Rating Rationale

22 Sept 2020

Azad Engineering Private Limited

Brickwork Ratings assigns ratings for the bank loan facilities of Rs.80.82 crs of Azad Engineering Pvt Ltd. ('Azad' or the 'Company')

Particulars:

Facility	Amount (Rs. in crs)	Tenure	Ratings
Fund Based Term Loans Term Loan- Proposed	 35.69 15.00	Long Term	**BWR BBB-/ Stable Assigned**
Fund Based EPC/ PCFC EPC/ PCFC- Proposed Sales Invoice Finance	 18.00 5.00 2.00	Short Term	**BWR A3 Assigned**
Non fund Based Bank Guarantee Derivative limits	 0.50 4.63		
Total	**80.82**	**Rupees Eighty crores and Eighty Two Lakhs Only**	

Please refer to BWR website www.brickworkratings.com/ for definition of the ratings; Details of Bank facilities are provided in Annexure-I;

Rating Action/Outlook

The ratings draw comfort from the promoters' experience of more than a decade in the precision engineering industry, established track record and developed infrastructure, long term contracts with reputed clientele, average financial profile marked by comfortable networth and low gearing and a moderate orderbook to be executed in FY21. However, the ratings are constrained by the moderate scale of operations, stretched working capital cycle and customer concentration risks with more than 50% of its revenue being derived from top two customers. The ratings also factor in the susceptibility to risks arising from tender-based nature of business, volatile input prices and exposure to exchange fluctuation risks on account of high exports without a natural hedge. BWR expects the COVID-19 pandemic impact to be minimal as most of the end user customers of the company are engaged in power generation. BWR notes that Azad had availed relief under the aforementioned package for the first tranche i.e. for Mar'20 till May'20 only.

The 'Stable' outlook indicates a low likelihood of rating change over the medium term. BWR believes Azad's business risk profile will be maintained over the medium term. The outlook may be revised to Positive if a sustained increase in scale of operations, healthy order book and higher than envisaged bottom line results in an improved financial risk profile and better gearing and debt protection metrics. The outlook may be revised to Negative if lower than expected revenue or profitability, a stretch in the working capital cycle, sizeable, unanticipated capex or weakening gearing impact the financial risk profile. Any sharp reversal in industry conditions post Covid-19 may exert a downward pressure on the ratings.

Key rating drivers

Credit Strengths:

- **Experienced promoters and management team:** The promoter Mr. Rakesh Chopdar has more than two decades of experience in the precision engineering industry. Over the years, the promoters have built strong relationships with customers. Strong track record, timely execution of orders, healthy relationships with customers and requisite quality certifications enable the company to cater to other reputed original equipment manufacturers and government departments seamlessly.

- **Established track record and developed infrastructure:** The company has established facilities at Hyderabad. The company has been adding capacity since FY18. The present capacity allows the company to manufacture ~2.4 lac pieces per annum. At present the infrastructure includes Forge Shop, Heat Treatment Shop, Hi-Tech CNC Machines, State of the art Laboratory, State of the art Inspection Facility, Heavy Machining Shop, Manufacturing software etc. Moreover, the company has obtained various international certifications namely,ISO 9001:2015 (QMS), AS9100 D, ISO 14001: 2015 (EMS), BS 45001: 2018 (OHSAS) and ISO 27001: 2013 (ISMS) for its facilities. The company has been a qualified Other Equipment Manufacturer for many of its clients since inception.

- **Average financial risk profile:** Total operating income was Rs.120.32 Crs during FY19 against Rs.82.56 Crs of FY18. The company recorded improvement in operations with EBITDA of Rs.41.48 crs in FY19 as against Rs.22.42 crs in FY18 on account of installation of new machinery, reduction in scrap and improvement in cost management. PAT was Rs.19.34 Crs in FY19 as against Rs.12.63 Crs of FY18. As per provisional FY20 results, the company's sales remained muted with growth of ~1.4% with revenue of Rs.122.05 crs, EBITDA of Rs.39.66 crs and PAT of Rs.20.20 crs. The company's net worth and gearing as on 31 Mar 2020 (prov) were comfortable at Rs.90.43 crs and 0.63 times, respectively. Debt protection metrics are comfortable with ISCR at 8.92 times and DSCR of 2.02 times as on 31 Mar 2019. As on 31 Mar 2020 (prov), the debt protection metrics continue to remain adequate. The liquidity profile also remains adequate. For 5MFY21 (provisional), the company has achieved a total operating income of around Rs.32 crs .

- **Established relationships with reputed clientele:** The Company has running long term contracts with reputed customers in domestic & export markets. During FY20, ~54% revenue was through export sales. The Company exports mainly to European Countries like Poland, Germany, Switzerland, Japan, UAE and USA. Key clients include Mitsubishi Hitachi Power Systems (Japan), ET International DMCC (UAE), Alstom Renewable (Poland), GE and Siemens (Across countries), which are dealing with the company since inception.

