December 26, 2022

Incap Contract Manufacturing Services Private Limited: Ratings downgraded to [ICRA]BBB+(Stable)/[ICRA]A2; Rated amount enhanced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Fund-based – Cash Credit	5.00	5.00	[ICRA]BBB+ (Stable); downgraded from [ICRA]A (Stable)
Long-term Fund-based – Term Loan	-	3.45	[ICRA]BBB+ (Stable); assigned
Short Term – Fund Based Limits	20.00	38.00	[ICRA]A2; downgraded from [ICRA]A2+
Short Term – Non-Fund Based – Letter of Credit	-	5.00	[ICRA]A2; assigned
Short Term – Non-Fund Based – Bank Guarantee	-	(5.00)	[ICRA]A2; assigned
Short Term – Non-Fund Based – Forward Cover	-	1.55	[ICRA]A2; assigned
Total	**25.00**	**53.00**	

**Instrument details are provided in Annexure-I*

Rationale

The ratings downgrade factors in Incap Contract Manufacturing Services Private Limited's (ICPL) procedural lapses in the financial controls, as reflected in instances of overdue of less than 30 days in the working capital facilities[1] on several occasions in FY2022. ICRA understands that even though there have not been any such instances in the current fiscal so far due to strengthening of the company's monitoring systems, ICRA would evaluate the effectiveness of such measures over a longer timeframe. ICPL has been going through a period of rapid growth, with its top line registering a compounded annual growth rate (CAGR) of ~43% between FY2018 and H1 FY2023. During this phase of accelerated growth, the company's ability to tighten the financial controls and liquidity management systems would remain important from the credit perspective. The rating is also tempered by ICPL's high dependency on a single customer in the power electronics sector, which accounted for 90% of its revenue in FY2022, exposing it to high sectoral and customer concentration risks. However, long track record of repeat orders from its top customer, timely collections so far, and its large expansion plans augur well for ICPL's future growth prospects.

The ratings also factor in the competitive nature of the electronics manufacturing services (EMS) industry, which limits the pricing flexibility and the sector's exposure to the risk of technological obsolescence and regulatory changes. ICPL also remains exposed to foreign currency fluctuations owing to sizeable net exports, which remain unhedged and can exert pressure on margins in case of an appreciation of the rupee. While ICPL's revenue and earnings growth have been much better than expectations, the operating margin declined to 14.89% in FY2022 from 17.55% in FY2021 partly due to the phasing out of the MEIS[2] scheme. However, a sharp depreciation of the rupee, along with price renegotiations with customers helped the company's operating margin to rise to 16.2% in H1 FY2023. The ratings also consider the company's exposure to sizeable imports of critical input materials like integrated chips and transformers primarily from China, which result in challenges in their timely availability and exposes ICPL to fluctuations in input materials prices. This can affect the company's margins as

[1] Export Packing Credit Facilities

[2] Merchandise Exports from India Scheme

well as block the working capital due to the long lead time of delivery, adversely impacting the liquidity. ICPL's inventory holding increased from 75-90 days in FY2022 to 150-160 days from FY2021 following the pandemic and disruption in global supply chains. However, ICRA notes that ICPL's long-term relationship with suppliers allowed it to get extended unsecured credit period, which partly cushioned the impact on the overall liquidity position and reduced dependence on borrowings.

The ratings are supported by consistent growth in ICPL's scale of operations and earnings and its healthy outstanding order book position, providing revenue visibility for the next 6-9 months. ICPL's revenues grew by 95.52% year-on-year (YoY) to Rs. 1,131.52 crore in FY2022. In the current fiscal, the company is poised to report a 40% YoY revenue growth, supported by healthy order inflows along with timely collections from its top customer, Victron Energy B.V. (VE). ICRA also notes that commissioning of the new unit in Tumkur, Karnataka in Q1 FY2024 is expected to support healthy earnings growth, going forward, owing to growing demand prospects in the EMS industry. The rapid growth in revenues along with the efficient working capital management and prudent capital allocation kept the debt level under check, leading to a healthy financial profile, characterised by comfortable credit metrics, strong return on capital employed (ROCE), and healthy cash accruals. The ratings continue to factor in ICPL's established track record in the EMS industry, along with the technical and marketing support provided by the parent company, Incap Corporation, Finland, which has played a critical role in getting new business/ customers and expanding footprint in new markets. However, royalty/ commission paid to the parent company constrains ICPL's profit margins.

The Stable outlook on the [ICRA]BBB+ rating reflects ICRA's opinion that ICPL would sustain its healthy financial profile during the ongoing high-growth phase, and maintain adequate internal monitoring and control systems for ensuring better credit discipline.

Key rating drivers and their description

Credit strengths

Established track record in EMS business – ICPL, along with its parent entity, Incap Oyj, Finland has a long experience in the EMS business. The parent is involved in contract equipment manufacturing for the power electronics sector for over three decades. The company receives technical and marketing support from its parent and in return pays ~5% of the export revenues and 1% of the total sales as commission to the parent. The key managerial personnel have more than two decades of experience in the electronics contract manufacturing industry. Over the years, ICPL has augmented its manufacturing capacities and increased the share of value-added products, which support its margin.

