December 20, 2019

H.G. Infra Engineering Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund Based – Cash Credit	120.00	120.00	[ICRA]A(Stable); reaffirmed
Fund Based – Proposed Cash Credit	10.00	10.00	[ICRA]A(Stable); reaffirmed
Non-fund Based – Bank Guarantee	1,000.00	912.00	[ICRA]A1; reaffirmed
Long-term/Short-term Non-fund Based – Bank Guarantee	-	88.00	[ICRA]A(Stable)/A1; reaffirmed
Non-fund Based – Proposed Bank Guarantee	80.00	80.00	[ICRA]A1; reaffirmed
Total	**1,210.00**	**1,210.00**	

**Instrument details are provided in Annexure-1*

Rationale

ICRA has taken a consolidated view of H.G. Infra Engineering Limited (HGIEL) as well as its special purpose vehicles (SPVs), incorporated to carry out road construction projects, wherein the company has extended unconditional and irrevocable corporate guarantees towards their debt obligations. The ratings continue to draw comfort from the promoters' long track record of over four decades in the civil construction business, coupled with the company's status as an AA class contractor with the Government of Rajasthan (GoR) and its SS class registration with the Military Engineer Services (MES). The ratings are also supported by the diversified client portfolio consisting of private customers as well as Government and semi-Government agencies, such as the National Highway Authority of India (NHAI), the Rajasthan State Road Development Corporation (RSRDC), the roads and building (R&B) divisions, the municipal corporations of various cities, and irrigation departments, among others. Further, the ratings factor in the company's operating income (OI) growth at a CAGR of 41% during FY2016-FY2019. The growth is expected to continue in the medium term on the back of a healthy order book position of over Rs. 6,272 crore as on September 30, 2019 (~3.1 times FY2019 OI). ICRA also notes the company's healthy profitability with operating margins of 15%, with high utilisation of owned fleet, and its improved capital structure (post de-leveraging through its initial public offering (IPO) proceeds), resulting in comfortable coverage indicators.

HGIEL's ratings are constrained by its increased working capital intensity, as reflected by NWC/OI of 24% in H1 FY2020 against 20% in FY2018-FY2019 and 10% in FY2017. This resulted in incremental working capital requirement to support the growth in the scale of operations. The ratings also factor in the high reliance on mobilisation advances and deposits from sub-contractors to fund the working capital requirements. Hence, any slowdown in such receipts increases HGIEL's reliance on bank borrowings. Further, the ratings factor in the execution related risks towards the completion of the hybrid annuity model (HAM) projects under its SPVs as well as the recently awarded projects that account for over 60% of the existing order book.

ICRA also notes that HGIEL has significant equity obligations of Rs. 285 crore towards its three HAM projects during FY2020-FY2021, of which it has infused Rs. 41.45 crore as of November 2019. Given the high investment commitment towards the ongoing HAM projects, any incremental equity commitment towards existing HAM projects or any new ones taken up by the company in the near term would be a key credit monitorable. ICRA also notes the intense competition in the civil construction space as well as the highly concentrated order book with the road sector contributing more than 90%. The ratings also take into account the vulnerability of HGIEL's profitability to fluctuations in input prices in some projects that do not have a price escalation clause. ICRA further notes the high off-balance sheet exposure (bank guarantees of over Rs. 693 crore as of September 2019) due to the submission of bid bond, performance and other guarantees.

The Stable outlook on HGIEL's long-term rating indicates ICRA's opinion that HGIEL would show moderate growth in the OI over the next two years considering the healthy order book position. Moreover, it would continue to benefit from its established position as an engineering, procurement and construction (EPC) contractor as well as the long-term track record of its promoters in the construction sector.

Key rating drivers and their description

Credit strengths

Long track record of promoters; AA class contractor – The promoters have established experience of over four decades in the civil construction segment. Further, the presence of experienced professionals ensures adequate in-house project planning and execution capabilities. HGIEL's long track record and adequate infrastructure (equipment and skilled manpower), coupled with its AA class certification from the GoR and SS class certification from the MES, ensure that it meets the financial and technical criteria of most of the tenders floated.

Reputed and diversified customer profile – HGIEL's customer base includes Government and semi-Government bodies, and private entities (like NHAI, RSRDC, MES and IRB Infrastructure Developers Limited). It has also executed orders for Public Works Departments, R&B divisions and State Road Project Divisions of various states like Rajasthan, Uttar Pradesh, Haryana and Maharashtra. The counterparty credit risks remain moderate, given the past track record of timely payments.

