BrahMos Aerospace Private Limited

March 07, 2022

Ratings

Facilities	Amount (Rs. crore)	Rating[1]	Rating Action
Long-term / Short-term Bank Facilities	1,000.00	CARE AA+ / CARE A1+ (CWD) (Double A Plus / A One Plus); (Under Credit watch with Developing Implications)	Placed on Credit Watch with Developing Implications
Total Bank Facilities	**1,000.00 (Rs. One thousand crore only)**		

Details of facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of BrahMos Aerospace Private Limited (BAPL) have been placed under 'Credit Watch with Developing Implications' on account of the uncertainty with respect to the impact on operations and finances of BAPL due to the ongoing conflict between Russia and Ukraine and subsequent sanctions imposed on Russia as well as Russian entities. BAPL procures around 50% of its components from the Russian joint venture (JV) partner, NPO Mashinostroyeniya (NPOM, Russia). CARE Ratings Ltd understands that there is no immediate impact on the operations of the company as it maintains sufficient inventory of about one year which would insulate the company from short-term disruptions in the supplies of components from NPOM and would also ensure uninterrupted manufacturing of missiles. However, the situation related to war and the sanctions is still evolving and there is an uncertainty around the exact implications on business operations of BAPL. CARE Ratings Ltd will monitor the developments in this regard and will take a view on the ratings after more clarity emerges on the conflict between Russia and Ukraine and exact implications of the same on the credit risk profile of the company.

The ratings assigned to the bank facilities of BAPL continue to derive strength from its strong parentage, the company being a JV between Defence Research & Development Organization (DRDO) and NPOM and its high strategic importance to Government of India (GoI), as it is the sole manufacturer and supplier of strategically critical supersonic cruise missiles to Indian Armed Forces. The ratings also factor in BAPL's established position in the manufacturing and supply of supersonic cruise missile systems with high entry barriers driven by research & development and technological capabilities of the company. Furthermore, the ratings consider BAPL's strong order book position, comfortable financial risk profile marked by negligible debt and its strong liquidity position. However, these rating strengths are partially offset by the elongated working capital cycle of the company, susceptibility to time and cost overruns in execution of orders along with high dependence on contracts from the Ministry of Defence (MoD).

Rating Sensitivities

Positive Factors – Factors that could lead to positive rating action/upgrade:

- Any significant increase in the shareholding of DRDO/GoI beyond current levels.
- Ability to sustain healthy flow of orders backed by customer advances and rationalisation of working capital cycle on a sustained basis.

Negative Factors – Factors that could lead to negative rating action/downgrade:

- Any change in BAPL's strategic importance to GoI or dilution in stake by DRDO.
- Any impact on the capabilities or operations of BAPL due to reduction in supplies or technical support from NPOM.
- Decline in the order book or delay in execution of orders resulting in fall in the total operating income (TOI) and margins.
- Substantial increase in the working capital borrowings or any large debt-funded capital expenditure leading to overall gearing above 0.5x.

Detailed description of the key rating drivers

Key Rating Strengths

Strong parentage

BAPL is 50.5% owned by GoI through DRDO, while the remaining 49.5% stake is held by NPOM, Russia. DRDO was formed in 1958 with the merger of Technical Development Establishment (TDEs) of the Indian Army and the Directorate of Technical Development and Production (DTDP) with the Defence Science Organization (DSO). DRDO is the research and development (R&D) wing of MoD, GoI, with a purpose to achieve self-reliance in critical defense technologies and systems, while equipping the Indian armed forces with state-of-the-art weapon systems and equipment in accordance with requirements laid down by the three services. NPOM is one of the leading aerospace enterprises in Russia and is held by 'Tactical Missile Corporation' which belongs 100% to the government of Russian Federation (Federal Agency for State Property Management). It was founded in 1944 and is responsible for the fulfilment of government orders, international contracts in the field of military and technical cooperation and augmentation of civil and dual-purpose equipment production. NPOM has developed and commissioned over 25 missile and space complexes for various purposes, including anti-ship cruise missiles in sea, underwater,

[1]Complete definition of the ratings assigned are available at www.careedge.in and other CARE publications

and ground and various space complex systems and apparatus used for reconnaissance, anti-space defence and for sensing earth in high resolution. The company has pioneered in many designs related to aerospace and missile technology in Russia.

Strategic importance to GoI
BAPL, being the only entity for production and supply of supersonic cruise missiles to the Indian Armed Forces, assumes high strategic importance to GoI. It is solely entitled for design, development, production and marketing of strategically critical advanced Supersonic Cruise Missile systems. The company benefits from GoI's thrust on the production of supersonic missile systems leading to a healthy order flow. Since inception, it has delivered a significant number of missiles to the Indian armed forces, viz., army, navy and air force.

