Risk Management Framework

Risk Management includes identification, measurement, and mitigation of risks. This includes judgements on the probability as well as severity of risk events. The Company has a 3-pronged approach to Risk Management – Operational, Tactical, and Strategic. These risks, at the level of individual projects as well as the portfolio level, are managed by robust processes, including statutorily mandated and various other internal processes. The Risk Management framework involves Business Heads and Risk Teams at various businesses working in close coordination with the Company-level teams. In addition to project-level risks, risks arising from Corporate Functions such as IT (including Cyber Security) and HR are also mapped and mitigated appropriately. The overall aim of the Risk Management function is to improve project outcomes, and thereby, aid financial performance.

The Chief Risk Officer closely monitors the overall Risk Management Process, which includes Project Pre-Bid, Execution, and Close-out Risk Reviews. Further, significant risks are presented to the Company's Risk Management Committee (twice a year) as well as the Apex Risk Management Committee, which lays down the essential guardrails such as Country Risk exposures, etc. The outcomes/learnings of Risk Reviews are captured in the ERM system, which helps track project-related and portfolio-related risks. Efforts are being made to use AI on the system to produce actionable insights.

Efforts are being undertaken to absorb risk-related learnings from an individual business and spread across the Company using forums such as 'Annual Risk Awards' and regular meetings of Business Level Risk Heads. These initiatives help in the dissemination of learnings across the Company, with respect to Specific Risks, Clients, Geographies, etc. Apart from internal learnings, efforts are also made to absorb best practices from outside the Company by participating in industry bodies/forums, etc.

Operational Risks

In the Projects business, normal risks like right-of-way, resource availability, utilities shifting, etc., are typically encountered. These are managed by proper planning at the pre-bid stage and continuous monitoring at the execution stage. Risks arising from the financial position of clients, JV partners, suppliers, etc., are also analysed and appropriately mitigated. Risk Registers are maintained and updated regularly. Further, all ongoing projects are also suitably insured.

Risks from large, complex projects are mitigated by having guardrails at the pre-bid review stage as well as by measures such as having experienced project managers, good client relationship management, and suitable mitigation of counterparty and payment risks. However, if there are issues in the execution of large/marquee orders, risks to reputation need to be guarded against.

Legal and contractual risks are also thoroughly reviewed at the pre-bid stage to ensure that these stay within the Company's overall risk appetite.

Supply Chain Risks - These risks have risen due to the volatile geopolitical environment, especially in the Middle East. These are being closely monitored. While they are not likely to have a significant impact on operations in the short-term, the long-term persistence of these challenges may result in adverse outcomes. Despite this, commodity-related inflation has remained subdued, with the overall environment for commodity prices remaining manageable.

Cyber Security - The Company has a Cyber Security Assurance Framework encompassing Processes & Standards and Technology. These risks are monitored/managed at the level of individual businesses/domains as well as by various Committees, including the Company's Risk Management Committee.

Climate Change - Climate change increases the impact and likelihood of some physical risks, which could lead to execution disruption and losses. These risks manifest both as acute physical risks, e.g., extreme weather conditions, heavy precipitation, etc., as well as chronic physical risks, e.g., higher ambient temperatures, increase in sea levels, etc. While business operations typically face a higher impact of such risks, now even assets and the built environment are increasingly facing such threats. The Company's major business segments, i.e., EPC projects and Hi-Tech Manufacturing, are exposed to such physical risks from climate change, requiring risk mitigation strategies. Some of the major challenges are:

i. Increasing frequency and intensity of extreme weather events or natural calamities pose significant threats to safety as well as the availability and utilisation of resources

ii. Extremely high daytime temperatures pose a danger to the health and safety of the workforce, which, in turn, impacts productivity

iii. Heavy precipitation or flooding poses a significant risk to project schedules

iv. Actual weather patterns at project sites/manufacturing facilities may be significantly different from historical or predicted meteorological data and can impact business performance

v. Changing weather patterns have the potential to cause disruptions in logistics and transportation of materials

vi. In addition to loss of productivity and threat to safety, climate events pose an additional burden in terms of higher contingencies and insurance costs

vii. Resource scarcity, e.g., availability of water due to changing rainfall patterns

To mitigate the impact of such risks, the Company proactively assesses the likelihood and impact of such risks. For EPC projects, this assessment is done both at the bidding stage and during the execution stage. Manufacturing facilities also undertake such assessments on a periodic basis. The Company has adopted and implemented Environment Management Systems based on ISO 14001 and Occupational Health & Safety Management Systems based on ISO 45001. This helps not only in meeting regulatory compliance, but also improves operational performance by identifying and addressing business operations risks.

