reduce the headcount under its French operations. However, translation of the same into improved financial performance remains to be seen.

The Group's Indian operations reported healthy revenue growth and operating margins in FY2019. The business also saw equity infusion and unsecured loans from the promoters. The promoters infused equity of USD 14.7 million in FY2019 and are expected to infuse incremental equity in FY2020 to fund the losses of various overseas entities and support the future growth requirements. Funds infused in APL are redeployed for utilisation in the overseas entities. ICRA also factors in the Group's established relationships and long-term contracts with marquee customers in the aerospace industry in addition to its strong order book ensuring revenue visibility. Going forward, the Group's ability to scale up the business while improving its margins and coverage metrics would remain a key rating sensitivity. In the past, APL has been active in the inorganic space targeting growth and diversification through acquisitions. While ICRA expects the company to maintain its credit profile through inorganic investments, this remains an event risk and would be evaluated on a case-by-case basis for its impact on the ratings.

Key rating drivers and their description

Credit strengths

Strong promoter group – The company's promoter, Mr. Aravind Melligeri, is also one of the co-founders and shareholders of Quality Engineering and Software Technologies Private Limited (QESTPL). The promoters have infused significant equity over the years to develop APL's capacities and capabilities under various segments of the aerospace business. They have also extended unsecured loans to the Group.

Healthy performance of Group's Indian operations – The strong revenue growth and margins of the Group's Indian operations continue to support its overall financial profile to a certain extent. Aero India, the Group's Indian operations, witnessed healthy performance, supporting APL's consolidated margins.

Strong geographical diversification – The company derives most of its revenues from aerospace majors. However, it has developed a global footprint and a local-global delivery model for its customers through geographical diversification and new customer acquisition with the acquisition of two companies — US-based T&K Machine Inc. (T&K) and French aerospace group, SIRA — in FY2016.

Robust order book position – APL has a strong order book providing revenue visibility for the medium term. ICRA also factors in the Group's established relationships and long-term contracts (generally five years) with its customers in its ratings.

Credit challenges

Weak performance of Group's overseas operations – Despite the improvement in Aero India, the successful integration of operations of the acquired companies (SIRA and T&K) and benefits from the synergies are yet to be seen. The acquired entities in France and USA continue to incur losses at the EBITDA level, resulting in the continued weaker-than-expected performance of the consolidated entity and the significantly weaker-than-expected financial profile for the current rating category.

Stretched debt metrics – Despite the improvement in Aero India, the Group's financial profile continues to be characterised by weak capitalisation and coverage indicators. The working capital utilisation for the past 12 months exceeded 90%. The company is expected to remain dependent on regular equity infusions from the promoters for the funding of losses and servicing of debt till the operations turn around.

Vulnerability to fluctuations in foreign exchange rates – The company's revenues and margins remain vulnerable to fluctuations in foreign exchange rates, as most of its revenues are in a foreign currency. However, the import of raw materials in foreign currencies provides a natural hedge to some extent. The company suffered foreign exchange loss for FY2019 owing to borrowings in foreign currencies.

Liquidity position: Stretched

The company's liquidity position is stretched with negative cash flow from operations of Rs. 17.9 crore in FY2019. APL is incurring net losses every year and its average working capital utilisation level exceeded 90% during the 12-month period ending August 2019. The company had cash and liquid investments of Rs. 34.6 crore as on March 31, 2019 and is expected to remain heavily reliant on equity infusions.

Rating sensitivities

Positive triggers – Given the current outlook, a rating upgrade over the next 6-12 months is less likely. However, the ratings can be upgraded if the company's revenue growth and margins exceed expectations and if its TD/OPBDITA is less than 3x and the interest coverage exceeds 3.5x on a sustainable basis.

Negative triggers – Pressure on the ratings could arise in the absence of a meaningful recovery in operations. The ratings can also be downgraded in case of a delay in equity infusion or if the same is inadequate to support the company's operations.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	Not applicable
Consolidation/Standalone	The ratings are based on the consolidated financial statements of the issuer

About the company

Aequs Private Limited was initially incorporated as Mechanical Training Academy Private Limited in 2000. Subsequently, the company was renamed QuEST Machining and Manufacturing Private Limited in 2006, QuEST Global Manufacturing Private Limited in 2011 and Aequs Private Limited in 2014. APL is a part of the Aequs Group and is primarily engaged in the precision manufacturing of aerospace precision industrial components. It commenced manufacturing operations in 2007 in Bangalore as a 100 per cent export oriented unit (EOU).

