February 19, 2020 (Revised)

ISGEC Heavy Engineering Limited: Ratings reaffirmed; rated amount enhanced

Summary of rated instruments

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based	380.00	400.00	[ICRA]AA (Stable); reaffirmed/assigned
Non-fund based	98.90	98.90	[ICRA]AA (Stable); reaffirmed
Non-fund based	2126.10	2726.27	[ICRA]A1+; reaffirmed/assigned
Fund-based / Non-fund based	995.00	974.83	[ICRA]AA (Stable)/A1+; reaffirmed
Unallocated	700.00	200.00	[ICRA]AA (Stable)/A1+; reaffirmed
Total	**4300.00**	**4400.0**	

** Instrument details are given in Annexure-1*

Rationale

The ratings favourably factors in the established position of IHEL as an engineering, procurement and construction (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 rating reaffirmation factors in the strong diversification of the company's revenue stream across a number of end user industries, geographies and clients. The market position is further supported by a healthy capital goods manufacturing and EPC order book (Rs. 6872 crore as on September 30, 2019) which lends healthy revenue visibility in the medium term. Steady execution pace across expanded order book resulted in strong revenue growth over FY2019 and 9MFY2020 (37% and 24% respectively) which along with healthy profitability, led to strong cash accruals. Moreover, limited reliance on debt and absence of long term loans has kept IHEL's debt coverage metrics strong (Interest coverage of 5.7 times, DSCR of 3.5 times, NCA/Total Debt of 71% for FY2019). Although the recent acquisition of CBPI Philippines[1] (that carries $ 34.7 mn debt on its books) is expected to moderate IHEL's coverage metrics in the medium term, ICRA notes that the company currently has moratorium till January 2022 for the associated debt servicing obligations and plans to liquidate these assets. IHEL's liquidity position continues to be healthy marked by sizeable undrawn limits and free cash balances, even as there has been a decline in cash balances and marketable investments over the past two years with growing working capital requirements. IHEL's exposure to price risks remains modest as it enters into back-to-back arrangements with vendors for majority of its material and the fact that many of its new orders have in-built price escalation for key inputs. Further, policy of fully hedging its forex exposures also mitigates currency fluctuation risks to a large extent.

[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.

The ratings, however, factor in the nascent completion stage of IHEL's current order book; however, the execution risks are mitigated to an extent by the company's long track record and experienced management team. The company also witnessed elongation of its working capital cycle (NWC/OI of 16% in FY2019, up from 9% in FY2018) led by change in its order book profile with lower availability of interest free customer advances, mainly across government clients, as well as build-up of retention money on an expanded order book and higher order tenor. In addition, healthy revenue growth has resulted in increased working capital requirements which the company has comfortably funded through its cash reserves and sufficient bank limits. Additionally, 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. While IHEL has extended corporate guarantees for working capital limits of various subsidiaries, these entities are expected to be self-sufficient in managing their funding requirements in the near to medium term. Nevertheless, weaker than expected performance of subsidiaries can entail funding requirements. This along with delay in selling of CBPI's assets which can result in increased debt obligations for IHEL will be a key rating sensitivity.

Key rating drivers and their description

Credit strengths

Established position as a leading EPC player and manufacturer for capital goods

The company enjoys a strong market position in the capital goods segment, which contributes to majority of its revenues and profits. Apart from in-house capabilities, IHEL has several technology joint ventures (JVs) and strategic technology partnerships with international majors. These along with IHEL's long track record in the industry and its ability to absorb and indigenise technology bolsters its market position. In FY2019, 64% of IHEL's gross revenues comes from the EPC business, 30% from manufacturing with balance from its sugar operations. With captive manufacturing facilities across key product segments likes presses, boilers, process equipment, IHEL enjoys benefits of synergies with its EPC segment.

Healthy and diversified order book

IHEL continues to have a healthy order book (Rs. 6872 crore as on September 30, 2019) which lends healthy revenue visibility over the medium term. Further, the order book is well diversified across industry segments, customers and geographies; covering a wide range of product segments. IHEL forayed into new segments like railways, material handling and water treatment in past few years and has been able to successfully scale up its order book from these segments. While cyclicality in a single industry would impact IHEL's order and revenue booking, it is not highly exposed to one sector. Moreover, the order book is spread across more than 112 individual orders resulting in modest order concentration. The top 5 and top 10 orders account for 31% and 46% respectively of the pending order book (as of September 30, 2019).