- **Moderate Orderbook:** The company holds confirmed orders worth ~Rs.156 crs as on 11 Sep 2020 with nearly ~85% to be executed during FY21. The order book continues to be skewed towards the Energy vertical of the company with ~78% of confirmed orders from the Energy vertical. In addition, the company has "in principle approved" orders worth Rs.450-Rs.500 crs in the aerospace segment. The said orders offer a near to mid term revenue visibility for the company.

Credit Concerns

- **Moderate scale of operations:** The company's business risk profile is constrained by its modest scale of operations and turnover. Thus, the company is yet to enjoy any significant economies of scale and bargaining power with customers.

- **Stretched working capital cycle:** The elongated working capital cycle is primarily on account of higher receivables days to the tune of 140-160 days and inventory holding of around ~60 days. Although the longer duration of time taken for manufacturing and receiving approvals and stringent quality norms are in line with the general industry trend, the same leads to the need for higher working capital requirements and dependence on bank borrowings. The company's ability to effectively manage its working capital cycle would be a key rating sensitivity.

- **Customer concentration risk and Business vertical concentration:** The company derives more than 50% of its revenue from top two customers, thereby exposing it to significant customer concentration risk. The associated risks are mitigated to a certain degree keeping in view the past satisfactory relationship and the repute of such clients which offer low counterparty risks. The company's primary business stream is from the energy sector or the power generation companies contributing~93% in FY19 and ~80% in FY20 (Prov). The company has taken cognizance of the associated risks and has been focusing on higher volumes in the aerospace vertical.

- **Susceptibility to tender-based nature of business and input prices:** Profitability remains susceptible to tender-based nature of business and input prices. Vulnerability to fluctuations in raw material prices persists because the company enters into long-term fixed-price contracts and has limited flexibility to pass on increase in the prices because of competitive pressures. BWR notes that most of the company's long term contracts have fixed prices generally for 3 years. Further, the agreements have renegotiation clauses in case of cost escalation of more than 10% on any of the raw materials. Further, the company procures nearly 70-80% of the raw materials required post signing of Long term Agreement (LTA) and sharing of the inventory management sheet.

- **Forex risks:** The company's export sales constitute ~50-60% of its revenues. However, the business does not have any natural hedge and the company is not utilising any forward contract/ derivative limits presently. The forex risks are mitigated to a certain degree as all the loan facilities are in foreign currency.

Analytical approach and Applicable Rating Criteria

BWR has adopted a Standalone approach while arriving at its ratings and applied its rating methodology as detailed in the Rating Criteria (hyperlinks provided at the end of this rationale). Azad has 3 wholly owned subsidiaries(WOS) viz, Swastik Coaters Pvt Ltd. , Rouland Chemicals Pvt ltd and Agen Metcast Pvt ltd. However, the operations of Azad Engineering Pvt Ltd contribute nearly ~96% of top line in FY19/ FY20 (prov) and contribution from the wholly owned subsidiaries is insignificant.

Rating sensitivities:

Going forward, the ability of the Company to ramp up its scale of operations and thereby its revenue and profitability, execute the present order book timely and build up its order book size are key rating sensitivities.

Positive:

- Substantial and sustained growth in revenue and EBITDA margin on a sustained basis.
- Steady improvement in business risk profile and build up of the order book size , with diversification of its customer concentration on a sustained basis.

Negative

- Deterioration in key credit metrics on account of weaker than expected business performance and sustained pressure on net margins.
- Specific credit metrics which may result in a rating downgrade include deterioration in EBITDA to <15% and DSCR and ISCR declining to below 1.50 times, deterioration in annual Net Cash Accruals < Rs.15 crs on a sustained basis.
- Increase in investment/advances in group entities leading to weakening liquidity.
- Any material impact on the business profile on the company on account of material unforeseen geopolitical events.

Liquidity - Adequate: The company's liquidity position is adequate marked by sufficient cash accruals as against repayment of term loan obligations and moderate current ratio. Also, average limit utilization remained moderate at ~85-90% as confirmed with the working capital lenders. Current ratio has improved to 1.22 times as on 31 Mar 2019 and declined marginally to 1.11 times as on 31 Mar 2020 (prov). Cash and cash equivalents were moderate at Rs.7.10 crs as on 31 Aug 2020 (Prov). On account of adequate EBITDA, Net cash accruals and moderate cash and cash equivalents, the liquidity position is considered adequate. The company's EBITDA of ~Rs.40 crs as on 31 Mar 2020 (Prov) is sufficient as against repayment of term loan obligations in the range of Rs.10-14 crs for FY21 and FY22.

