India Ratings Revises NCC's Outlook to Positive; Affirms 'IND A+'; Upgrades Short-term Debt to 'IND A1+'

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India Ratings and Research (Ind-Ra) has revised NCC Limited's Outlook to Positive from Stable while affirming the Long-Term Issuer Rating at 'IND A+'. The instrument-wise rating actions are as follows:

Instrument Type	Date of Issuance	Coupon Rate	Maturity Date	Size of Issue (billion)	Rating/Outlook	Rating Action
Fund-based working capital limits	-	-	-	INR22	IND A+/Positive/IND A1+	Long-term rating affirmed, Outlook revised to Positive; Short-term rating upgraded
Non-fund-based limits	-	-	-	INR130	IND A+/Positive/IND A1+	Long-term rating affirmed, Outlook revised to Positive; Short-term rating upgraded

Analytical Approach: Ind-Ra continues to rate NCC on a standalone basis after factoring in the support extended by the company to its subsidiaries to arrive at the ratings.

The Positive Outlook and upgrade of the short-term debt rating reflect Ind-Ra's expectation of an improvement in NCC's working capital cycle over FY25-FY26, along with stable business, financial and credit profiles. Ind-Ra expects the gross working capital as a percentage of revenue to improve further from the levels of FY23 and NCC's interest coverage (operating EBITDA/finance cost) to remain above 3x in FY24 and FY25, if there is a sustained improvement in EBITDA, liquidity profile and gross working capital cycle as demonstrated in 1HFY24.

Key Rating Drivers

Robust Order Book with Moderate Concentration: NCC received orders amounting to INR204 billion during 1HFY24 (FY23: INR259 billion; FY22: INR122 billion). This led to a strong closing order book of INR618 billion at end-September 2023 with a healthy revenue visibility of 4.6x of the FY23 revenue. The current orderbook displays moderate geographical and segmental concentration. Geographically, the top four states in terms of the order book exposure are Uttar Pradesh (32%), Maharashtra (21%), Karnataka (10%) and Andhra Pradesh

(7%). During 1HFY24, major order inflows have been from state electricity distribution companies of Bihar and Maharashtra as well as tunnel, building and water supply projects from various other states.

The projects having an execution rate of below 10% at 1HFYE24 cumulatively comprise 49% of the overall unexecuted order book. As the company is in receipt of continuous new orders, the % share of less than 10% execution is likely to remain higher even in 2HFY24 and FY25 and it does not necessarily pose an execution risk. The order book excluding the orders received during January-September 2023 has a large number of projects requiring an increased run-rate of execution to meet the stipulated completion dates. The NCC management has informed Ind-Ra that an extension of timelines is available in the regular course of business and it does not foresee any challenge in order execution.

Segmentally, the buildings segment had a 41% share at end-1HFY24 (FY23: 46%), followed by the electrical and water segments at 22% (14%) and 16% (16%), respectively. However, Ind-Ra draws comfort from adequate project-level diversification in terms of project execution risk, with the top five projects contributing 20% to the orderbook and the top 10 projects contributing 32% at end-September 2023.

Increasing Scale of Operations: Ind-Ra believes NCC's revenue shall grow 30% yoy in FY24 and 10%-12% yoy in FY25 and FY26, backed by strong order inflows during FY22-FY23 and 1HFY24. The company achieved revenue of INR81 billion at end-1HFY24 (FY23: INR133 billion; FY22: INR99 billion) in line with Ind-Ra's estimates, due to a steady inflow of new orders during FY22 and FY23. Although the company's EBITDA margins appear to have reduced to 8.1% in 1HFY24 (FY23: 10.1%; FY22: 10.0%), this is on account of a charge-off of INR3,513.4 million towards the arbitration awarded during 2QFY24. Adjusting for the charge-off amount, the revenue, EBITDA and EBITDA margin for 1HFY24 improve to INR83 billion, INR8.6 billion and 10.3%, respectively. Ind-Ra believes the margins will remain stable at 10%-11% over FY24-FY26 due to the presence of high-margin orders from the electrical segment in the order book.

