

March 16, 2023

Mecon Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Letter of credit	10.0	8.0	[ICRA]BBB(Stable) reaffirmed
Bank guarantee	346.0	330.95	[ICRA]BBB(Stable) reaffirmed
Working capital facilities	50.0	100.0	[ICRA]A2 reaffirmed
Unallocated limits	103.0	70.05	[ICRA]BBB(Stable)/[ICRA]A2 reaffirmed
Total	509.0	509.0	

*Instrument details are provided in Annexure-I

Rationale

The ratings reaffirmation reflects MECON Limited's (MECON) strong liquidity position as reflected by a sizeable free cash balance of around Rs. 591 crore outstanding as on March 31, 2022 and its status as a 100% Government of India (GoI) owned public sector undertaking (PSU), which lends it with a high degree of financial flexibility. Mecon's profitability remained volatile in the past with operating losses in the last 7-8 years, except in FY2020 and FY2022. In the current year as well, Mecon is expected to incur operating losses due to execution of low margin orders and a steep increase in commodity prices. The net cash accruals are, however, expected to be supported by substantial non-operating income arising out of its large cash and investment balance. Going forward, while a healthy outstanding order book position provides revenue visibility in the near term, the operating profitability is expected to continue to remain subdued owing to losses in a few engineering contracts. Nonetheless, Mecon's debt-free status and healthy liquidity position will keep the debt metrics comfortable. Execution of high margin contracts and diversification into non-metals segments is expected to improve the financial performance of the company in the medium term and the same will be a key monitorable.

The ratings continue to factor in Mecon's high level of competency in the engineering and consultancy segment with a demonstrated track record of more than four decades and its continued efforts into diversifying in higher non-metals segment, thus reducing sectoral concentration risks. Further, the company's high share of revenue from PSU clients, limits counterparty risks, however, increases the working capital cycle due to elongated receivable period. ICRA also notes that out of MECON's three strategic business units (SBU), the metals and infrastructure SBUs remain loss-making at the EBIT¹ level, which remains a credit concern. Given the company's volatile and subdued net profits over the years, the company has seen limited accretion to reserves.

The Stable outlook on the long-term rating reflects Mecon's comfortable revenue visibility, and ICRA's expectation of a gradual pick-up in execution of higher-margin orders from the next fiscal, which would help the company generate profit at the operating level in the medium term and maintain a healthy liquidity profile.

Key rating drivers and their description

Credit strengths

Status of the company as a 100% GoI-owned entity – MECON is a Miniratna PSU under the administrative control of the Ministry of Steel. In the past, the company has received financial support from the GoI, both in the form of equity infusion, and extension of corporate guarantee for its borrowing programmes. Moreover, given its 100% GoI ownership, MECON enjoys a high degree of financial flexibility with lenders, which supports its credit profile.

¹ Earnings before interest and tax

Strong liquidity profile reflected by sizeable cash balance and debt-free status – During the last steel capex boom (FY2005 – FY2013), MECON was able to build a sizeable cash balance of Rs. 786 crore as on March 31, 2013. The company's performance started deteriorating from FY2014, following which its cash balance steadily declined to around Rs. 300 crore in FY2020. However, the same again increased to ~Rs. 590 crore as on March 31, 2022, driven by a large income-tax refund and higher level of advances from customers. Large cash balances, along with its debt-free status, are likely to support MECON's operations till it turns profitable at the operating level.

High level of competency in engineering and consultancy segment – MECON has a demonstrated track record of over four decades in the engineering and consultancy segment and has established itself as one of the leading consultancy companies in India, especially in the metals and mining segments. Over the last several years, MECON has also progressively built capabilities in the energy and infrastructure segments, especially in sectors like power and oil & gas.

Increase in share of orders from non-metals segment partly mitigated sectoral concentration risks – MECON traditionally had high dependence on the metals sector, thus exposing the company to sectoral concentration risks. However, as the pace of fresh steel capacity addition slowed down in India, MECON started diversifying into the infrastructure and energy sectors from FY2016. Thus, the share of metals projects steadily reduced to 53% in H1 FY2023 from 83% in FY2015. A major growth area for MECON has been in the energy SBU, where it has received large orders in the oil & gas segment. Going forward, the share of metals is expected to remain in the range of ~50-60%.

Low counterparty risks, with over 90% orders from PSU clients – Around 90-95% of MECON's outstanding order book as on date is from PSU clients. Though this leads to higher working capital requirement due to elongated payment cycle, the counterparty risks are largely mitigated.

