Azad Engineering Limited

November 07, 2024

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Long-term bank facilities	145.00	CARE A-; Stable	Assigned
Long-term / Short-term bank facilities	35.00	CARE A-; Stable / CARE A2+	Assigned

Details of instruments/facilities in Annexure-1.

Rationale and key rating drivers

Ratings assigned to Azad Engineering Limited (AEL) derive strength from experienced promoter and leadership team, established relationship with reputed original equipment manufacturing (OEMs), track record of supplying mission/life critical components to OEMs and advanced infrastructure. Ratings also consider the consistent growth in revenue in FY24 (FY refers to April 01 to March 31) with healthy profitability margins, satisfactory financial profile despite moderation expected in near term and presence in critical products of energy, defence, aerospace and oil & gas.

The company operates as one of the few suppliers that has wide spectrum of products used in critical operations of energy, defence, aerospace and oil & gas sector. One of the major components manufactured by the company is turbine blade used on utility supply turbines essentially designed to be failsafe. AEL achieved qualification for over 1700+ products through testing procedures from OEMs, which are then put for production based on the long-term orders placed by these OEMs. Such orders generally span for 4-5 years based on the volume of order and machine availability at AEL.

AEL consistently supplied against the orders in the past five years which led to improvement in total operating income (TOI) that increased from ₹122.08 crore in FY20 to ₹257.68 crore in FY23 and further increased to ₹343.19 crore in FY24. The company maintained profit before interest, lease rentals, depreciation, and taxation (PBILDT) margin above 25% in this period.

AEL's credit profile improved significantly in FY24 due to successful completion of initial public offering through which the company generated ₹240 crore, which was deployed for repayment of existing loans, planned capital expenditure and working capital purposes.

However, ratings are constrained by elongated working capital cycle due to lengthy qualification process and commercialisation and project risk associated with large-sized debt-funded capex.

Rating sensitivities: Factors likely to lead to rating actions

Positive factors

- Sustained increase in scale of operations while maintaining PBILDT margin above 30%.
- Significant improvement in operating cycle or sustaining total debt to earnings before interest, taxation, depreciation, and amortisation (TD/EBIDTA) below 1.2x.

Negative factors

- Significant decline in TOI or PBILDT by over 30% y-o-y.
- PBILDT margin falling below 20%, going forward on a sustained basis.
- Overall gearing deteriorating to over 0.50x.

Analytical approach: Standalone

Outlook: Stable

Stable outlook assigned to rating considers the company's satisfactory operations in the near term with achievement of projected performance based on orders in hand and committed upcoming orders from existing and new customers.

Detailed description of key rating drivers:

Key strengths

Experienced promoters and leadership team

The promoter Rakesh Chopdar has over 25 years of experience in precision engineering industry. He developed healthy relationship with customers through timely execution, consistent quality and achieving requisite certifications for the processes followed. Business operations are led by professionals having average experience of over 16 years in their individual field of expertise and having played key roles in Siemens, Godrej Aerospace, Toshiba amongst others.

[1]Complete definition of ratings assigned are available at www.careedge.in and other CARE Ratings Limited's publications.

Consistent growth in revenue with healthy profitability margins
The company's TOI depicted compound annual growth rate (CAGR) of 36% for five years ended March 31, 2024. TOI increased from ₹122.08 crore in FY20 to ₹257.68 crore in FY23 and further increased to ₹343.19 crore in FY24. This has been achieved because of consistent supply of products with focus on the quality of components supplied. The company's major sales are in the form of exports which commands better profitability margins. The company's profitability remained satisfactory with PBILDT margins of over 25% in the last five years. In FY24, margins further improved to 34.67% due to decrease in the overall cost of sales. The company commands profitability margins because of critical components manufactured and lack of notable competition in the domestic market and very few players in global market.

Satisfactory financial profile with moderation expected in medium term
The company's financial profile is comfortable marked by overall gearing at 0.06x and debt equity ratio also at 0.06x as on March 31, 2024. This is in comparison to overall gearing of 0.38x and debt equity ratio at 0.23x as on March 31, 2023. The company's total debt levels stood at ₹39.43 crore which consist of term loan of ₹39.00 crore and working capital of ₹0.40 crore. However, overall gearing is projected to moderate in the medium term but remain below ~0.32x in FY25, considering newly sanctioned term loan of ₹139 crore and ₹35 crore of working capital borrowings. The company's debt coverage ratios stood satisfactory with total debt to gross cash accruals (TD/GCA) at 0.45x (PY: 5.17x), interest coverage ratio at 2.51x (PY: 1.50x) and TD/PBILDT stood at 0.33x (PY: 1.81x). Long-term funding availed has been deployed for enhancing capacity by adding advanced CNC Machines and auxiliary equipment.