Sustained Strong Credit Metrics: Ind-Ra expects NCC's credit metrics to further improve in FY24-FY26 with a gross interest coverage ratio of above 3x and net leverage below 1x, owing to higher EBITDA generation and debt levels reducing below FY23's, along with the presence of orders providing non-interest bearing mobilisation advances. The total outside liabilities (TOL)/EBITDA was higher than some of AA category peers and lower than A+ peers, and Ind-Ra expects it to improve to around 6x in FY24 (FY23: 6.9x; FY22: 8.1x) and sustain below 6x in FY25, reflecting the need to fund the gross working capital cycle (GWC) through debt, mobilisation advances and sundry creditors. At end-FY23, TOL aggregated to around INR92.8 billion (FY22: INR80 billion; FY21: INR73 billion), comprising current liabilities of INR91 billion. While the overall debt component reduced in FY23 (INR9.8 billion) from FY19 (INR21 billion), this has been compensated by an increase in mobilisation advances (around half are interest-bearing) up to INR32 billion from INR17 billion. Cumulatively, the interest-bearing liability including mobilisation advances remains unchanged and NCC still operates with significantly higher working capital intensity than in FY19. In line with improved working capital cycle in 1HFY24, Ind-Ra expects NCC to reduce its working capital intensity for FY24 and FY25 by way of the initiatives taken to improve diversification away from Andhra Pradesh and dealing increasingly with the government of India-owned counterparties. Ind-Ra believes any further delays in the certification of bills or undue delays in realisation of the same can impact the overall liquidity profile of the company, leading to an increase in debt levels and/or a higher interest outflow and could be negative for the ratings.

NCC's credit metrics improved yoy in FY23 with the net leverage of around 0.6x (FY22: 1.0x; FY21: 2.1x) and gross interest coverage of 2.6x (2.2x, 1.9x). The interest coverage ratio further improved during 1HFY24 to 3.0x (1HFY23: 2.5x), factoring in the adjusted EBITDA. The company had an outstanding term debt of INR1,542.7 million at end-September 2023, while the repayment obligation for 2HFY24 is INR526.8 million.

Liquidity Indicator – Adequate; Cash Outflow Expected towards Special Project Vehicles: Ind-Ra expects the liquidity profile to remain adequate over 2HFY24-FY25. It has an unutilised working capital limit of 43% at end-September 2023, despite the traditionally weaker quarter in EPC segment. Also, it could improve its free cash flow to around INR3.2 billion in FY24 (FY23: negative INR0.16 billion; FY22: INR6.4 billion) and approximately INR2.2 billion in FY25, in view of the robust order book. The company's average utilisation of working capital limits (around 64% over the 12 months ended November 2023) is likely to remain in the range of 60%-70% and there will be the availability of funding for vehicle/equipment financing during FY25. NCC had free cash of INR2,151.7 million at end-September 2023. The repayment obligation scheduled in the remaining period of 2HFY24 is INR526.8 million. Furthermore, the company envisages an equity commitment of about INR5 billion over FY25 and FY26 and has a capex plan of INR2,000 million-2,500 million each year over FY24-FY26. The company had already incurred capex of INR469 million during 1HFY24.

Pertaining to the equity commitment, the company has setup two SPVs for the execution of smart meter orders and is also pursuing for a strategic equity partner. The execution of smart meter orders (two SPVs & one directly executed by NCC) is likely to entail an equity outflow of INR5 billion and a debt tie-up of about INR20 billion, which is under progress. As per the NCC management, NCC is not expected to extend corporate guarantees towards the debt raised at SPV level. Since the company has yet to achieve financial closure for the projects, any upward deviation towards the estimated equity support other than envisaged INR5 billion or provision of any other support in terms of corporate guarantee shall be negative for the ratings. However, given the presence of undrawn mobilisation advances of about INR10 billion at end-1HFY24 and aforementioned unutilised fund-based working capital limits, the overall liquidity of NCC shall remain adequate. Also, a successful tie-up with a strategic investor is likely to result in an outflow of INR1.3 billion instead of INR5 billion over FY25-FY27 towards SPVs.

Previously, the company has been able to divest its complete stake in NCC Vizag Urban Infrastructure to Garden Realty Private Limited. On the conclusion of the sale, NCC had estimated to receive INR5 billion against loans and equity. INR0.5 billion had been received in 4QFY22, and INR1.5 billion was expected to be received in three tranches from 2QFY23 while the remaining INR3 billion (apportioned portion against loans) was expected in FY24 and FY25. However, the expected tranches have been delayed and NCC management expects the same to be received in FY25 and FY26. Overall, NCC has received about INR1 billion till end-December 2023 pertaining to the equity repayment. Ind-Ra believes the timely realisation of funds from the sale of NCC Vizag Urban Infrastructure shall improve NCC's overall liquidity profile, leading to lower utilisation of debt and/or mobilisation advances.