Credit challenges

Profits remain highly volatile with operating losses in the past – MECON's financial performance has remained volatile, with the company consistently reporting operating losses since FY2014, except for marginal profits in FY2020 and FY2022. However, the company's operating losses have reduced significantly since FY2018 due to its focus on revenue diversification and growth in the non-metals segments like energy and infrastructure. In the current year as well, the company is expected to incur operating losses due to execution of lower margin metal EPC contracts. ICRA, however, notes that the company has been reporting profits at the net level in the recent years, supported by its treasury income and write-back of past liabilities. MECON has received fresh orders from the consultancy segment, which is expected to be executed in the second half of the next fiscal, leading to better profitability levels in the near to medium term.

Two out of MECON's three SBUs remain loss-making at the PBIT level – MECON's revenue from the metals SBU declined significantly from ~Rs. 579 in FY2012 to ~Rs. 258 crore in FY2022. Given this fall in business volumes, the metals SBU consistently registered EBIT loss since FY2015. Out of the two other SBUs where MECON has aggressively grown since FY2016, it has been able to earn marginal profits only in the energy SBU. ICRA understands that competition remains high in the infrastructure SBU due to the low entry barriers, and consequently, the company remains loss-making in this segment.

Limited accretion to reserves over the years – MECON's accretion to reserves remains limited in the recent past due to subdued profitability. Consequently, the tangible net worth declined to ~Rs. 371 crore in FY2021 from Rs. 398 crore in FY2022, to marginally improve to Rs. 383 crore in FY2022. Going forward, due to low profitability, the TNW is expected to remain range bound and therefore, MECON's TOL/TNW has remained elevated at ~3 times for the last two years.

Liquidity position: Strong

MECON's liquidity position is **strong**, supported by its large cash and FD balance of ~Rs. 600 crore and no debt repayment obligations and no major capex requirements. While ICRA expects MECON's cumulative free cash flows to remain marginally negative in the near term, the liquidity position is expected to remain healthy.

Rating sensitivities

Positive factors - ICRA could upgrade MECON's ratings if there is a meaningful improvement in the company's operating profits, along with sustenance of healthy liquidity.

Negative factors - Pressure on MECON's ratings could arise in case of a significant deterioration in its liquidity profile along with limited earnings visibility.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology
Parent/Group support	Parent: Government of India As MECON plays a key supporting role in the infrastructure development in the country, the assigned ratings factor in its strategic importance to the GoI, which ICRA expects should induce the Government to extend financial support to the rated entity, should there be a need.
Consolidation/Standalone	Standalone

Note (for analyst reference only):

About the company

Incorporated in 1973 as a subsidiary of Steel Authority of India Limited, MECON is one of the leading organisations that provides design, engineering, consultancy and contracting services in the field of metals and mining, power, oil & gas, and infrastructure. MECON provides full range of services required for setting up of greenfield and brownfield projects from the concept to the commissioning, including turnkey execution. Subsequently, in 1978, MECON was made an independent company under the administrative control of the Ministry of Steel.

In FY2022, the company reported a net profit of Rs. 14 crore on an operating income of Rs. 603 crore compared to a net profit of Rs. 6 crore on an operating income of Rs. 732 crore in FY2021.

Key financial indicators (audited)

Mecon Standalone	FY2021	FY2022
Operating income	732	603
PAT	6	14
OPBDIT/OI	-3.6%	0.5%
PAT/OI	0.9%	2.3%
Total outside liabilities/Tangible net worth (times)	2.7	2.8
Total debt/OPBDIT (times)	0.0	0.0
Interest coverage (times)	-20.1	1.8

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 Dec 31, 2022 (Rs. crore)	Date & Rating in	Date & Rating in FY2022	Date & Rating in FY2021	Date & Rating in FY2020	
					Mar 16, 2023	Dec 31, 2021	Sep 04, 2020	-	
1	Letter of Credit	LT	8.0	198.0	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	-	
2	Bank Guarantee	LT	330.95		[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	-	
3	Working Capital Facilities	ST	100.0	48.2	[ICRA]A2	[ICRA]A2	[ICRA]A2	-	
4	Unallocated Limits	LT/ST	70.05	-	[ICRA]BBB (Stable)/ [ICRA]A2	[ICRA]BBB (Stable)/ [ICRA]A2	[ICRA]BBB (Stable)/ [ICRA]A2	-	

Complexity level of the rated instruments

Instrument	Complexity Indicator
Letter of Credit	Very Simple
Bank Guarantee	Very Simple
Working Capital Facilities	Simple
Unallocated Limits	NA

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	Letter of Credit	NA	NA	NA	8.0	[ICRA]BBB (Stable)
NA	Bank Guarantee	NA	NA	NA	330.95	[ICRA]BBB (Stable)
NA	Working Capital Facilities	NA	NA	NA	100.0	[ICRA]A2
NA	Unallocated Limits	NA	NA	NA	70.05	[ICRA]BBB(Stable)/[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

NA

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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.

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Branches



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