Monsoon preparedness plans, cover plans for the protection of equipment (covering, tying down, or other suitable arrangements), backup for power/fuel, human safety, and plans for restoring normal operations, e.g., dewatering arrangements are a standard requirement now for all projects. For dealing with periods of extremely high temperature, measures are taken to reschedule the work-rest cycle, additional measures are taken for shelters and hydration of the workforce, and awareness sessions and advisories are organised to apprise the workforce of risks, reporting issues, and preventive measures to be taken.

Tactical and Strategic Risks

For the Projects Business, the risks arising from high debt levels in various emerging markets (Asia/Africa) have to be addressed while bidding for/executing projects in these regions. This is done using an appropriate approval matrix for Country Risk and focussing on multilaterally funded projects to mitigate sovereign risk.

Both Manufacturing and Projects businesses have faced additional risks due to the ongoing geopolitical tensions and a shifting Sanctions regime. Appropriate measures, such as end-to-end Sanction checks, are in place to manage these risks. Apart from Sanctions, every country's foreign policy can also impact business to some extent. This year, post-election outcomes (in India and overseas) are additional risks to be mitigated when required.

Technology/Business Model Risks - Changes in technologies/business models can affect the performance of clients and thus impact the type of projects that the Company executes. As such, the Company closely monitors these changes with respect to its clients. Trends in Business Model changes for the EPC business (e.g. the trends towards localisation, reduced site work/greater modularisation, and digitalisation) are also tracked.

Concentration Risks - The increase in the order book share of the Middle East has increased the concentration risk. This risk is monitored regularly at various levels and suitably mitigated by measures such as rigorous Sovereign Analysis and Client Financial Strength reviews.

Business Continuity Plan (BCP) - The Company has a process by which BCPs for various risk scenarios are prepared and tested. BCPs are reviewed at several levels and updated suitably, keeping in mind project/portfolio level changes in the Order Book.

Risks from Energy Transition - The current megatrend of Energy Transition is fundamentally reshaping several industries across the globe. This affects the businesses at the operational level by increasing 'green specifications' in tenders, building codes, etc. It has also facilitated opportunities such as Green EPC in the Middle East, domestic Pump Hydro Storage Projects (PSP), new business areas such as Green Hydrogen/Electrolyser manufacturing, and more Transmission & Distribution opportunities due to evacuation requirements/grid reconfiguration for renewables. However, risks could arise from the potential failure of any of these new initiatives.

The Company also sees significant business opportunities from energy transition linked to the decarbonisation of the energy sector. These are in areas of renewable energy (solar, hydel), clean energy (nuclear, natural gas), renewable fuels (green diesel), green hydrogen, battery energy storage, offshore wind, etc.

Talent Risks - The large volume of projects underway in India, as well as in key markets like Saudi Arabia, has increased the demand for key skill sets. As such, talent risks are likely to persist, given the focus on CapEx by both the Central and State Governments of India, as well as Saudi Arabia's ongoing plan to diversify its economy away from oil.

Overall, the Company strives to maintain its robust Risk Management Process, which is far ahead of the statutory stipulation. Despite this, tail risks (potential large impact from a very low probability event) can manifest themselves and will need to be appropriately managed when they arise.

Financial Risks

Financial risk management is governed by the Risk Management Framework and Policy approved by the Company's Audit Committee under the guidance of the Board. Financial risks in each business portfolio are collated, measured, and managed by the Corporate Finance Department.

The global economy proved to be resilient in 2023 despite high inflation, significantly tight monetary policy, supply chain disruptions, volatile commodity prices, and a fragile Chinese economy. However, 2024 is likely to have comparatively slower growth due to the lagged impacts of monetary policy tightening. Political and geopolitical risks will be more pronounced in 2024, with an election-packed events calendar. More than 60 countries, representing half the world's population, will go to the polls in 2024. For G10, the main event is likely to be the US election. Inflation dynamics will look quite similar across developed and emerging economies, as most countries are experiencing gradual disinflation driven by the dissipating effects of supply-side shocks combined with tightening financial conditions. Disinflation in goods is proving to be faster than in services, but as it continues normalising, it is expected that the Fed & ECB would start their easing cycles by the middle of 2024.

With oil prices expected to be in a range of USD 80-90 per barrel, the Middle Eastern countries are likely to continue their investments in the energy transition journey. The Company had a record order inflow from the Middle East in FY 2023-24 in the hydrocarbon and renewable segments, and the positive momentum may continue in FY 2024-25 as well.

