

November 28, 2022

ISGEC Heavy Engineering Limited: Ratings reaffirmed; 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	600.00	600.00	[ICRA]AA(Stable); reaffirmed
Short-term – Non-fund Based Working Capital	2,755.17	3800.17	[ICRA]A1+; reaffirmed/assigned
Fund-based/Non-fund Based Working Capital	1,044.83	1,099.83	[ICRA]AA(Stable)/[ICRA]A1+; reaffirmed/assigned
Total	4,400.00	5,500.00	

*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 reaffirmation of the rating continues to draw comfort from steady order flows transpiring in healthy and well diversified consolidated order book of Rs 7,762 crore as on September 30, 2022 (~1.42 times FY2022 operating income), and expectations of improvement in profitability and coverage metrics of the company. In ICRA's opinion, the expected expansion in operating profits benefitting from healthy pace of order execution and stabilisation of commodity prices along with the reduction in debt from the FY2022 levels would allow improvement in 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 assets¹ 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

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.

entering 2-3 months forward contract with steel manufacturers to partially mitigate the commodity risk, as is evident by OPM improving to 5.9% in H1FY2023. Further, the policy of 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 as well H1 FY2023, the EPC business contributed ~58-59% to IHEL's gross revenues, ~29-30% 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. 7,762 crore at the consolidated level and Rs. 6,931 crore at the standalone level (order book to FY2022 OI ratio is ~1.42 times) as on September 30, 2022, which lends healthy medium-term revenue visibility. Further, the consolidated order book is well diversified across industry segments with refineries contributing 27% of the order book, followed by power (26%), sugar (12%), steel, cement and aluminium (12%), chemicals, petrochemicals and fertiliser (7%), railways (3%) and the balance (13%) by other segments. While cyclicity 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 ~32% and ~45%, respectively, of the pending order book as on September 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 5.9% in H1 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). The consolidated debt remained at a similar level at Rs 1,210 crore as on September 30, 2022. 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.

Environmental and Social Risks

Environmental considerations: As per the disclosures made by IHEL, its products and services are designed to achieve better parameters than the legal environment norms set by the Government for emission, water and energy efficiency. Further, some of IHEL's products (air pollution control equipment) are focused on addressing environmental problems. Also, the Group is alert to the possibility of environmental risks due to discharge of waste water and hence it ensures waste water treatment, recycling and reuse. Additionally, IHEL gets periodic energy audits done. Also, there were no pending show cause/legal notices from Central Pollution Control Board (CPCB)/State Pollution Control Board (SPCB) at the end of FY2022. This indicates that IHEL has been able to mitigate the regulatory risks by demonstrating a sound operational track record and ensuring regulatory compliance. Moreover, with respect to the sugar business, being an agri-commodity, the sugarcane crop depends on climatic conditions, besides being vulnerable to pests and diseases. These factors can affect both the yield per hectare as well as the recovery rates which in turn can affect SSML's profitability.

Social considerations: IHEL's success depends critically on its competent workforce. As per the disclosures made by the company, it has initiated various measures to improve the retention of trained and talented employees in the context of emerging market conditions. Additionally, customer satisfaction remains critical for IHEL's successful operations and it conducts surveys on a regular basis to ensure this. With respect to the sugar business, the worldwide societal shift to less sugar-intensive food products because of health issues could structurally reduce the demand for sugar products. However, such changes in consumer behaviour or any other driver of change is expected to be relatively slow paced. Therefore, while IHEL remains exposed to the aforementioned social risk, it does not materially affect its credit profile as of now.

Liquidity position: Adequate

IHEL's liquidity profile is adequate with free cash balance and liquid investments of ~Rs. 200 crore (consolidated) as on September 30, 2022 and average cushion in sanctioned limit of Rs. ~390 crore (standalone) in H1FY2023. Further, retained operating cash flows are likely to be comfortable in H2FY2023 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/OPBDITA 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	Type	Amount rated (Rs. crore)	Amount outstanding as of Sep 30, 2022 (Rs. crore)	Current rating (FY2023)		Chronology of rating history for the past 3 years		
				Date & rating in FY2023		Date & rating in FY2022	Date & rating in FY2021	Date & rating in FY2020
				Nov 28, 2022	Aug 25, 2022			
1 Fund-based Working Capital	Long term	600.00	-	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Negative)	-	[ICRA]AA (Stable)
2 Non fund based Working Capital	Short term	3800.17	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	-	[ICRA]A1+
3 Fund based / Non fund based Working Capital	Long term/ Short term	1,099.83	-	[ICRA]AA (Stable)/ [ICRA]A1+	[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: [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	NA	NA	NA	600.00	[ICRA]AA (Stable)
NA	Short-term – Non fund based Working Capital	NA	NA	NA	3800.17	[ICRA]A1+
NA	Fund based / Non fund based Working Capital	NA	NA	NA	1,099.83	[ICRA]AA (Stable)/ [ICRA]A1+

Source: Company

[Please click here to view details of lender-wise facilities rated by ICRA](#)

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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