Established position in the supply of supersonic missile systems to the Indian armed forces
BrahMos was made possible due to the collaboration of India and Russia through signing of inter-governmental agreement for sharing technological strength, methodology and experience of both the JV partners, viz., DRDO and NPOM. BrahMos missile has a range of 290 km with a speed of 2.8 Mach (2.8 times the speed of sound), travelling in multiple trajectories from multiple platforms on sea, subsea, land, and air, capable of striking the targets on sea and land with high precision. The missile's propulsion and seeker systems are from Russia, while the guidance, electronics and ground systems are developed by India. It is the only modern missile to complete the tactical cruise missile triad (can be launched from surface, sea and air).

Strong R&D capabilities
BAPL operates in an industry which requires constant innovation and technological upgradations and hence it is critical for the company to innovate, adapt to technological advancements and absorb imported technologies. To ensure the same, the company has been constantly spending on R&D through the JV partners-DRDO and NPOM. It has been making dedicated contribution towards R&D costs over the years in the range of 3%-4% of the total yearly sales. Besides, the company also maintains a special R&D reserve wherein appropriations are made out of the net profit of the year.

Healthy order book position
BAPL gets regular orders from Indian army, navy and airforce, which ensures strong revenue visibility for the company. The company has a healthy order book position as on September 30, 2021, to be executed in the next 3-5 years. The exploration of export market is likely to supplement the order book of the company substantially. During January 2022, BAPL received a contract of US $ 375 million for the supply of shore-based anti-ship missile system to Philippines.

Sizable scale of operation albeit moderate and fluctuating profit margins
The business profile of the company is marked by sizable and growing scale of operations and moderate profitability margins. The total operating income of the company witnessed a compounded annual growth rate (CAGR) of around 11.17% FY18-FY21 (refers to the period April 01 to March 31) to reach Rs.3,249.83 crore in FY21 (PY: Rs.2,226.75 crore). However, the fluctuation in the profitability margin remains due to the quantum of R&D Expenses, inherently different margin in individual orders and different proportions of service income in each year's total income. Resultantly, the company's PBILDT margins stood at 10.25% during FY21 (PY: 10.0%) recovering from low of 5.53% in FY19. Consequently, the PAT margin also improved to 7.08% in FY21 from 5.96% in FY20. In H1FY22 (refers to the period April 01 to September 30), the company has reported a total income of Rs.1,711.13 crore with a PBILDT margin of 12.99%.

Comfortable financial risk profile
The company's operations are broadly self-financing through receivables from the customers resulting in negligible reliance on the bank borrowings. Furthermore, the company does not have to submit any financial bank guarantees against these advances. Thus, the capital structure of the company is comfortable with overall gearing of 0.01x as on March 31, 2021 (PY: 0.28x). The total debt includes only short-term loans which are also taken against bank fixed deposits (FDs). The other debt coverage indicators also remained comfortable in FY21 with interest coverage and total debt/gross cash accruals (TDGCA) of 40.26x (PY: 7.16x) and 0.06x (PY: 4.45x), respectively. Going forward, the company plans to enter into exports in the future, which necessitates some reliance on the bank limits, however, the financial profile is likely to remain comfortable.

Key Rating Weaknesses
Elongated working capital cycle
The operating cycle of BAPL remained elongated at 839 days in FY21 (PY: 1,148 days) largely on account of high inventory holding period as the company executes the orders over an average period of five years wherein the raw materials are procured over the first two years, while deliveries of missiles and other products commence from third year onwards. Besides, there was additional raw material inventory build-up over the last couple of years due to longer development time involved in one of the orders. Moreover, the company faced delays in the collections from armed forces during FY20, thereby resulting in the stretched collection period. However, in FY21, the company has received major overdue invoices resulting in the improved working capital cycle. Thus, on account of increased receivables and inventory holding, the operating cycle increased significantly in FY19 and FY20 to 1069 days and 1148 days, respectively, which though improved, continues to remain stretched at 839 days in FY21. The receivables of the company stood at Rs.592.62 crore as on September 30, 2021.

Susceptibility to time and cost overruns in order execution
The company's operations and profitability remain exposed to time and cost overruns as order execution has stiff timelines. The company enters into fixed price contracts with the clients, while some element of future cost escalation is already built at the

time of finalising the orders. The company remains exposed to various penalties including liquidated damages in case of delay in delivery of the contracts and approached its customers for extension of the timeline for calculation of liquidated damages in some cases. As a result, it makes regular yearly provisions for penalties which has a bearing on its profitability margins. Going forward, the company's ability to timely execute the orders, especially in the export market where it is entering for the first time, will remain a key monitorable.

Prospects of company depend on Indian defence sector with limited exports
Being a sole supplier of supersonic cruise missiles to armed forces, the fortunes of the company are directly linked to the defense spending by GoI. During FY22, the MoD has received a budgetary allocation of Rs.478,196 crore for expenditure on salaries of armed forces and civilians, pensions, modernisation of armed forces, production establishments, maintenance, and R&D organisations. During FY22, capital outlay has been budgeted at Rs.128,150 crore (27% of the budget of the Ministry) which augurs well for companies like BAPL which supplies critical defense equipment to the armed forces.