APL had one unit in Bangalore for the manufacture of automotive precision components. Further, to capitalise on increasing orders from the aerospace vertical in low-cost countries like India, APL set up a unit in a special economic zone (SEZ) in Belgaum (developed by one of its Group companies) for the machining of precision components under the aerospace segment. Subsequently, in FY2012, as a part of the consolidation of manufacturing facilities, APL shifted its entire aerospace manufacturing operations to the facilities at Aequs SEZ, Belgaum. The facility has 25 fully functional and operating units along with 1 million sq.ft. of manufacturing space.

Currently, the company has more than 2,100 employees along with six manufacturing sites worldwide. According to the management, APL has the largest trained manpower in aerospace in India after Hindustan Aeronautics Limited (HAL) and is the only Indian aerospace company to have European and US delivery capability. The company had also acquired US-based T&K Machine Inc and France-based SIRA group in FY2016. The Group undertakes forging, precision machining, sheet metal fabrication, surface treatment, engine component manufacturing and aerostructure assemblies, all forming an integral part of the aerospace value chain. The Group continues to adopt strategies like forward stocking, single supplier advantage, accelerated scale and vertical integration, which have helped land substantial business for the company in FY2018 and FY2019.

Key financial indicators

	FY2018 (I-GAAP)	FY2019 (Prov; IND-AS)
Operating Income (Rs. crore)	544.5	651.9
PAT (Rs. crore)	-46.1	-75.5
OPBDIT/OI (%)	1.9%	5.4%
RoCE (%)	-3.7%	-7.3%
Total Outside Liabilities/Tangible Net Worth (times)	4.3	4.0
Total Debt/OPBDIT (times)	43.6	11.3
Interest Coverage (times)	0.4	1.0
DSCR	0.5	0.3

Note: Numbers are not strictly comparable; the company has provided adjusted FY2018 numbers as per IND-AS for like-to-like comparison

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2020)				Rating History for the Past 3 Years		
		Type	Amount Rated	Amount Outstanding	Rating	FY2019	FY2018	FY2017
				31-Mar-2019	21-Oct-2019	28-Sep-2018	-	22-Mar-2017
1	Fund Based – Term Loan	Long Term	4.00	2.86	[ICRA]BB+ (Negative)	[ICRA]BBB- (Negative)	-	[ICRA]BBB (Negative)
2	Fund Based – Working Capital Facilities	Short Term	14.50	NA	[ICRA]A4+	[ICRA]A3	-	[ICRA]A3+
3	Non-fund Based Facilities	Short Term	0.50	NA	[ICRA]A4+	[ICRA]A3	-	[ICRA]A3+

Amount in Rs. crore

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Fund Based – Term Loan	NA	NA	NA	4.00	[ICRA]BB+ (Negative)
NA	Fund Based – Working Capital Facilities	NA	NA	NA	14.50	[ICRA]A4+
NA	Non-fund Based Facilities	NA	NA	NA	0.50	[ICRA]A4+

Source: Company

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Aerostructures Manufacturing India Private Limited	100.00%	Full Consolidation
Aequs Aerospace Private Limited	100.00%	Full Consolidation
Aequs Oil & Gas LLC, USA	95.00%	Full Consolidation
Aequs Aerospace LLC, USA	100.00%	Full Consolidation
Aequs Aerospace BV, Netherlands	100.00%	Full Consolidation
Aequs Aero Machine Inc., USA	100.00%	Full Consolidation
Aequs Aerospace Besancon SAS, France	100.00%	Full Consolidation
Aequs Holdings France SAS, France	100.00%	Full Consolidation
Aequs Aerospace France SAS, France	100.00%	Full Consolidation
Bernar SAS, France	100.00%	Full Consolidation
Aequs Aerospace Aubigny SAS, France	100.00%	Full Consolidation
Aequs Aerospace Cholet SAS, France	100.00%	Full Consolidation
AeroStructures Assemblies India Private Limited	74.00%	Equity Method
SQuAD Forging India Private Limited	50.00%	Equity Method
Aerospace Processing India Private Limited	50.00%	Equity Method

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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.

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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