

## India Optel Limited

July 16, 2024

Facilities/Instruments	Amount (₹ crore)	Rating <sup>1</sup>	Rating Action
Long-term bank facilities	400.00	CARE AA+; Stable	Assigned

Details of instruments/facilities in Annexure-1.

### Rationale and key rating drivers

The rating assigned to bank facilities of India Optel Limited (IOL) derives strength from its strategic importance to the Government of India (GoI) with established market position in defence sector and its growing scale of operations year-on-year (y-o-y). The rating is also underpinned by robust order book, healthy operating margins, comfortable liquidity position, exclusive technology transfer from foreign original manufacturer limiting competition and resulting in high entry barrier within the industry, support from GoI for capex, comfortable capital structure, and minimal reliance on debt.

These strengths are partially offset by high dependence on the defence sector, which contributes to the bulk of its revenues, qualified audit report, and its working capital-intensive nature of operations due to high inventory and receivable days.

### Rating sensitivities: Factors likely to lead to rating actions

#### Positive factors

- Significantly and sustainably improving total operating income (TOI) with profit before interest, lease rentals, depreciation and taxation (PBILDT) margin sustaining beyond 22%.
- Gross current asset days sustaining under 200 days.

#### Negative factors

- Diluting stake of GoI to below 51% in the company.
- Changing stance of GoI support to IOL reflecting in lower order inflows and revenues.
- Weakening of operating performance leading to significantly declining margin and increasing reliance on working capital limits borrowings.
- Large debt-funded capex or sizeable working capital requirement weakening the capital structure beyond 0.50x.

**Analytical approach:** Standalone along with factoring its 100% ownership by the GoI for which it is a strategically important entity in the defence sector.

#### Outlook: Stable

The stable outlook reflects the rated entity likely to maintain its established position in the defence sector and will continue to remain strategically important to GoI.

### Detailed description of key rating drivers:

#### Key strengths

##### High strategic importance to GoI and a major supplier to other Defence Public Sector Undertakings

IOL is wholly owned by GoI. The cabinet committee on security (CCS) in its meeting held on July 29, 2020, approved to convert Ordnance Factory Board (OFB), an attached office of Ministry of Defence (MoD), into more than one 100% Government-owned corporate entities registered under the Companies Act 2013. The cabinet meeting held on June 16, 2021, approved to convert 41 production units of OFB into seven Defence Public Sector Undertakings (DPSUs). IOL is one of such seven DPSUs. Accordingly, three production units of erstwhile OFB, pertaining to electro-optical sensors, weapon sights, and communication equipment were transferred to IOL on October 1, 2021. The total consideration payable was determined at about ₹5,630 crore based on the fair value of assets.

<sup>1</sup>Complete definition of the ratings assigned are available at [www.careedge.in](http://www.careedge.in) and other CARE Ratings Ltd.'s publications

**Accredited manufacturing units with reputed client base**

OEL is engaged in producing electro-optical sensors, weapon sights, and communication equipment. It has three manufacturing units in Dehradun and Chandigarh. The product manufactured is supplied to the Army, other DPSUs such as Armoured Vehicles Nigam Limited (AVNL), Advanced Weapons and Equipment India Limited (AWEIL), Munitions India Limited (MIL), and other PSUs such as Bharat Dynamics Limited, Bharat Electronics Limited etc. The products of the company are also supplied to Ministry of Home Affairs (MHA).

**Significant support from Government of India**

Being a DPSU and owned entirely by GoI, IOL has significant support and involvement from the government. The company is the preferred supplier to other DPSUs and army. The funding for the capex is being provided by the government. GoI have infused about ₹275 crore post corporatisation in IOL for capex and meeting other liabilities which belonged to pre-corporatisation period. Upon corporatisation of the erstwhile OFB, its employees have been transferred to the company on deemed deputation for an initial period of two years (the same has been extended by one more year, till September 30, 2024). The employees continue to be the GOI employees with their pay allowances, leave, medical facilities, and pension liability continuing to be the obligation of Central Government.

