

June 04, 2020

International Combustion (India) Limited: Ratings downgraded to [ICRA]BB+ / [ICRA]A4+ and outlook on the long-term rating revised to Negative

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based- Working Capital Facilities	15.25	15.25	[ICRA]BB+ / [ICRA]A4+; Downgraded from [ICRA]BBB- / [ICRA]A3 and outlook on long-term rating revised from Stable to Negative
Non-fund based- Working Capital	18.00	18.00	[ICRA]BB+; Downgraded from [ICRA]BBB- and outlook on long-term rating revised from Stable to Negative
Fund based/ Non-fund based (sub-limits)	(12.00)	(12.00)	[ICRA]A4+; Downgraded from [ICRA]A3
Total	33.25	33.25	

*Instrument details are provided in Annexure-1

Rationale

The downgrade of the ratings and the revision in the outlook on the long-term rating from Stable to Negative for International Combustion (India) Limited (ICIL) primarily consider the weakening demand, adversely impacting ICIL's financial performance. The company posted a net loss and its interest coverage stood at a subdued level (0.29 times) in 9M FY2020 (April 2019-December 2019). Moreover, the Covid-19 pandemic and the consequent lockdown imposed by the Government have accentuated the sluggishness in demand, which may lead to a further deterioration in the company's credit profile. The ratings, however, continue to consider ICIL's proven track record in the engineering/material handling equipment (MHE) as well as the industrial gear/gear drives (gear) segments and its technological tie-ups with reputed global players, which enhance the company's competitive position. ICRA also notes the company's conservative capital structure.

The ratings are constrained by the continuing weak performance of the building material segment, which is likely to exert pressure on the company's overall profitability and cash flows until the segment's scale of operation surpasses the break-even level. Moreover, as a manufacturer of capital goods, ICIL remains vulnerable to the cyclicity in the end-user industries, particularly steel, which contributes a significant portion to its sales. ICRA further notes that most of the contracts that ICIL enters have fixed prices. Hence any adverse movement in raw material prices is likely to negatively impact its profitability. The company faces intense competition from the unorganised segment as well as large organised players, which is likely to keep its margins under check.

The Negative outlook on the [ICRA]BB+ rating reflects ICRA's opinion that ICIL's credit profile will remain significantly vulnerable to a sustained sluggishness in demand from its main user industries.

Key rating drivers and their description

Credit strengths

Established track record in material handling and industrial gear segment – ICIL has been involved in the MHE and gear segments for a long time, initially as a trader (since incorporation in 1936) and subsequently as a manufacturer (since 1961). It caters to reputed EPC contractors, engineering companies and leading manufacturing entities, mainly in the

steel, sugar and cement industries. Repeat orders from the reputed clientele in both the private and public segments reflect ICIL's good product quality.

Technological tie-ups with reputed global players enhance market position – ICIL has technical tie-ups with globally established players for both the MHE and the gear divisions. Apart from enhancing the product reach, such tie-ups improve the company's market position. ICRA notes that historically such tie-ups have led to frequent transfer of technology, enabling ICIL to introduce new products in the domestic market. ICIL, through its linkages with global players, has been able to establish itself as a supplier of capital goods to various industries including steel, sugar, cement etc.

Conservative capital structure – The company's tangible net worth remained healthy due to accretion to reserves accumulated over the years. This along with limited borrowing kept ICIL's gearing low at 0.24 times as on March 31, 2019. Its total outside liabilities relative to tangible net worth (TOL/TNW) also remained conservative at 0.65 times as on March 31, 2019.

Credit challenges

Sluggish demand adversely impacting ICIL's financial profile; trend likely to linger in the current fiscal following the Covid-19 pandemic – Weakening of demand, mainly from the MHE segment, has adversely impacted ICIL's financial performance. The company reported a net loss of Rs. 4.44 crore in 9M FY2020 on an operating income of Rs. 91.14 crore vis-a-vis a net profit of Rs. 0.68 crore on an operating income of Rs. 94.48 crore in 9M FY2019. Its interest coverage deteriorated significantly to 0.29 times only in 9M FY2020 compared to 2.76 times in 9M FY2019. Moreover, the outbreak of the Covid-19 pandemic and the consequent lockdown announced by the Government are likely to have a further adverse impact on the demand scenario, affecting the company's credit profile.

Significant losses incurred in building material segment exert pressure on cash flows; turnaround of the segment remains critical from credit perspective – The company commissioned its dry mortar manufacturing unit in Ajmer, Rajasthan in March 2016. However, its market penetration in the building material segment remained limited so far, leading to low capacity utilisation and sales. This, in turn led to significant losses (Rs. 4.17 crore at the PBIT level in FY2019) in the segment, which adversely impacted the overall profitability. Weak performance of the building material segment is likely to exert pressure on ICIL's cash flows. In the recent past, ICIL has entered a technical collaboration with a reputed multinational entity, enabling it to produce and sell products under the latter's brand name. This is likely to impart operational strength to ICIL's building material segment, a turnaround of which remains critical from the credit perspective.