Strong order book position – HGIEL's execution of progressively sizeable orders over time has made it eligible to bid for higher-value orders by meeting the stipulated technical and financial eligibility criteria. Accordingly, its order book remains healthy with an unexecuted position of over Rs. 6,272 crore as on September 30, 2019. The ratio of the current pending order book to FY2019's OI was healthy at ~3.1 times, indicating healthy revenue visibility for the next two-three years.

Healthy growth and improved profitability – The order book scale-up and timely execution helped HGIEL boost its revenue, with the OI registering a 44% growth to Rs. 2,010 crore in FY2019. The company will continue to grow with the healthy order book position. HGIEL reported revenues of Rs. 1,000 crore in H1 FY2020. The overall profitability improved to ~15.1% in FY2019 from ~11.0% in FY2016 and remained stable at ~15.3% in 6M FY2020, supported by lower sub-contracting expenses, in line with the expansion of owned fleet. Further, HGIEL would benefit from the lower corporate tax rate announced in September 2019. Consequently, the net margin improved to 7.4% in H1 FY2020 from 6.1% in FY2019. The return indicators remained healthy in FY2019, as reflected by RoCE of 24.5%.

Credit challenges

High equity commitment and execution risks related to HAM projects – HGIEL is the sponsor of three SPVs, which are executing HAM projects, thereby leading to an equity commitment of ~Rs. 285 crore on the part of HGIEL. HGIEL has already contributed Rs. 41.5 crore as of November 30, 2019. The company has significant equity commitment of Rs. 243.5 crore of which Rs. 133 crore must be infused upfront prior to debt drawdown. While its track record of execution has been good in the past, HGIEL remains exposed to risks pertaining to the execution of the projects within the stipulated time and cost.

Increased working capital intensity; high off-balance sheet exposure – The company's working capital intensity remained in the range of 10-15% over FY2014-FY2017. However, the same increased to 20% in FY2018 and further to 24% in H1 FY2020, primarily due to higher receivable days. Moreover, HGIEL has high reliance on mobilisation advances and security deposits from sub-contractors to fund its working capital requirements and any slowdown in the same may increase its reliance on bank borrowings. ICRA further notes the high off-balance sheet exposure (bank guarantees of over Rs. 693 crore as of September 2019) due to the submission of bid bond, performance and other guarantees.

Low sector diversity – A significant proportion of the orders executed by HGIEL are in the road construction segment. About 95% of its unexecuted order book, as of September 30, 2019, included roads/highway construction contracts, while the rest were canal construction and irrigation projects. Thus, the company is exposed to any slowdown in new order flow faced by the road sector.

Moderate execution risk – HGIEL's execution risk remains at moderate levels, particularly for the newly awarded projects (which account for over 60% of the current order book), wherein securing all necessary approvals and work completion in a timely manner will be key for achieving growth in the near to medium term. With the recently achieved financial closure of HAM projects and capex during the last three years towards enhancing execution capabilities, the company has adequate resources to execute the orders in a timely manner.

Intense competition; vulnerability to price fluctuations – HGIEL's growth prospects remain constrained by the intense competition in the civil construction space and the project order-based nature of the business. There is a risk of reduction in the work flow in case of any prolonged downcycle in the road construction sector, which remains the company's major revenue contributor. Besides, the overall profitability remains vulnerable to fluctuations in the input prices, although the presence of a price escalation clause in most of the contracts for major components mitigates the risk to a large extent.

Liquidity position

HGIEL's average utilisation of fund-based limits during the 12-month period ended October 2019 was high at ~86% due to the increased working capital intensity. Despite improved cash flow from operations and positive retained cash flows, significant capex towards expanding its fleet of construction equipment resulted in negative free cash flows in FY2019. The company has committed cash outflows of Rs. 146 crore in FY2020 and Rs. 45 crore in FY2021 for its debt repayment along with the equity requirement of ~Rs. 243 crore during FY2020-FY2022 towards the HAM projects. Further, HGIEL generated Rs. 193 crore of net cash accruals (NCA) in FY2019 and is expected to generate cash accruals of Rs. 230-250 crore in FY2020, which, in ICRA's opinion, would be adequate for its committed obligations. However, any additional exposure towards new HAM projects or a stretch in the working capital position could adversely impact the liquidity position of the company.

Rating sensitivities

Positive triggers – The ratings may be upgraded if the company continues its growth momentum, while improving its working capital intensity, resulting in an improved liquidity position, thereby improving its overall financial risk profile.