Presence in critical products of energy, aerospace and oil & gas
The company manufactures blades for turbines which are deployed for utility supply and are required to be fail safe. Performance of these utility turbine is super critical as downtime can lead to failing power transmissions grids. Blades are required to be manufactured from single piece of high-grade metal alloy that can withstand immense temperature and pressure. AEL developed itself to supply such blades and other components regularly with consistent quality, where tolerance level is as low as 4 to 5 microns. Aerospace components such as air generation systems, auxiliary power units & engine systems, which are life critical parts of aircraft are supplied to OEMs such as Honeywell and GE Aviation among others. Manufacturing requirements in this segment are characterised by light weight material retaining its structure at varying temperature, pressure, and altitude.

Established relationships with reputed OEMs

AEL has running long-term contracts with reputed customers in domestic and export markets. The business can be broadly divided into three business verticals – Energy, Aerospace and oil & gas. The company is a supplier to established and known OEMs such as GE, Mitsubishi, BHEL, Siemens, and Toshiba among others in the energy segment, Honeywell, GE Aviation, Rafael, and HAL among others in the Aerospace segment and . Export sales are well-diversified to regions such as US, UK, Europe, Japan, and Middle East. The market for turbine blades is valued ~₹12,600 crores. However, there is no other qualified local domestic player for these supplies. Product and process qualification is capital and time consuming. AEL obtained 1400+ product qualifications and 45+ process qualifications in the last 10 years which provides it an edge over competition. The company is one of the four major players offering similar products. Other three players are AECC Aero Science & Tech, Pietro Rosa, and Wuxi.

Key weaknesses

Lengthy qualification process and commercialisation thereof
AEL caters energy turbine, aerospace, defence and oil & gas industry which is characterised by a lengthy qualification process for components driven by criticality of their usage. Thus, each component supplied is required to pass through stringent qualification process that necessitates regular capital allocation for product development and financials resilience to see through the development stage. Such process has to be continuously followed to diversify product offering and sectors to which they cater.

Elongated working capital cycle
The company's working capital cycle continues to be elongated considering higher receivables as on March 31, 2024, as the export receivables have credit period of 120 - 180 days. Inventory holding increased and stood at 183 days as on March 31, 2024, from 150 days as on March 31, 2023, due to increase in inventory as a result of products which are under development and need customised alloys that are procured following minimum ordering quantity. Normalisation of inventory position is expected to take place once the serial production is starts. Receivables days as on March 31, 2024, stood high at 154 days compared to 138 days in FY23. Although collection period increased by 16 days, total receivables to the company's total income marginally increased from 47% in FY23 to 50% in FY24. Stretched collection period is expected to continue due to operations. The company's creditor period stood at 81 days in FY24 compared to 92 days in FY23. This is due to an advance payments to suppliers for imports while quicker payments made to suppliers to avail cash discounts.

Project risk associated with large-sized debt-funded capex

The company is in the process of enhancing its installed capacity by setting up a new plant. Estimated capex for this new plant and installation of machinery is ~₹207.67 crore which is debt funded. This CAPEX is heavily debt funded with ₹139 crore through a consortium loan from three bankers, including Union bank of India, ICICI Bank and IndusInd Bank. Major share of ₹57 crore is from UBI followed by ₹43 crore from IndusInd Bank and ₹39 crore from ICICI Bank. Apart from the debt, the company expects to utilise internal accruals of ₹41 crore for funding the CAPEX. The unit is expected to commence its operations by early FY26. The project is in the initial stage of execution, and thus exposed to execution risk. CARE Ratings notes time or cost overrun may strain the liquidity and will remain a key monitorable going forward. However, the company enjoys PBILDT margins over 30% and with gross loan repayments of ₹9.92 crore in FY25, the company has enough cash accruals from FY24 to fund the CAPEX.

Liquidity: Adequate

Liquidity is marked by strong accruals against repayment obligations of ₹9.91 crore and cash and cash equivalents of ₹58.76 crore on March 31, 2024 (₹39.99 crore on March 31, 2023). Though the bank limits have been reduced by using IPO proceeds, the company availed fresh term loans and working capital borrowings in Q1FY25. But still, working capital utilisation stood at moderate levels of 57% for the last 12 months ending June 30, 2024. Current ratio improved to 3.86x for FY24 compared to 1.80x for FY23. The company invests steadily in addition of machines to support the customer demand.