Steady execution pace over an expanded order book resulted in strong revenue growth

IHEL's revenues witnessed a strong growth of 37% in FY2019 and 24% in 9MFY2020 led by a steady execution pace over its healthy order book in the capital goods business. Further, the company's operating profits expanded in the backdrop of a larger operating scale even as operating margins contracted slightly led by lower margins in SSML's sugar mill business and higher legal expenses owing to arbitration related to CBPI. Nevertheless, IHEL's cash accruals and return metrics remained healthy (NCA of Rs. 216 crore and ROCE of ~16% in FY2019). IHEL is expected to achieve strong growth in revenue and OPBDIT in FY2020 followed by some moderation in growth rate going forward given the high revenue base achieved over FY2019-20. The pace of growth will continue to be a factor of steady order build-up and timely execution.

Limited price escalation and forex fluctuation risks

In its EPC business, a large proportion (70-80%) of the equipment is bought out and IHEL typically enters into back to back contracts with the equipment suppliers and remains exposed to input price risks for the balance 20-30% equipment which is manufactured in-house. However, over the last 1-2 years, the company's order book composition has witnessed a shift towards orders from government/public sector clients, most of which offer contracts with price variation clauses which augur well for longer tenor contracts. At present, six of the company's top ten orders have in built escalation clauses. This apart, the company also follows a full hedging policy to cover its forex risk. The margins in the sugar business, however, remains vulnerable to change in government policy and agro-climatic conditions.

Limited reliance on debt and healthy profitability result in healthy debt coverage

IHEL's reliance on debt traditionally has remained limited as reflected by gearing of 0.19 times as on March 31, 2019. Healthy profitability and low long-term debt obligations have kept its debt coverage metrics at comfortable levels as reflected by Interest coverage of 5.7 times and DSCR of 3.5 times in FY2019. However, the recent acquisition of CBPI as part of the settlement and ongoing capex in SSML is expected to increase IHEL's long term debt levels going forward ($ 34.7 mn loan in CBPI). ICRA notes that IHEL has received a moratorium on the loan availed by CBPI upto January 2022 and the management plans to liquidate this investment, thereby limiting IHEL's financial commitments. Any sizeable financial support to CBPI or inability to liquidate the assets would remain a key rating monitorable.

Credit challenges

Large proportion of current order book is in nascent stage of execution

IHEL is exposed to execution risks including delay in client related approvals and site availability as is common in the EPC space. Further, with most of the build-up in the current order book done in FY2019, many orders are in nascent stage of progress. As on September 30, 2019, the company had completed 23% of its top 10 orders (which accounted for 65% of the pending order book). Moreover, about 23% of the orders were yet to witness the first billing. Notwithstanding the initial stages of completion, IHEL's long execution track record provides comfort.

Growing working capital requirements with changing order mix

IHEL's working capital requirements steadily rose over FY2017-19 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 results in higher working capital intensity (NWC/OI of 16% in FY2019, up from 5% in FY2017). IHEL utilised its existing cash and liquid investments and bank limits to fund these increased requirements. The company has received enhancement in its non-fund-based facilities which are sufficient to address its requirements over the medium term. Further, absence of cash margin requirements supports the company's financial flexibility.

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 moderation in order flow during 9MFY2020 even as the management focussed on execution of its strong order additions made in FY2019.

Weaker than expected performance of subsidiaries/ JVs can entail in funding requirements, any delay in sale of CBPI assets a concern

IHEL has extended corporate guarantees for working capital limits of its joint venture entities (Rs.586 crore as on September 30, 2019). Further, wholly owned subsidiaries SSML, Eagle Press Canada have long term debt obligations. While these entities are expected to be self-sufficient in managing their funding requirements in the near to medium term, weaker than expected performance of the subsidiaries can entail funding requirements. This along with delay in liquidation of CBPI's assets or significant funding support will be a key rating sensitivity.

Liquidity position: Strong

IHEL's cashflows from operations turned negative in FY2018 and continued to remain negative in FY2019 on the back of growing working capital requirements. However, the same were comfortably funded mainly through existing cash and liquid investments followed by incremental working capital borrowings. Though the company steadily utilised its existing cash and liquid investments over the last few years, it continues to have adequate liquidity (cash and liquid investments of ~Rs. 110 crore as on Feb 10, 2020on a standalone basis, other group entities are smaller in size with limited cash reserves). This apart, IHEL continues to have substantial drawing power and unutilised working capital limits support its liquidity position.

Rating sensitivities

Positive triggers: With CBPI's debt being consolidated, IHEL's consolidated debt metrics are expected to moderate. Thus, even as standalone execution continues to be steady, an upgrade is unlikely pending the improvement of consolidated credit metrics.

