

Press Release

Vascon Engineers Limited (VEL)

30 September, 2017

Rating Assigned



Total Instruments Rated*	Rs.250.00 Cr
Long Term Rating	SMERA BBB-/Stable (Assigned)
Short Term Rating	SMERA A3 (Assigned)

**Refer Annexure for details*

Rating Rationale

SMERA has assigned rating of '**SMERA BBB-**' (read as **SMERA triple B minus**) and short-term rating of '**SMERA A3**' (read as **SMERA A three**) on the Rs.250.00 crore bank facilities of Vascon Engineers Limited (VEL). The outlook is '**Stable**'.

Incorporated in 1986, VEL is a listed company engaged in real estate development. The company undertakes EPC (Engineering, Procurement and Construction) contracts for residential, commercial and allied sectors. The registered office is located at Mumbai and the head office at Pune. An 85 per cent subsidiary of VEL, GMP Technical Solutions Private Limited (GMP) is engaged in the manufacturing of clean room partition and building management systems.

Analytical Approach: For arriving at the ratings, SMERA has considered the consolidated financial and business risk profile of VEL along with its subsidiaries, hereinafter referred to as the 'VEL Group'.

List of key rating drivers and their detailed description

Strengths:

Established track record of operations and experienced management: The VEL Group was incorporated in 1986 to undertake real estate projects and execute EPC contracts. The company started as an in-house developer for Cipla Limited and later on expanded to execute contracts for other parties. VEL has developed area of more than 50 million sq.ft till 31 March, 2017 in EPC and the real estate segment. Most of its real estate projects are in and around Pune and Mumbai. Some of the landmark projects are Forest County, Windermere and Parthenon.

In the EPC segment, VEL focusses on executing projects for marquee developers like Shapoorji Pallonji, Transcon Sheth Creators Private Limited and others. Apart from private players, VEL has also secured orders from government-backed players like UP Housing Board. Being in the construction business for over three decades, the company has gained strong technical and design expertise. Mr. R Vasudevan (Managing Director) has over three decades of experience in the construction and real estate sector. VEL has a capable second line of management with personnel who have been associated with the company since its inception.

SMERA believes that the established track record and experienced management will enable the company to sustain its position in the EPC and real estate market.

Expected improvement in operating cash flows on the back of strong EPC order book and healthy bookings in real estate projects: VEL's operating performance over the past three years was mainly affected by the slowdown in the real estate and EPC segments. On standalone basis, VEL's operating income dipped to Rs. 208.46 crore in FY2017 as against Rs. 305.73 crore in FY2016 and Rs. 285.19 crore in FY2015. However, the company has demonstrated signs of a recovery in the current fiscal. For Q1FY2018, VEL, on standalone basis, reported revenue of Rs. 81.38 crore compared to Rs. 56.27 crore in Q1FY2017.

Currently, VEL has completed three projects - Forest County Phase I & II, Platinum Square phase I and Garnet Bay. There are three ongoing projects - Windermere, Forest County Phase III and Platinum Square Ph II and two that are upcoming - Tulip - Phase III and Talegaon Affordable Phase I. Forest County II, (519060 sq. ft project) has received 93 per cent bookings whereas Platinum Square Phase I and Garnet Bay have been able to attract 56 per cent and 83 per cent bookings respectively. Since these are projects are already complete and project costs have been incurred, the future inflows from these are expected to support the company's operating cash flows.

Among the ongoing projects, the company has been able to attract 43 per cent bookings for Windermere and around 90 per cent bookings have been made in Platinum Square Ph II. Windermere is a premium project, expected to generate customer interest in a phased manner over the next couple of years.

Apart from the traction in its real estate projects, VEL also stands to benefit from a strong EPC unexecuted order book of Rs. 706.30 crore as on 17 September, 2017 to be executed over the next two years. Further, the company has an expected order pipeline of around Rs. 2345.00 crore. The order book position provides revenue visibility for the medium term. Since most of the EPC projects undertaken by VEL belong to the real estate sector, the company continues to be exposed to the vagaries of the segment. The declining trend in interest rates and macro economic variables such as favourable demographic profile and rapid urbanisation augurs well for the prospects of the residential real estate sector.

The introduction of legislation like RERA will prompt a shift from the unorganised segment to organised players. Besides, RERA is also expected to ensure better adherence to timelines by realtors. This is expected to result in timely execution of projects and more predictability in the cash flow streams of players like VEL.

VEL proposes to focus more on the affordable housing segment in future, which has been a thrust area of the government. The favourable policy initiatives of the government to support the Affordable Housing programme will provide an impetus to entities like VEL.

SMERA believes that a healthy EPC order book and improved demand for its real estate projects are expected to support VEL's credit risk profile.

Liquidity profile to be supported by monetisation of non core assets : VEL is in the process of monetising its non-core assets in and around Mumbai, Pune and Goa with estimated value of around Rs.193.00 crore (as per company estimates) which will augment cash flows and support liquidity. Most of these assets were acquired as consideration for certain past projects executed by the company. Besides, VEL holds 85 per cent stake in its subsidiary, GMP Technical Solution Private Limited (GMP), valued at around Rs. 150.00 core (VEL's share as per company estimates). The quantum and timely monetisation of these non-core investments will be key rating sensitivities. In the event of slower than expected monetisation of non-core assets, the company may need to refinance its debt.