**Robust order book position providing revenue visibility**

The company's order book position remains strong. As on April 01, 2024, the unexecuted order book stood at ₹6,793 crore, which stands at around 4.91x of FY24 revenue. The order book is to be executed by FY27. Moreover, the company has been nominated for the additional order worth about ₹3,000 crore which are in pipeline. To run these DPSUs, indents placed up to September 30, 2021, on erstwhile OFB have been converted into deemed contracts, and every year, 60% of the amount of these contracts for supply of respective products pertaining to that year's target is being paid by the DPSUs and army as advance per the terms and conditions stipulated in the deemed contract and the same are interest free. Additionally, the government's focus on rolling out reforms to increase India's defence product manufacturing capability and gradually reduce imports will support the order inflow in the medium-to-long term. CARE Ratings Limited (CARE Ratings) anticipates that in the coming years these new DPSU would explore and establish newer markets both in the country and abroad and become self-sustainable. With the support from Ministry of External Affairs, the company can explore new markets overseas for products through their diplomatic channels. Post corporatisation, the order from DPSUs and army are received on single party tender basis. The company is also participating in tenders floated by third parties and will start supplying its products to them as well.

**Monopoly over the product with high entry barriers**

IOL is the only player in India manufacturing opto-electronics sighting system for battle tanks. AVNL which is in to manufacturing battle tanks and army both are dependent on IOL for procurement of sighting system for battle tanks. Being the only player in the field provides IOL monopoly market over its product. Moreover, operating in defence industry involves strict compliance with stringent rules and regulations imposed by government. The sector being of national importance requires any new entrants to have established track record and relevant experience along with financial and technological competence. The sector requires maintaining high degree of confidentiality about the process and the supplies to be made.

**Growing scale of operations with healthy operating margins**

The company started its operations from October 01, 2021, and operated for six months in FY22. It had reported revenue of ₹564.37 crore with PBILDT margin of ~16%. In FY24, the company's revenue grew to ~₹1,382 crore improved from ~₹1,084 crore reported in FY23, growth of about 28%. The company has been witnessing growing scale of operations consistently and has a healthy PBILDT margin since the first year of its operations. Although the supplies made by the erstwhile OFB did not carry any profit element, the prices for the goods were fixed based on the historical cost. In case of IOL, most of the raw material was imported from Russia where the prices were high and the cost for supply of material was fixed keeping in mind the imported cost. Over time, the units of IOL (even in OFB era FY18 onwards) had started developing the products indigenously either in their own factories or through local third party by way of collaboration with them. This led to rationalisation of the raw material cost significantly resulting in improving profits for OFB. Upon corporatisation, Government has allowed a one-time price escalation of 7.50% on the deemed contract value and a yearly escalation of 6% over the previous year cost. Corporatisation has introduced systems and controls, leading to healthy profitability margins for the company. Going forward, CARE Ratings estimates that for the supplies to be made till FY27, the operating margin is expected to remain healthy above 20%.

**Comfortable financial risk profile**

The company's capital structure is comfortable, with no outstanding term loan as on March 31, 2024. The company does not have any plan to avail any term debt for its capex, as the same will be funded by GoI. However, total debt in the form of working capital loan to the tune of ₹347 crore was outstanding as on March 31, 2024. The company's financial risk profile had remained

comfortable signified by overall gearing of 0.05x as on March 31, 2024. Other debt coverage metrics such as total debt/ PBILDT and total debt to gross cash accruals (TD/GCA) has remained comfortable at 1.59x and 1.49x. CARE Ratings expects that the company's financial risk profile will continue remain comfortable.

### **Key weaknesses**

#### **Customer concentration risk with high dependence on defence sector for orders**

The Indian army and other DPSUs are IOL's primary customers. In the past, over 80% of the revenue has been contributed by AVNL and army. In case of any changes in the procurement policy of the defence forces or a significant cutback in defence spending, the company's revenue and order book position can be adversely impacted. Due to the high concentration of the government sector orders, the revenue booking and cash flows are vulnerable to delays in project execution or final payment clearance in some cases. It has significant exposure to Ministry of Defence under GoI, which relies on budgetary means to clear its dues.

#### **Working capital intensive nature of the business**

The company operates in a working capital-intensive industry. The high working capital requirement is primarily due to high inventory cost. The inventory holding period stood at about 188 days as on March 31, 2024. The high inventory is mainly due to wide variety of products which company manufactures and the minimum stock which it has to maintain in case any emergency arises. The receivable days also remained at about 147 days. According to the conditions, IOL receives 60% advance for the goods supplied to army and other DPSUs, while the payment should be received within 30-45 days for the balance 40%. However, currently the company is receiving payments in about 140 days, and is working with its customers, expecting that receivable days over time will come down to around 90 days.

