ISGEC Heavy Engineering Limited

November 12, 2018

Summary of rated instruments

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based	300.0	380.0	[ICRA]AA (Stable); reaffirmed
Non-fund based	98.9	98.9	[ICRA]AA (Stable); reaffirmed
Non-fund based	2451.1	2126.1	[ICRA]A1+; reaffirmed
Fund-based / Non-fund based	150.0	695.0	[ICRA]AA (Stable)/A1+; reaffirmed
Unallocated	300.0	1000.0	[ICRA]AA (Stable)/A1+; reaffirmed
Total	**3300.0**	**4300.0**	

*Instrument details are provided in Annexure-1

Rating action

ICRA has reaffirmed the long-term rating of [ICRA]AA (pronounced ICRA double A) to the Rs. 380.0-crore[1] (enhanced from Rs. 300.0 crore) fund-based limits and Rs. 98.9-crore non-fund based limits of ISGEC Heavy Engineering Limited (IHEL). ICRA has also reaffirmed the short-term rating of [ICRA]A1+ (pronounced ICRA A one plus) to the Rs. 2,126.1-crore (reduced from Rs. 2,451.1 crore) non-fund based facilities of IHEL. Further, ICRA has reaffirmed the rating of [ICRA]AA on the long-term scale and [ICRA]A1+ on the short-term scale for Rs. 695.0-crore (enhanced from Rs. 150.0-crore) fund based/non-fund based bank limits and Rs. 1,000.0-crore (enhanced from Rs. 300.0-crore and the rating is now provided on both long-term and short-term scale) unallocated limits of IHEL[2]. The outlook on the long-term rating is Stable.

Rationale

The rating action positively factors in the track record of promoters and the established position of IHEL as an engineering, procurement and construction (EPC) company and a fabricator for various equipment/machinery in the capital goods sector, both in India and in the overseas markets. The ratings also factor in the stability in operations which arises due to the defensible market position of IHEL, especially in India, across divisions such as boilers, presses, sugar plant machinery and process equipment. The same is aided by IHEL's long-term technical tie-ups/alliances with a number of recognised global heavy engineering companies as well as its in-house design and manufacturing capability. The strong market position enables IHEL to keep its working capital requirements negligible as it receives adequate customer advances and maintains a short receivables cycle. Its market position is demonstrated by an improving order backlog position aided by strong order bookings in CY2018. Further, ICRA acknowledges the prudent risk management techniques followed by IHEL such as hedging of the entire forex exposure (forex risk), back-to-back arrangement with vendors as well as satisfactory assessment of various other risks such as political, environmental, commercial, legal etc. before taking up a project. Apart from this, the rating reaffirmation factors in the strong diversification of IHEL's revenue stream across a number of end markets, geographies and clients, and a consistently satisfactory order book which offers revenue visibility in the medium term. The strong business position is also reflected by the robust financial profile though the same dipped in FY2018 compared with the previous two years. IHEL has a negative net debt position, interest coverage ratio of 24.0x and NCA/total debt of 167% in FY2018 apart from unutilised bank lines. IHEL's short-term liquidity is supported by more than Rs. 400-crore of liquid investments and cash and cash equivalents.

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[1] *100 lakh = 1 crore = 10 million*

[2] *For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications*

Despite its credit strengths, ICRA acknowledges the negative impact of the ongoing dispute between IHEL and Cavite Biofuels of Philippines. As a result of the encashment of performance bank guarantee by Cavite Biofuels for a project that IHEL was executing in the Philippines, its liquidity position took a hit, albeit remaining satisfactory. ICRA also notes that the two parties are now involved in a legal tussle with substantial claims and counterclaims made by each party against the other. Although the matter is sub-judice and expected to be heard in Singapore International Arbitration Centre in September/October 2019 it remains a key event risk going forward. Other than this, the rating continues to factor in the competitive pressures from other engineering firms and equipment manufacturers and the vulnerability of the company's revenues to cyclical trends in some consuming industries, which may affect the future order inflows. The same has been demonstrated by ~22% reduction in revenues in FY2017 and ~14% reduction in revenues in FY2018, both on a YoY basis, which was attributed largely to a lower opening order book in FY2017 and FY2018. The ratings also take into consideration the business risks arising out of the company's exposure to raw material price fluctuations for the products manufactured in-house, though the percentage of the same in overall mix is low. Further, the profitability of Saraswati Sugar Mills Ltd., a 100% subsidiary of IHEL which is into sugar manufacturing, is likely to remain exposed to cyclicality in the sugar industry, necessitating financial support from the parent entity in downturns.