Negative triggers – Downward pressure on the ratings could emerge if there is a delay in the execution of the ongoing HAM projects or a delay in meeting the equity commitments towards such projects. Pressure on the ratings could also materialise if the financial risk profile weakens due to a slowdown in the execution pace, moderation in profitability and sizeable LD claims or if any increase in the working capital cycle leads to a significant increase in the working capital requirement and impacts the cash flows.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Construction Entities Consolidation and Rating Approach
Parent/Group Support	Not applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has consolidated the financials of the various Group entities (as mentioned in Annexure-2), given the close business, financial and managerial linkages among them

About the company

H.G. Infra Engineering Limited was incorporated in 2003 by Mr. Hodal Singh Choudhary, Mr. Girish Pal Choudhary, Mr. Vijendra Singh Choudhary and Mr. Harendra Singh Choudhary in Jodhpur, Rajasthan. It is primarily involved in infrastructure development and the construction of roads and highways across Rajasthan, Uttar Pradesh, Haryana, Maharashtra and Goa. Over the last few years, it diversified into the construction of water distribution projects. In FY2018, the company successfully concluded its IPO. HGIEL is accredited AA class by Public Works Department (PWD) of the Government of Rajasthan (GoR) and is also registered as an SS class contractor by the Military Engineer Services (MES).

Key financial indicators (audited)

	FY2018	FY2019
Operating Income (Rs. crore)	1,393	2,010
PAT (Rs. crore)	84	124
OPBDIT/ OI (%)	14.9%	15.1%
RoCE (%)	24.4%	24.5%
Total Debt/ TNW (times)	0.8	0.6
Total Debt/ OPBDIT (times)	2.0	1.3
Interest Coverage (times)	5.2	6.2
DSCR (times)	2.0	1.6

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

		Current Rating (FY2020)				Chronology of Rating History for the Past 3 Years			
					Date & Rating	Date & Rating in FY2019		Date & Rating in FY2018	Date & Rating in FY2017
	Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	December 20, 2019	March 1, 2019	June 22, 2018	December 15, 2017	December 7, 2016
1	Cash Credit	Long Term	120.00	-	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A- (Positive)	[ICRA]A- (Stable)
2	Proposed Cash Credit	Long Term	10.00	-	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A- (Positive)	[ICRA]A- (Stable)
3	Letter of Credit and Bank Guarantee	Short Term	912.00	-	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A2+	[ICRA]A2+
4	Bank Guarantee	Long Term/Short Term	88.00	-	[ICRA]A (Stable)/A1				
5	Proposed Letter of Credit and Bank Guarantee	Short Term	80.00	-	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A2+	[ICRA]A2+

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	Cash Credit	NA	NA	-	120.00	[ICRA]A(Stable)
NA	Proposed Cash Credit	NA	NA	-	10.00	[ICRA]A(Stable)
NA	Letter of Credit and Bank Guarantee	NA	NA	-	912.00	[ICRA]A1
NA	Bank Guarantee	NA	NA	-	88.00	[ICRA]A(Stable)/A1
NA	Proposed Letter of Credit and Bank Guarantee	NA	NA	-	80.00	[ICRA]A1

Source: H.G. Infra Engineering Limited

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Gurgaon Sohna Highway Private Limited	100.00%	Full Consolidation
H.G. Ateli Narnaul Highway Private Limited	100.00%	Full Consolidation
HGIEPL - Colossal JV	70.00%	Proportionate Consolidation
HGIEPL - Ranjit JV	30.00%	Proportionate Consolidation
HGIEPL - MGCPL JV	30.00%	Proportionate Consolidation
HGIEPL - RPS JV	51.00%	Proportionate Consolidation
TPL - HGIEPL JV	26.00%	Equity Method

Analyst Contacts

K. Ravichandran
+91 44 45964301
ravichandran@icraindia.com

Ankit Patel
+91 79 4027 1509
ankit.patel@icraindia.com

Ravish Mehta
+91 79 4027 1522
ravish.mehta@icraindia.com

Relationship Contact

Jayanta Chatterjee
+91 80 43326401
jayantac@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries:

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

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

ICRA Limited

Corporate Office
Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002
Tel: +91 124 4545300
Email: info@icraindia.com
Website: www.icra.in

Registered Office
1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001
Tel: +91 11 23357940-50

Branches

Mumbai	+ (91 22) 24331046/53/62/74/86/87
Chennai	+ (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,
Kolkata	+ (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008,
Bangalore	+ (91 80) 2559 7401/4049
Ahmedabad	+ (91 79) 2658 4924/5049/2008
Hyderabad	+ (91 40) 2373 5061/7251
Pune	+ (91 20) 2556 0194/ 6606 9999