Assumptions/Covenants: Not applicable

Environment, social, and governance (ESG) risks:

Parameters	Risk factors
Environmental	The company has valid TSPCB consent for compliance of pollution norms. The coolant used in the process of manufacturing is recycled and disposed of through approved vendors.
Social	The board approved CSR spending of ₹47.20 Lakh in FY24 vs ₹60.20 Lakh in FY23. The areas for CSR activities are Education, Health and Wellness. CSR committee has been formed by the company per the Act. Funds are utilised through the year on these activities.
Governance	The management is led by professional for each department having experience. The company has sufficiently disclosed transactions with related parties.

Applicable criteria

Definition of Default
Liquidity Analysis of Non-financial sector entities
Rating Outlook and Rating Watch
Manufacturing Companies
Financial Ratios – Nonfinancial Sector
Short Term Instruments

About the company and industry

Industry classification

Macroeconomic indicator	Sector	Industry	Basic industry
Industrials	Capital Goods	Industrial Manufacturing	Industrial Products

AEL incorporated by Rakesh Chopdar in 1983, is engaged in manufacturing precision forged and machined components for clean energy, aerospace, defence, oil and gas, standalone power supply (SPS) as required by OEMs, with its manufacturing unit in Hyderabad. The company manufactures all types of blades for radial and axial flow. The company's infrastructure includes a Forge Shop, Heat Treatment Shop, Hi-Tech CNC Machines, State of the art Laboratory, State of the art Inspection Facility, Heavy Machining Shop, and Manufacturing software among others. Moreover, the company obtained international certifications, including National Aerospace and Defense Contractors Accreditation Program (NADCAP), ISO 9001:2015 (QMS), AS9100 D, ISO 14001: 2015 (EMS), BS 45001: 2018 (OHSAS) and ISO 27001: 2013 (ISMS) for its facilities. It has recently been certified for the supply of components for nuclear turbines from EDF, France.

Brief Financials (₹ crore)	March 31, 2023 (A)	March 31, 2024 (A)	Q1FY25 (UA)
Total operating income	257.69	343.20	99.02
PBILDT	77.07	119.02	33.36
PAT	8.51	58.58	17.24
Overall gearing (times)	0.38	0.06	NA
Interest coverage (times)	1.51	2.52	NA

A: Audited UA: Unaudited NA: Not available; 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

Detailed explanation of covenants of rated instrument / facility: Annexure-3

Complexity level of instruments rated: Annexure-4

Lender details: Annexure-5

Annexure-1: Details of instruments/facilities

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of the Issue (₹ crore)	Rating Assigned and Rating Outlook
Fund-based - LT-Term Loan		-	-	31-03-2031	145.00	CARE A-; Stable
Fund-based - LT/ ST-Packing Credit in Foreign Currency		-	-	-	35.00	CARE A-; Stable / CARE A2+

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	Debentures-Non-convertible debentures	LT	-	-	-	1)Withdrawn (07-Apr-23)	1)CARE BBB+; Stable (03-Mar-23)	-
2	Fund-based - LT-Term Loan	LT	-	-	-	1)Withdrawn (22-Mar-24) 2)CARE BBB+; Stable (07-Apr-23)	-	-
3	Fund-based - LT-Cash Credit	LT	-	-	-	1)Withdrawn (22-Mar-24) 2)CARE BBB+; Stable (07-Apr-23)	-	-
4	Fund-based - LT-Proposed fund based limits	LT	-	-	-	1)Withdrawn (22-Mar-24) 2)CARE BBB+; Stable (07-Apr-23)	-	-
5	Fund-based - LT-Term Loan	LT	145.00	CARE A-; Stable				
6	Fund-based - LT/ ST-Packing Credit in Foreign Currency	LT/ST	35.00	CARE A-; Stable / CARE A2+				

LT: Long term; LT/ST: Long term/Short term

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

Annexure-4: Complexity level of instruments rated

Sr. No.	Name of the Instrument	Complexity Level
1	Fund-based - LT-Term Loan	Simple
2	Fund-based - LT/ ST-Packing Credit in Foreign Currency	Simple

Annexure-5: Lender details

To view lender-wise details of bank facilities please click here

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

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About us:
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