Outlook: Stable

ICRA believes that IHEL will continue to benefit from the extensive experience of its promoters, technical tie-ups with renowned global engineering companies, defensible market position, especially in the domestic market and healthy financial profile. The outlook may be revised to Positive if order bookings continue to improve, the scale and margins pickup materially and working capital and project risk management remains strong, leading to further strengthening of the financial profile. The outlook may be revised to Negative if the event risk associated with the Cavite Biofuels project materialises.

Key rating drivers

Credit strengths

Extensive experience of promoters – IHEL was established in 1946 by the Puri family and has a track record of more than 75 years in the capital goods industry. It has presence in more than 90 countries and has executed orders in countries in South East Asia, Americas, Africa and the Middle East, apart from India. As per the management, it is the market leader for the EPC of boilers and sugar plant segment as well as the fabrication of mechanical and hydraulic presses (for the addressable market).

Market position aided by technical tie-ups/alliances – 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, Amec Foster Wheeler North America Corp., Envirotherm Germany, Babcock Power Environmental Inc, USA etc., which enables it to command leadership position in the market across many product categories such as boilers, presses, process equipment etc. IHEL's long track record in the industry, technical tie-ups with international majors and ability to absorb and indigenise technology results in strong brand recall for its products. Entry barriers for new entrants are high because of requirement of strong track record, technical competence and pre-qualification status.

Strong and well-diversified order book – IHEL has a strong order backlog aided by robust order bookings in CY2018. The order book is well diversified and adequately focussed towards international business in regions such as Central America, Africa, the Middle East and South East Asia apart though the majority of orders are for Indian clients. Though the cyclical nature of some of consuming industries (notably sugar and steel) poses risk for IHEL's business growth, its diverse client base mitigates the risk to some extent. Further, most of the consumer companies are private sector industrial customers, which reduces the risk of exposure of the order book to a few lumpy orders. The company's order book has, therefore, remained well diversified both geographically and in terms of exposure to industries catered to.

Risk mitigation processes are robust – IHEL sources its raw material and a sizable portion of equipment from external vendors/suppliers. For any order received by the company, it enters into back-to-back orders for supply of key equipment on similar commercial and technical terms. However, for the products manufactured in-house by the company, raw materials, such as steel, is largely procured from the open markets at spot rates. This makes the company vulnerable to raw material price fluctuations as most of its contracts are on a fixed-price basis. Apart from raw material risk, IHEL takes vanilla forward covers on most of its forex exposures to manage the currency risk. These covers are taken within a short period from the date of receiving new order. IHEL also undertakes risk assessment studies before bidding for any project.

Strong profitability and healthy capital structure – IHEL's operating profitability and working capital intensity has improved over the last few years, which has positively impacted its liquidity profile and capital structure though it deteriorated in FY2018. Short-term liquidity is supported by more than Rs. 400-crore of liquid mutual fund and FD investments and cash and bank and a near negative working capital requirement.

Credit challenges

Risks arise on account of dispute with Cavite Biofuels of Philippines – As a result of a dispute with one of its clients – Cavite Biofuel of Philippines – for which IHEL was executing a fully-integrated sugar mill, bioethanol distillery and co-generation facility in Philippines, the client encashed bank guarantees (BG) of Rs. 134 crore in April 2018. Further, both the parties filed claims and counterclaims against each other in Singapore International Arbitration Centre (SIAC) due to which IHEL recorded a contingent liability of over Rs. 350 crore. The hearing of the dispute is slated to take place in September/October 2019, until which the matter remains sub-judice. However, ICRA notes that the encashment of the Rs. 134-crore BG has negatively impacted the liquidity profile of IHEL. Further, any adverse ruling in the above-mentioned case may jeopardise the liquidity of the company and lead to an erosion of its net worth, thereby weakening its financial profile. Therefore, it remains a key event risk, going forward.