Liquidity: Strong
BAPL's financial flexibility is largely derived from it being majorly held by GoI and its strategic importance to the latter. The liquidity profile of the company is strong marked by nil debt repayment obligations and healthy free cash and bank balance of Rs.3,481 crore as on September 30, 2021. The company has planned capex of about Rs.100 crore over the next 3 years, which would be funded through internal accruals and no debt-funded capex is envisaged in the medium-term.

Analytical approach: Standalone, however, factoring in the strong parentage of the company and strategic importance of BAPL to GoI.

Applicable Criteria
Criteria on assigning 'outlook' and 'credit watch' to Credit Ratings
CARE's Policy on Default Recognition
Financial ratios – Non-Financial Sector
Criteria for Short Term Instruments
Rating Methodology - Manufacturing Companies
Rating Methodology: Notching by factoring linkages with Government
Liquidity Analysis of Non-Financial Sector Entities

About the Company
BrahMos Aerospace Private Limited (BAPL) was formed as a JV through an Inter-Governmental Agreement between India and Russia signed in 1998, with Defence Research and Development Organisation (DRDO), Govt. of India and "NPO Mashinostroyenia" (earlier known as Federal State Unitary Enterprise NPOM of Russia), Govt. of Russian Federation. The company was established with an authorised share capital of USD 250 million and was subsequently increased to USD 300 million and is contributed in the ratio of 50.5%:49.5% between DRDO and NPOM, respectively. The company is solely responsible for the design, development, production and marketing of the advanced supersonic cruise missile system (range of 290 km with a speed of 2.8 times the speed of sound). Besides manufacturing of missiles, it also supplies ground-handling equipment and services related to missiles and equipment including repair and training.

Covenants of rated instrument / facility: *Detailed explanation of covenants of the rated instruments/facilities is given in Annexure-3.*

Brief Financials (Rs. crore)	FY20 (A)	FY21 (A)	H1FY22 (UA)
Total operating income	2626.75	3249.83	1711.13
PBILDT	262.55	333.11	222.22
PAT	156.50	230.14	159.43
Overall gearing (times)	0.28	0.01	NM
Interest coverage (times)	7.16	40.26	NM

A: Audited; UA: Unaudited; NM: Not meaningful

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating History for last three years: Please refer Annexure-2

Complexity level of various instruments rated for this company: Please refer Annexure-4

Annexure-1: Details of Instruments/Facilities

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Non-fund-based - LT/ ST-Bank Guarantees		-	-	-	1000.00	CARE AA+/ CARE A1+ (CWD)

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/ Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2021-2022	Date(s) & Rating(s) assigned in 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019
1	Non-fund-based - LT/ ST-Bank Guarantees	LT/ ST	1000.00	CARE AA+/ CARE A1+ (CWD)	1)CARE AA+; Stable / CARE A1+ (26-Nov-21) 2)CARE AA+; Stable / CARE A1+ (28-Jul-21)	-	-	-

Annexure-3: Detailed explanation of covenants of the rated instrument / facilities: NA

Annexure-4: Complexity level of various instruments rated for this company

Sr. No	Name of instrument	Complexity level
1	Non-fund-based - LT/ ST-Bank Guarantees	Simple

Annexure 5: Bank Lender Details for this company
To view the lender-wise details of bank facilities please **click here**

Note on complexity levels of the rated instrument: CARE Ratings Ltd has classified instruments rated by it on the basis of complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careedge.in for any clarifications.

Contact us

Media Contact
Name: Mradul Mishra
Contact no.: +91-22-6754 3573
Email ID: mradul.mishra@careedge.in

Analyst Contact
Name: Ajay Kumar Dhaka
Contact no.: 8826868795
Email ID: ajay.dhaka@careedge.in

Relationship Contact
Name: Swati Agrawal
Contact no.: +91-11-4533 3200
Email ID: swati.agrawal@careedge.in

About CARE Ratings Limited:
Established in 1993, CARE Ratings Ltd. is one of the leading credit rating agencies in India. Registered under the Securities and Exchange Board of India (SEBI), it has also been acknowledged as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI). With an equitable position in the Indian capital market, CARE Ratings Limited provides a wide array of credit rating services that help corporates to raise capital and enable investors to make informed decisions backed by knowledge and assessment provided by the company.
With an established track record of rating companies over almost three decades, we follow a robust and transparent rating process that leverages our domain and analytical expertise backed by the methodologies congruent with the international best practices. CARE Ratings Limited has had a pivotal role to play in developing bank debt and capital market instruments including CPs, corporate bonds and debentures, and structured credit.

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