Negative triggers: Negative pressures on rating would arise in case of considerable decline in revenue due to lower order book execution, or sizeable reduction in profit margins and cash flow generation on sustained basis. Further, higher than expected support to group entities or delay in liquidation of CBPI assets that may result in increased repayment obligations.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	Not applicable
Consolidation / Standalone	Consolidation, list of companies given in Annexure 2

About the company

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. Apart from EPC of industrial boilers, sugar machinery, power plants, material handling projects, air pollution equipment etc, it also has fabrication and casting facilities across five manufacturing facilities in India, two of which are in Haryana and one each in Gujarat, Uttar Pradesh and New Delhi. The EPC business comprised 84% of the IHEL's current order book. IHEL's capital goods and EPC business contributes majority of the group's revenues and profit (82% of revenues and 90% of the net profit in FY2019) followed by its sugar mill operations in Saraswati Sugar Mills Limited or SSML (12% of revenues and 6% of net profit in FY2019) with other entities contributing the balance.

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. In FY2019, IHEL acquired a 100% stake in Eagle Press, a company domiciled in Canada and manufacturing mechanical presses, through its Canadian subsidiary. In October 2019, as part of a settlement, IHEL through its 100% subsidiary the entities owning assets related to CBPI, Philippines for a nominal amount.

Key financial indicators (audited)

	FY2018	FY2019
Operating Income (Rs. crore)	3663	5015
PAT (Rs. crore)	168	144
OPBDITA/OI (%)	5.4%	5.2%
RoCE (%)	17.5%	15.6%
Total Debt/TNW (times)	0.12	0.19
Total Debt/OPBDITA (times)	0.88	1.17
Interest coverage (times)	5.80	5.78

Source: IHEL
Amounts in Rs. crore

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for the past three years

				Current Rating (FY2020)		Chronology of Rating History for the past 3 years			
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating in FY2020	Date & Rating in FY2019	Date & Rating in FY2018	Date & Rating in FY2017	Date & Rating in FY2017
					19-Feb 2020	12-Nov 2018	12-Sep 2017	04-Oct 2016	31-May 2016
1	PC/PCFC/ Letter of Credit	Long Term	400.00	-	[ICRA]AA(Stable)	[ICRA]AA(Stable)	[ICRA]AA(Stable)	[ICRA]AA(Stable)	[ICRA]AA(Stable)
2	BG/LC	Short Term	2726.27	-	[ICRA]A1+	[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]AA(Stable)	[ICRA]AA(Stable)
4	PC/PCFC/ Letter of Credit/BG/LC	Long Term/ Short Term	974.83	-	[ICRA]AA(Stable)/[ICRA]A1+	[ICRA]AA(Stable)/ [ICRA]A1+	[ICRA]AA(Stable)/[ICRA]A1+	[ICRA]AA(Stable)/[ICRA]A1+	[ICRA]AA(Stable)/[ICRA]A1+
5	Unallocated	Long Term/ Short Term	200.0	-	[ICRA]AA(Stable)/[ICRA]A1+	[ICRA]AA(Stable)/ [ICRA]A1+	[ICRA]AA(Stable)/[ICRA]A1+	[ICRA]AA(Stable)/[ICRA]A1+	[ICRA]AA(Stable)/[ICRA]A1+

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 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	-	-	-	400.0	[ICRA]AA(Stable)
NA	BG/LC	-	-	-	2726.27	[ICRA]A1+
NA	BG/LC	-	-	-	98.90	[ICRA]AA(Stable)
NA	PC/PCFC/ Letter of Credit/BG/LC	-	-	-	974.83	[ICRA]AA(Stable)/A1+
NA	Unallocated	-	-	-	200.0	[ICRA]AA(Stable)/A1+

Source: IHEL

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
A ISGEC Heavy Engineering Limited	100.00%	Full Consolidation
B ISGEC Coverna Ltd.	100.00%	Full Consolidation
C ISGEC Exports Ltd.	100.00%	Full Consolidation
D Saraswati Sugar Mills Ltd.	100.00%	Full Consolidation
E ISGEC Engineering & Projects Ltd.	100.00%	Full Consolidation
F Free Look Software Private Ltd.	100.00%	Full Consolidation
G ISGEC Hitachi Zosen Ltd.	51.00%	Full Consolidation
I ISGEC Foster Wheeler Boilers Private Ltd.	51.00%	Full Consolidation
J ISGEC Titan Metal Fabricators Private Ltd.	51.00%	Full Consolidation
K ISGEC Redecam Enviro Solutions Private Ltd.	51.00%	Full Consolidation
L Eagle Press & Equipment Co. Limited	100.00%	Full Consolidation
M ISGEC Investments Singapore Pte Ltd.*	100.00%	Full Consolidation

* Acquired entities which effectively own CBPI assets

Source: IHEL

Corrigendum

Document dated February 19, 2020 has been corrected with revisions as detailed below:

Page 9 – Relationship contact has been changed from Jayanta Chatterjee to L Shivakumar, along with the contact details.

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