About the Company

Azad Engineering Pvt. Limited (Azad) was incorporated in Sep 1983 with its registered office at Hyderabad. Azad started its core manufacturing activity in 2008 to make the complex and critical parts for power generation OEMs. The company manufactures Airfoils for turbine blades and Engine parts primarily used in turbines (Gas/ steam) and Aerospace industry. The company's business can be broadly divided into 3 business verticals- Energy, Aerospace and Heavy Machining. The company's Energy vertical constitutes the bulk of the revenue (~80% as on FY20) with aerospace vertical contributing balance ~20%. The Heavy Machining vertical is yet to contribute to the top line. The company is a supplier to established and known companies like GE, Mitsubishi, BHEL, Doosan, Siemens, Toshiba etc in the energy segment and Honeywell , GE aviation, Rafael, HAL etc in the Aerospace segment. The majority of clientele are from Europe, Japan, UAE and USA. The company has a total area of 19,884 sqm encompassing its Corporate Office and CNC Machining facility spread across 11,108 sqmt and the forging facility in the balance area of 8,776 smt. The company produces ~240000 parts per annum in various sizes and materials.

The company was set up and promoted by Late Mr.Bajaranglal Chopdar. The company is a closely held family owned business with Mr. Rakesh Chopdar (Son of Late Mr. Bajaranglal Chopdar) and Mrs. Jyoti Chopdar (wife of Mr. Rakesh Chopdar) as directors.

Key Financial Indicators

Parameters		31 Mar 2018 Audited	31 Mar 2019 Audited
Revenue	Rs. Crs	82.56	120.32
EBITDA	Rs. Crs	22.42	41.48
PAT	Rs. Crs	12.63	19.34
Tangible Net Worth (TNW)	Rs. Crs	50.89	70.23
Total Debt/TNW	Times	1.03	0.74
Current Ratio	Times	0.96	1.22

On a provisional basis, the Company has reported total operating income of Rs.122.05 crs for FY20 and Rs.32.03 crs for 5MFY21.

Key Covenants of the facility rated: The terms of sanction include standard covenants normally stipulated for such facilities.

Status of non-cooperation with previous CRA: NA

Rating History For The Previous Three Years [including withdrawal and suspended]

<table>
<tr><th>Facility</th><th colspan="3">Current Rating (Sep 2020)</th><th colspan="3">Rating History</th></tr>
<tr><td></td><td>Tenure</td><td>Amount (Rs Crs)</td><td>Rating</td><td>2019</td><td>2018</td><td>2017</td></tr>
<tr><td>Fund Based</td><td></td><td></td><td></td><td rowspan="8">Nil</td><td rowspan="8">Nil</td><td rowspan="8">Nil</td></tr>
<tr><td>Term Loans
Term Loans- Proposed</td><td>Long Term</td><td>35.69
15.00</td><td>BWR BBB-/Stable</td></tr>
<tr><td>EPC/ PCFC
EPC- PCFC- Proposed</td><td rowspan="2">Short Term</td><td>18.00
5.00</td><td rowspan="2">BWR A3</td></tr>
<tr><td>Sales Invoice Finance</td><td>2.00</td></tr>
<tr><td>Non Fund Based</td><td></td><td></td><td></td></tr>
<tr><td>Bank Guarantee</td><td rowspan="2">Short Term</td><td>0.50</td><td rowspan="2">BWR A3</td></tr>
<tr><td>Derivative Limits</td><td>4.63</td></tr>
<tr></tr>
<tr><td colspan="2">Total</td><td>80.82</td><td colspan="4">Rupees Eighty Crores and Eighty Two Lakhs Only</td></tr>
</table>

Complexity Levels of the Instruments

For more information, visit www.brickworkratings.com/download/ComplexityLevels.pdf

Hyperlink/Reference to applicable Criteria

General Criteria	**Services Sector**
Approach to Financial Ratios	**Short Term Debt**

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Azad Engineering Pvt Ltd

Annexure I: Details of Bank Facilities rated by BWR

Sl. No.	Name of the Bank	Type of Facilities	Long Term (Rs. Crs)	Short Term (Rs. Crs)	Total (Rs. Crs)
1	ICICI Bank Ltd	EPC/PCFC	-	10.00	10.00
		Term Loans	14.70	-	14.70
		Bank Guarantee	-	0.50	0.50
		Derivative Limit	-	2.18	2.18
2	Kotak Mahindra Bank	EPC/PCFC	-	8.00	8.00
		Term Loan	14.86	-	14.86
		Sales Invoice Finance	-	2.00	2.00
		Derivative Limit	-	2.45	2.45
3	Tata Capital Limited	Term loan	6.13	-	6.13
4	Proposed	EPC/ PCFC	-	5.00	5.00
		Term Loan	15.00	-	15.00
Total			**50.69**	**30.13**	**80.82**

Note:

- ICICI Sanction: FUBD/FBP/PSCFC of Rs.10 crs, FCNR-B of Rs.5.00 crs, CC of Rs.5.00 cr, LC of Rs.1.50 crs are sub limits of EPC/ PCFC; TLs have sub limit for FCNRB-TLs,
- Kotak Mahindra Sanction: FBD/FBN of Rs.8.00 crs, CC of Rs.2.00 crs, SBLC of Rs.5.00 crs, LC of Rs.5.00 crs as sub limit of EPC/ PCFC.

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