The company has faced liquidity pressures in the past (2017) due to slowdown in the real estate sector as also the EPC segment, which impeded its ability to meet its debt obligations in a timely manner. The company had to resort to long-term financing (albeit at a higher cost) to align its debt servicing commitments to its operational cash flows. Currently, the company has consolidated debt of Rs. 272.00 crore (as on 31 March, 2017), of which working capital borrowings were Rs.125 crore and the balance of Rs. 147.00 crore, comprised term debt (including NCDs, term loans from NBFCs, public deposits etc) of Rs. 119.00 crore and current portion of debt was Rs. 2.09 crore. The loan from ECL Finance will be repayable from November 2018 onwards thus providing adequate liquidity buffer to VEL.

SMERA expects the liquidity profile to be supported by the comfortable maturity profile of its term debt, improved traction in real estate segment and timely monetisation of non core assets.

Weaknesses:

Working capital intensive operations: VEL has working capital intensive operations with gross current assets (GCA) of 607 days in FY2017 as against 510 days in FY2016. The high GCA days are mainly on account of high inventory holding of 334 days in FY2017 as against 285 days in FY2016. The debtor's days stood high at 168 days in FY2017 as against 154 days in FY2016. VEL is getting liberal credit terms from its suppliers thereby creditor days stood at 344 days in FY2017 as against 433 days in FY2016. Out of the total debtors of Rs. 224.10 crore as on 31 March, 2017, debtors of Rs. 61.96 crore are outstanding for more than a year mainly in the EPC segment. As on August 2017, out of the total outstanding debtors of Rs. 220.56 crore, debtors of Rs. 85.05 crore are outstanding for more than six months. The average utilisation of cash credit limit has been almost full in the last six months ended August 2017.

SMERA believes that VEL's operations will remain working capital intensive on the back of long tenure of EPC projects and high level of inventory in the real estate business.

Susceptibility of performance to the vagaries of EPC and real estate sector: The real estate sector is rate sensitive and cyclical which leads to significant lumpiness in the cash flow profiles of real estate players. The demand for residential real estate is driven by factors like interest rates, demographic profile, expectations regarding future incomes whereas demand for commercial real estate is a function of the level of economic activity in a region.

VEL's major projects are in and around Pune which has attracted significant buying interest mainly on account of Pune's attractiveness as a software hub. The increasing employment opportunities for young professionals, its proximity to Mumbai, the overall industrial development and the 'education hub' tag have contributed to development of Pune's residential segment. However, the downsizing by companies and shifting of operations to other states are expected to impact the demand for real estate in and around Pune which could affect cash flow profiles of players like VEL.

Similarly, the EPC segment also exposes VEL to significant risk. Any funding/operational issues faced by the counterparties in these projects could impact the cash flows of VEL from there.

Significant quantum of contingent liabilities: VEL, at consolidated level has contingent liabilities of around Rs. 800.00 crore as on 31 March, 2017 which comprises mostly claims regarding title of land, property, disputed statutory dues, claims filed by clients and corporate guarantees extended to group entities. The company has been contesting these claims at various forums. In the event of crystallisation of any major liabilities, requiring immediate outflow of funds, the company's liquidity profile could be impacted. SMERA believes that the high quantum of contingent liabilities are likely to have a bearing on the credit profile of the company in the near to medium term.

Outlook – Stable

SMERA believes that VEL will maintain a 'Stable' outlook over the medium term owing to its experienced management and long operational track record. The outlook may be revised to 'Positive' in case the company registers significant growth in revenues and cash accruals while improving financial risk profile and working capital cycle. Conversely, the outlook may be revised to 'Negative' in case of steep decline in revenues and cash accruals or deterioration in the capital structure and liquidity position.

Analytical approach: as mentioned above

Applicable Criteria

- Infrastructure entities: <https://www.smera.in/criteria-infra.htm>
- Manufacturing Entities: <https://www.smera.in/criteria-manufacturing.htm>
- Application of Financial Ratios and Adjustments: <https://www.smera.in/criteria-fin-ratios.htm>
- Default Recognition: <https://www.smera.in/criteria-default.htm>

About the Rated Entity – Key financials

For FY2016-17, on consolidated basis, the VEL Group reported net profit after tax (PAT) of Rs.1.21 crore on operating income of Rs.481.23 crore as against PAT of Rs. 9.21 crore on operating income of Rs. 571.78 crore. The tangible net worth stood at Rs.619.31 crore as on 31 March, 2017 as against Rs. 597.67 crore as on 31 March, 2016.

Status of non-cooperation with previous CRA: Brickwork Ratings in its press release dated December 31, 2016 had inter-alia mentioned the following 'Vascon Engineers Limited have not provided required information for carrying out a review of the Rating (BWR C-/A4) despite close follow up, and hence the said rating is placed under not reviewed category'.

Any other information: Not Applicable

Rating History for the last three years: Not Applicable

*Annexure – Details of instruments rated:

Name of the Facilities	Date of Issuance	Coupon Rate (Per cent)	Maturity Date	Size of the Issue (Rs. Crore)	Ratings/ Outlook
Cash Credit	NA	NA	NA	73.00	SMERA BBB- /Stable (Assigned)
Proposed Term Loans	NA	NA	NA	37.00	SMERA BBB- /Stable (Assigned)
Bank Guarantee I	NA	NA	NA	120.00	SMERA A3 (Assigned)
Bank Guarantee II	NA	NA	NA	20.00	SMERA A3 (Assigned)

Note on complexity levels of the rated instrument: <https://www.smera.in/criteria-complexity-levels.htm>

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ABOUT SMERA

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