Intense competition from domestic and international players – Given the competitive nature of the domestic and international markets, order booking is expected to remain cyclical. The risk is further amplified by the competitive nature of the market and overall weak market scenario notwithstanding the recent strong order bookings. However, IHEL has demonstrated a solid track record of booking orders in the past despite a difficult external environment.

Possible support extended to Saraswati Sugar Mills Ltd (SSML) – SSML is a 100% subsidiary of IHEL and is non-integrated sugar mill based in Yamunanagar, Haryana. SSML is likely to remain exposed to cyclicality in the sugar industry, which could necessitate financial support from the parent entity in downturns.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below.

Links to applicable criteria:

Corporate Credit Rating Methodology

About the company

IHEL, a publicly listed company under the ISGEC Group, is engaged in the EPC of industrial boilers, sugar machinery, power plants, material handling projects, air pollution equipment etc. It also has the capability to fabricate capital goods such as mechanical and hydraulic presses, process equipment, heat exchanges, castings etc. It has five manufacturing facilities in India, two of which are located in Haryana and one each in Gujarat, Uttar Pradesh and New Delhi. The EPC business comprises 80–85% of the IHEL's current order book with fabrication accounting for the rest.

IHEL has a 100% subsidiary – SSML – which is a 10,000-tcd sugar mill located in Yamunanagar, Haryana. IHEL also floated a 51:49 JV with Hitachi Zosen Ltd, Japan in March 2012. The JV, known as ISGEC Hitachi Zosen Ltd, is involved in manufacturing of pressure vessels and heat exchangers for exports market at Dahej, Gujarat and caters to the petrochemical, oil refining and fertiliser industries. IHEL has entered into a 51:49 JV both with Titan Metal Fabricators of the USA (ISGEC Titan Metal Fabricators) for production and sale of engineering equipment and with Redecam Group of Italy (ISGEC Redecam Enviro Solutions Pvt Ltd) for executing orders in air pollution control segment. Finally, in September 2018, IHEL acquired a 100% stake in Eagle Press, a company domiciled in Canada and manufacturing mechanical presses, through its Canadian subsidiary.

Key financial indicators (audited)

	FY2017	FY2018
Operating Income (Rs. crore)	3,031.5	2,599.8
PAT (Rs. crore)	188.6	119.0
OPBDIT/OI (%)	8.5%	6.5%
RoCE (%)	23.2%	14.1%
Total Debt/TNW (times)	0.1	0.1
Total Debt/OPBDIT (times)	0.4	0.5
Interest coverage (times)	12.5	24.0

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

	Instrument	Current Rating (FY2019) Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating November 2018	Chronology of Rating History for the Past 3 Years: Date & Rating in FY2018 Sep 2017	Date & Rating in FY2017 Oct/ May 2016	Date & Rating in FY2016 Jun 2015
1	PC/PCFC/ Letter of Credit	Long Term	380.0		[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)
2	BG/LC	Short Term	2126.10		[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
3	BG/LC	Long Term	98.90		[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]A1+
4	PC/PCFC/ Letter of Credit/BG/LC	Long Term/ Short Term	695.0		[ICRA]AA (Stable)/A1+	[ICRA]AA (Stable)/A1+		
5	Unallocated	Long Term/ Short Term	1000.0		[ICRA]AA (Stable)/A1+	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)

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 No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	PC/PCFC/ Letter of Credit				380.0	[ICRA]AA(Stable)
NA	BG/LC				2126.10	[ICRA]A1+
NA	BG/LC				98.90	[ICRA]AA(Stable)
NA	PC/PCFC/ Letter of Credit/BG/LC				695.0	[ICRA]AA(Stable)/A1+
NA	Unallocated				1000.0	[ICRA]AA(Stable)/A1+

Source: IHEL

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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.

For more information, visit www.icra.in

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