Consistent growth in revenues and profits – ICPL's revenues rose at a healthy compounded annual growth rate (CAGR) of 40% in the last five years on the back of an increase in repeat orders from VE. The revenues surged by 95.52% YoY to Rs. 1,131.52 crore in FY2022 from Rs. 578.72 crore in FY2021 primarily on the back of higher sales to VE, which has been expanding its footprint across new geographies like the US, Africa, and Australia. Further, the company has reported revenue of Rs. 758.14 crore in H1 FY2023. With the company sitting on a healthy order book position of ~Rs. 1,346 crore as on December 3, 2022, the execution momentum is expected to remain healthy for the remainder of FY2023. ICPL's other major customers include MG Energy Systems B.V., Kone Elevators, ABB Industrial Solutions (previously GE Appliances), Hitachi Hi-Rel etc. ICPL has developed strong relationships with these customers and enjoys repeat orders, supporting its revenue growth. ICRA also notes that given the growing demand prospects in the EMS industry, the expected commissioning of the new unit in Tumkur, Karnataka in Q1 FY2024 would support healthy earnings growth, going forward.

Comfortable financial risk profile characterised by healthy profitability and debt coverage metrics – The company's business return indicators remain attractive, as reflected by ROCE of 55% in FY2022. The company's operating profit margins remain healthy while marginally declining to 14.89% in FY2022 from 17.55% in FY2021 partly due to phasing out of the earlier MEIS scheme. ICPL has been prudent in funding its business growth largely through internal accruals. The external borrowings are limited to cash credit of Rs. 5 crore, export credit facilities of Rs. 38 crore and term loan of Rs. 3.08 crore as on March 31, 2022. This, coupled with the strong growth in its net worth resulted in a low gearing of 0.13 times as on March 31, 2022. Moreover, ICPL's coverage indicators remained healthy with a total debt/OPBDITA of 0.25 times, interest coverage of 42.97 times and DSCR of 27.57 times in FY2022. Following the pandemic and disruptions in global supply chains, ICPL's inventory holding increased from 75-90 days to 150-160 days from FY2021 due to the disruptions in global supply chains. However, ICRA notes that ICPL's long-term relationship with suppliers allowed them to get extended unsecured credit period, which partly cushioned the impact on the overall liquidity position due to an increase in inventory holding and limited dependence on borrowings.

Credit challenges

Procedural lapses in financial controls leading to instances of overdue (less than 30 days) in working capital facilities – Procedural lapses in ICPL's financial control systems led to instances of overdue of less than 30 days in the working capital facilities on several occasions in FY2022. ICRA understands that even though there have not been any such instances in the current fiscal so far due to strengthening of the company's monitoring systems, ICRA would evaluate the effectiveness of such measures over a longer timeframe.

High customer and sector concentration risks – Most of ICPL's customers are in the power electronics segment, thereby exposing the company to sector concentration risk. In FY2022, the company derived ~90% of its revenues from a single customer, VE, exposing it to high customer concentration risks as well. However, the long track record of repeat orders from its largest customer and its large expansion plans augur well for ICPL's future growth prospect.

Stiff competition from other contract manufacturers limits pricing flexibility – ICPL remains a mid-sized player, which faces intense competition in the electronic contract manufacturing services industry. The company is not involved in designing of the PCBs, but only assembles components based on the designs provided by its customers, so value addition in its operations remains limited. This restricts its pricing flexibility and bargaining power with customers.

Risk of technological obsolescence necessitates continuous upgrade to sustain competitive advantage – The electronic products industry is characterised by continuous product and process innovation, along with rapid adoption of new technology. Given the risk of technological obsolescence, the industry players are required to undertake continuous upgrades to sustain the competitive advantage. However, the technical and marketing support provided by the parent company, Incap Corporation, Finland, has played a critical role in new business/ customer acquisition and expanding footprint in new markets against the royalty/ commission paid to the parent company, which constrains ICPL's profit margins.

Exposure to foreign currency fluctuation risk – ICPL also remains exposed to foreign currency fluctuations owing to sizeable net exports, which remains unhedged and can exert pressure on margins in case of an appreciation of the rupee. The ratings also consider the company's exposure to sizeable imports of critical input materials like integrated chips and transformers primarily from China, which results in challenges in their timely availability and exposes ICPL to fluctuations in input material prices. This can affect the company's margins as well as block working capital due to the long lead time of delivery, adversely impacting the liquidity. Imports of critical input materials like integrated chips and transformers primarily from China accounted for approximately 88% of ICPL's raw material requirement in FY2022.