Exposed to cyclicity inherent in the capital goods industry – The performance of the company's MHE and gear segments remains exposed to the cyclicity inherent in the capital goods sector. In FY2019, the company witnessed an increase in order flow for capital goods, driven by improved demand from its main user industries, leading to an improvement in turnover and profitability. Nevertheless, in 9M FY2020, the revenues from the relatively high margin MHE segment dropped significantly, leading to a decline in the overall turnover and a net loss.

Vulnerability of margins to fluctuation in raw material prices as contracts are fixed price in nature – ICIL mainly enters fixed-price contracts with its clients. Hence, a significant increase in the raw material (mainly steel) prices during the execution period may adversely impact the company's profitability. Nevertheless, the company usually maintains a short interval between order receipt and raw material procurement, which mitigates the raw material price fluctuation risks to an extent.

Competitive nature of industry limits scope of margin expansion – The capital goods manufacturing industry is characterised by intense competition from the unorganised segment as well as large organised companies, including the players involved in project execution and multinationals entering the segment. This is likely to keep the company's profit margins under check.

Liquidity position: Stretched

ICIL's liquidity position is **stretched**. Its cash flow from operations is estimated to remain negative in FY2020 due to weak operating profitability, exerting pressure on the liquidity position. The company pre-paid a portion of the existing term loans in FY2020, reducing the debt repayment obligation for FY2021 (currently around Rs. 3 crore). Moreover, the moratorium availed due to the pandemic will lead to a further reduction in debt repayment obligation for the current fiscal. ICIL also has a moderate cushion in its working capital utilisation. However, the company has availed a fresh loan (overdraft) by pledging its entire liquid investments (around Rs. 14.80 crore as on March 31, 2020), reflecting a stretched liquidity position.

Rating sensitivities

Positive triggers – A rating upgrade in the near term is unlikely. The outlook on the long-term rating may be revised to Stable if a sustained growth in the revenues and profits, aided by an improved demand scenario, strengthens the company's debt coverage metrics.

Negative triggers – Continuing weak financial performance may adversely impact ICIL's credit profile, triggering a rating downgrade.

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 standalone financial statements of the entity

About the company

ICIL manufactures mineral and material processing and handling equipment (MHE) and gear box and geared motor drive system (gears). Incorporated in 1936, the company commenced trading operations as a wholly-owned subsidiary of International Combustion, U.K. It forayed into manufacturing in 1961 and went public in 1974. ICIL manufactures MHE products in its plants in Baidyabati, West Bengal and Nagpur, Maharashtra. The company's gear manufacturing unit is located in Aurangabad, Maharashtra. In March 2016, ICIL commissioned a dry-mortar manufacturing plant in Ajmer, Rajasthan to diversify into the building material industry. The company has also set up an artificial sand manufacturing unit as a backward integration facility for its dry mortar production, though the same has not commenced commercial production as dry mortar sale has remained low.

Key financial indicators

	FY2018 (Audited)	FY2019 (Audited)	9M FY2019 (Unaudited)	9M FY2020 (Unaudited)
Operating Income (Rs. crore)	108.52	135.01	94.48	91.14
PAT (Rs. crore)	-2.35	3.56	0.68	-4.44
OPBDIT/OI (%)	3.29%	8.04%	6.83%	0.68%
RoCE (%)	0.29%	5.99%	-	-
Total Outside Liabilities/Tangible Net Worth (times)	0.68	0.65	-	-
Total Debt/OPBDIT (times)	7.90	2.14	-	-
Interest Coverage (times)	0.90	3.43	2.76	0.29
DSCR	0.56	1.19	-	-

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2021)			Rating History for the Past 3 Years						
		Type	Amount Rated	Amount Outstanding	Rating	FY2020		FY2019	FY2018		
					4-June-2020	18-Feb-2020	10-Oct-2019	12-Mar-2019	13-Feb-2018	19-Dec-2017	31-Aug-2017
1	Cash Credit	Long Term	12.25	-	[ICRA]BB+ (Negative)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)
2	Bank Guarantee	Long Term	18.00	-	[ICRA]BB+ (Negative)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)
3	Bill Discounting	Short Term	3.00	-	[ICRA]A4+	[ICRA]A3	[ICRA]A3	[ICRA]A3	[ICRA]A3	[ICRA]A2	[ICRA]A2
4	Export Packing Credit / Bill Discounting	Short Term	(10.00)*	-	[ICRA]A4+	[ICRA]A3	[ICRA]A3	[ICRA]A3	[ICRA]A3	[ICRA]A2	[ICRA]A2
5	Letter of Credit	Short Term	(2.00)*	-	[ICRA]A4+	[ICRA]A3	[ICRA]A3	[ICRA]A3	[ICRA]A3	[ICRA]A2	[ICRA]A2

Amount in Rs. crore

*Sub-limits under the facilities rated on long-term scale

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	NA	12.25	[ICRA]BB+ (Negative)
NA	Bank Guarantee	NA	NA	NA	18.00	[ICRA]BB+ (Negative)
NA	Bill Discounting	NA	NA	NA	3.00	[ICRA]A4+
NA	Export Packing Credit / Bill Discounting	NA	NA	NA	(10.00)*	[ICRA]A4+
NA	Letter of Credit	NA	NA	NA	(2.00)*	[ICRA]A4+

*Sub-limits under the facilities rated on long-term scale
Source: International Combustion (India) Limited

Annexure-2: List of entities considered for consolidated analysis: Not applicable

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