Shortening-but-long Working Capital Cycle; Recovery of Debtors Including Unbilled Revenue Remains Crucial: Ind-Ra expects NCC to sustain its net working capital cycle at 60-70 days during FY24 (FY23: 68 days; FY22: 76 days) and reach levels of around 50 days by end-FY25 due to improved execution and lower receivables from the outstanding order book. Consequently, the net working capital cycle as a % of revenue is expected to sustain below 20% in FY24-FY25 (FY23: 19%; FY22: 22%). Owing to the presence of orders from electrical division and water & environment divisions and receivables pending for realisations from the closed sites, the GWC/revenues (%) remained higher than other 'IND A+' rated peers at 79% in FY23 (FY22: 88.5%, FY21: 110%) and could improve to below 70% in FY24-FY25. Given the nature of construction segment and with the presence of orders to be executed over a period of one to three years, Ind-Ra expects the working capital requirements to be funded by a combination of working capital debt, mobilisation advances and sundry creditors.

The recovery of debtors from distribution companies, state governments of Andhra Pradesh, Telangana and other counterparties remains crucial. This is because the quantum of receivables (as a percentage of overall receivables) outstanding for more than a year remained high at 22% at end-1HFY24, despite reducing to 19% at end-FY23 (FY22: 27%; FY21: 35%). Furthermore, the unbilled revenue has risen to INR36.5 billion at end-1HFY24 (FY23: INR32.2 billion; FY22: INR22.8 billion) largely on account of underlying payment terms of the contracts. The timely recovery of the same is crucial and a key monitorable for the agency as the share of unbilled revenue over 90 days has also risen to INR8.9 billion at end-1HFY24 (FY23: INR5.3 billion).

Rating Sensitivities

Positive: Events that could, individually or collectively, lead to a positive rating action are:

- timely execution of the order book with a majority share of strong counterparties, and increased segmental and geographical diversification

- a substantial improvement in the working capital cycle with GWC reducing to below 70% of revenues and TOL/EBITDA reducing below 6x and strong cash flow generation on a sustained basis
- the gross interest coverage exceeding 3.5x, while net leverage staying below 1x on a sustained basis

Negative: Events that could, individually or collectively, lead to outlook revision back to stable are:

- delayed execution of the order book and decreased segmental and geographical diversification
- deterioration in the working capital cycle with GWC staying above 70% of revenues and TOL/EBITDA staying above 6x and weak-to-moderate cash flow generation
- the gross interest coverage staying below 3.5x, while net leverage exceeding 1x on a sustained basis
- higher-than-envisaged cash outflow towards project SPVs or support by way of corporate guarantees

Company Profile

NCC is a Hyderabad-based construction company listed on the National Stock Exchange Limited and BSE Limited. It is engaged in the construction of roads, buildings, irrigation, water and environment, electrical, metals, mining and railways. Apart from executing projects across India, the company has a presence in the Middle East through its subsidiaries in Muscat and Dubai. NCC also has interests in road and energy projects through its 62.1%-owned subsidiary NCC Infrastructure Holdings Limited and in real estate through its 80%-owned subsidiary NCC Urban Infrastructure Limited.

FINANCIAL SUMMARY

Particulars (INR billion)	FY23	FY22
Revenue	134	99.3
EBITDA	13.4	10.0
EBITDA margin (%)	10.1	10.0
Total adjusted debt	9.8	12.2
Cash and cash equivalent	2.3	2.5
Net adjusted debt	7.5	9.7
Source: NCC, Ind-Ra		

Non-Cooperation with previous rating agency

Not applicable

Solicitation Disclosures

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APPLICABLE CRITERIA

Evaluating Corporate Governance

Short-Term Ratings Criteria for Non-Financial Corporates

Corporate Rating Methodology

The Rating Process

Rating History

Instrument Type	Current Rating/Outlook			Historical Rating/Outlook/Rating Watch				
	Rating Type	Rated Limits (billion)	Rating	19 January 2023	12 December 2022	29 March 2022	14 March 2022	6 January 2021
Issuer rating	Long-term	-	IND A+/Positive	IND A+/Stable	IND A+/Stable	IND A/Positive	IND A/Positive	IND A/Positive
Fund-based facilities	Long term/Short-term	INR22	IND A+/Positive /IND A1+	IND A+/Stable/IND A1	IND A+/Stable/IND A1	IND A/Positive/IND A1	IND A/Positive/IND A1	IND A/Positive/IND A1
Non-fund-based facilities	Long term/Short-term	INR130	IND A+/Positive /IND A1+	IND A+/Stable/IND A1	IND A+/Stable/IND A1	IND A/Positive/IND A1	IND A/Positive/IND A1	IND A/Positive/IND A1

Bank wise Facilities Details

Click here to see the details

Complexity Level of Instruments

Instrument Type	Complexity Indicator
Fund-based working capital limits	Low
Non-fund-based working capital limits	Low

For details on the complexity level of the instruments, please visit https://www.indiaratings.co.in/complexity-indicators.

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