#### **Challenges faced by the new DPSUs**

Although corporatisation is expected to improve efficiencies, any transition is a critical and complex process having many inherent challenges. IOL also faced initial challenges with respect to implementation of various business strategies, change of tax regime, financial accounting, quality management systems, store procurement procedures, enhanced delegation of financial powers, and to reduce bureaucratic administrative procedures.

#### **Qualified audit report**

In the audit report for FY23, IOL's statutory auditor has given a qualified opinion with respect to write-off and revaluation of fixed assets, provision made in current assets, overall weak/inadequate internal financial control, compliance related with GST, and income tax and for various accounting policies and practices. This apart, some other key audit matters have been emphasised by the statutory auditor. Upon discussion with the management of the company, CARE Ratings notes that some of the above-mentioned qualifications have subsequently been addressed by the company. IOL has appointed a registered chartered accountant (CA) firm for strengthening its internal financial control systems along with formal training of some of its employees in accounts and finance. CARE Ratings also notes the Comptroller and Auditor General (CAG) Audit for FY23 has been completed without any such qualifications. Going forward, the strengthening of internal financial control will continue to remain a key rating monitorable.

#### **Liquidity: Strong**

The company's liquidity profile is healthy supported by cash and liquid investments of over ₹1,500 crore as on March 31, 2024, against nil term loan repayments. The company plans to undertake capex to the tune of about ₹170 crore over two years for which funds will be made available by GoI. Hence, the company does not plan to avail any term debt. It also receives advance for the order it executes. The average working capital utilisation remained at ~28%, providing cushion to the company's liquidity.

**Assumptions/Covenants:** Not applicable

**Environment, social, and governance (ESG) risks:** Not applicable

#### **Applicable criteria**

[Definition of Default](#)

[Liquidity Analysis of Non-financial sector entities](#)

[Rating Outlook and Rating Watch](#)

[Manufacturing Companies](#)

[Financial Ratios – Non financial Sector](#)

[Factoring Linkages Government Support](#)

## About the company and industry

### Industry classification

Macro-economic Indicator	Sector	Industry	Basic Industry
Industrials	Capital goods	Aerospace & defense	Aerospace & defense

Incorporated in August 2021, IOL is a Central Public Sector Enterprise (CPSE) under MoD, GoI. It is one of the seven DPSUs, carved out of erstwhile OFB. The company is fully owned by GoI, and primarily manufactures electro-optical sensors, weapon sights, and communication equipment. The company is headquartered in Dehradun and has three manufacturing units in Dehradun and Chandigarh.

Brief Financials (₹ crore)	March 31, 2023 (A)	March 31, 2024 (UA)
Total operating income	1,083.57	1,381.94
PBILDT	283.46	217.98
PAT	236.39	203.02
Overall gearing (times)	0.00	0.05
Interest coverage (times)	2,817.65	21.54

A: Audited, UA: Unaudited; Note: 'these are latest available financial results'

**Status of non-cooperation with previous CRA:** Not applicable

**Any other information:** Not applicable

**Rating history for last three years:** Annexure-2

**Covenants of rated instrument / facility:** Annexure-3

**Complexity level of various instruments rated:** Annexure-4

**Lender details:** Annexure-5

### Annexure-1: Details of instruments/facilities

Name of the Instrument	ISIN	Date of Issuance (DD-MM-YYYY)	Coupon Rate (%)	Maturity Date (DD-MM-YYYY)	Size of the Issue (₹ crore)	Rating Assigned along with Rating Outlook
Fund-based - LT-Cash credit		-	-	-	400.00	CARE AA+; Stable

### Annexure-2: Rating history for last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating History			
		Type	Amount Outstanding (₹ crore)	Rating	Date(s) and Rating(s) assigned in 2024-2025	Date(s) and Rating(s) assigned in 2023-2024	Date(s) and Rating(s) assigned in 2022-2023	Date(s) and Rating(s) assigned in 2021-2022
1	Fund-based - LT-Cash credit	LT	400.00	CARE AA+; Stable				

LT: Long term

**Annexure-3: Detailed explanation of covenants of rated instruments/facilities:** Not applicable

#### Annexure-4: Complexity level of various instruments rated

Sr. No.	Name of the Instrument	Complexity Level
1	Fund-based - LT-Cash credit	Simple

#### Annexure-5: Lender details

To view the lender wise details of bank facilities please [click here](#)

**Note on complexity levels of rated instruments:** CARE Ratings 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](mailto:care@careedge.in) for any clarifications.

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#### About us:

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