Liquidity position: Adequate

ICPL's liquidity is expected to remain adequate, as evident from positive cash flow from operations in four out of the last five fiscals and low scheduled repayment obligation. It has enhanced its PCFC[3] limits and availed a Rs. 2.14-crore ECLGS loan in FY2022 to meet the incremental working capital requirement, providing additional cushion to its liquidity in the current fiscal. The company had high drawing power (average of ~Rs. 315 crore during April-October of FY2023 against the sanctioned

[3] Pre-shipment Credit in Foreign Currency

working capital limits of Rs. 43 crore) which, along with its established relationship with banks, can help secure ad-hoc limits/ enhanced lines, as and when required. As the company is going through a high growth phase, its free cash flows are expected to remain constrained owing to sizeable funding requirement towards working capital as well as the ongoing capex for setting up a new unit to cater to the growing demand. However, flexibility on payment of royalty/ commission to the holding company supports the overall liquidity of the company.

Rating sensitivities

Positive factors – ICRA may upgrade ICPL's ratings if the company is able to strengthen its internal control/ financial monitoring systems for a sustained period while maintaining healthy scale of operations along with comfortable liquidity and credit metrics.

Negative factors – Pressure on ICPL's ratings may arise if there is an increase in the working capital intensity that results in tightening of the liquidity position. The ratings could also be downgraded if there is a significant decline in the scale of operations, resulting in a fall in earnings and a consequent deterioration in the leverage position.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology
Parent/Group support	Not Applicable
Consolidation/Standalone	Standalone

About the company

Incorporated in 2007, ICPL is involved in providing electronics manufacturing services mainly to companies operating in the power electronics segment. The company, which started its operations by taking over TVS Electronic Limited's contract manufacturing services division, is a 100% subsidiary of Incap OYJ, Finland. It manufactures products based on design specifications given by its customers at its manufacturing facility in Tumkur (near Bangalore). Its major products are inverters, printed circuit board assemblies (PCBA), uninterruptible power supply systems (UPS) and emergency rescue devices (ERD). ICPL derives a predominant share of its income through exports to companies based in The Netherlands and Switzerland.

Key financial indicators (audited)

ICPL (Standalone)	FY2021	FY2022	H1 FY2023 (Provisional)
Operating income	578.72	1131.52	758.14
PAT	66.56	117.19	81.45
OPBDIT/OI	17.55%	14.89%	16.21%
PAT/OI	11.50%	10.36%	10.74%
Total outside liabilities/Tangible net worth (times)	0.96	1.04	0.92
Total debt/OPBDIT (times)	0.23	0.25	0.16
Interest coverage (times)	56.37	42.97	27.95

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2023)				Chronology of rating history for the past 3 years		
		Type	Amount rated (Rs. crore)	Amount outstanding as of March 31, 2022 (Rs. crore)	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021	Date & rating in FY2020
					Dec 26, 2022	Sep 13, 2021	Jul 16, 2020	Apr 05, 2019
1	Cash Credit	Long term	5.00	1.98	[ICRA]BBB+ (Stable)	[ICRA]A (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)
2	Term Loan	Long term	3.45	3.08	[ICRA]BBB+ (Stable)	-	-	[ICRA]A- (Stable)
3	Fund based	Short term	38.00	37.00	[ICRA]A2	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+
4	Letter of Credit	Short term	5.00	-	[ICRA]A2	-	-	-
5	Bank Guarantee	Short term	(5.00)	-	[ICRA]A2	-	-	-
6	Forward Cover	Short term	1.55	-	[ICRA]A2	-	-	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term fund-based – Cash Credit	Simple
Long-term fund-based – Term Loan	Simple
Short Term – Fund based	Very Simple
Short Term – Non-Fund Based – Letter of Credit	Very Simple
Short Term – Non-Fund Based – Bank Guarantee	Very Simple
Short Term – Non-Fund Based – Forward Cover	Very Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	**Cash Credit**	NA	NA	NA	5.00	[ICRA]BBB+ (Stable)
NA	**Term Loan**	FY2019	NA	FY2025	3.45	[ICRA]BBB+ (Stable)
NA	**Fund Based Limits**	NA	NA	NA	38.00	[ICRA]A2
NA	**Letter of Credit**	NA	NA	NA	5.00	[ICRA]A2
NA	**Bank Guarantee**	NA	NA	NA	(5.00)	[ICRA]A2
NA	**Forward Cover**	NA	NA	NA	1.55	[ICRA]A2

Source: Company

Please click here to view details of lender-wise facilities rated by ICRA

Annexure II: List of entities considered for consolidated analysis: Not Applicable

ANALYST CONTACTS

Jayanta Roy
+91 33 7150 1100
jayanta@icraindia.com

Priyesh Ruparelia
+91 22 6169 3328
priyesh.ruparelia@icraindia.com

Ritabrata Ghosh
+91 33 6114 3438
ritabrata.ghosh@icraindia.com

Ayushi Mittal
+91 80 4332 6417
ayushi.mittal@icraindia.com

RELATIONSHIP CONTACT

Jayanta Chatterjee
+91 80 4332 6401
jayantac@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

ICRA Limited

Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001
Tel: +91 11 23357940-45

Branches