The Indian economy has exhibited remarkable resilience. Output has expanded at a faster pace compared to major economies in 2023, and the outlook remains positive in the medium-term. The country is on track to emerge as the third largest economy in the world within this decade after overtaking the United Kingdom to become the fifth-largest in the world on a nominal GDP (USD) basis last year. An expanding growth pie is expected to lift per capita GDP, which trails most emerging market peers at this juncture. Going by the Government's CapEx emphasis in the Interim Budget of FY 2024-25, we expect public spending to remain strong and consequently, drive growth. Private CapEx could pick up incrementally in FY 2024-25 post-general elections, with improvement in capacity utilisation. However, private consumption is likely to remain modest as the lagged impact of past rate hikes filters through the real economy. NPAs in the banking system have reduced sharply. Hence, banks are well-positioned to fund the next CapEx cycle. Real GDP growth is likely to average around 7.0-7.5 % in FY 2024-25.

Unlike advanced countries, India does not face a big risk from wage-price inflation, which is supported by the recent trend of moderation in core inflation (currently at 3.5% vs. 6%+ in 2022). Headline CPI inflation is expected to moderate to 4.7% in the calendar year 2024.

There is a broad consensus on economic stability over the short- to medium-term post-general election results, which is positive for the continuation of the reform agenda and the structural outlook for the Indian economy. One can also expect fiscal consolidation to pick up pace, with the centre's fiscal deficit likely to narrow to 5.1% of GDP in FY 2024-25 and finally to 4.5% of GDP in FY 2025-26, as per the medium-term macro framework.

India's foreign exchange reserves stood at an all-time high of USD 646 billion as of March 29, 2024. The relative stability of the INR reflects India's sound macroeconomic fundamentals, financial stability and improvements in the external position. The slowing trajectory of inflation and improving CAD position would also allow the RBI to ease rates, maybe towards the end of the financial year.

Foreign Exchange and Commodity Price Risks

The Company's businesses are exposed to fluctuations in foreign exchange rates and commodity prices. Additionally, it has exposures to foreign currency-denominated financial assets and liabilities. Net foreign exchange risk on revenues, costs, assets, and liabilities are managed through a combination of forwards and options wherein the counterparties are regulated banking entities. The financial risks involving commodity prices are managed through a combination of price variation clauses embedded in customer contracts, hedges in financial markets, and price pass-through arrangements. In the case of contracts with price variation clauses, the Company may run a Basis Risk between the actual price of the commodity and the reference indices.

The disclosure of commodity exposures as required under clause 9(n) of Part C, Schedule V of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, in the format specified vide Chapter VI-E of SEBI Master Circular No. SEBI/HO/CFD/PoD2/CIR/P/2023/120 dated July 11, 2023 is given below:

Sr No	Commodity Name	Exposure in INR towards the particular commodity (₹ crore)	Exposure in Quantity terms towards the particular commodity (Tn)	% of such exposure hedged through commodity derivatives				
				Domestic market		International market		Total
				OTC	Exchange	OTC	Exchange	
1	Aluminium - Buy	2,314.98	1,10,094	-	-	73.33	-	73.33
2	Aluminium - Sell	(23.30)	(1,406)	-	-	75.11	-	75.11
3	Zinc - Buy	69.11	3,400	-	-	100.00	-	100.00
4	Copper - Buy	2,774.60	38,952	-	-	62.59	-	62.59
5	Copper - Sell	(283.80)	(5,654)	-	-	100.00	-	100.00
6	Lead - Buy	78.11	5,000	-	-	100.00	-	100.00
7	Coking coal - Buy	71.04	30,030	-	-	9.99	-	9.99
8	Iron ore - Buy	53.55	57,290	-	-	58.65	-	58.65
9	Steel - Buy	19,410.19	53,67,394	-	-	-	-	-
10	Cement - Buy	5,502.16	85,61,148	-	-	-	-	-
11	Nickel - Buy	292.67	1,458	-	-	88.38	-	88.38
12	Thermal Coal - Buy	8.43	6,440	-	-	-	-	-
	Total exposure	**30,267.73**						

Liquidity and Interest Rate Risks

The Company constantly monitors the liquidity levels and economic & capital market conditions and maintains access to sources of liquidity with competitive cost structure through a combination of approved banking lines, trade finance and capital markets. The Company judiciously deploys its surplus funds in short-term investments, which is in line with its Treasury Policy. The Company dynamically manages interest rate risks through a mix of fund-raising, investment products, and derivatives across maturity profiles and currencies within the robust Risk Management Framework.

Financial Resources and Capital Allocation

The capital allocation philosophy of the Company is geared to support business initiatives for the profitable growth of the Company, while retaining adequate liquidity to support any sudden short-term requirements of the Group. After facing uncertainties in past periods due to the pandemic and geopolitics, which resulted in liquidity and supply chain disruptions, the Company has built appropriate cash buffers to meet both opportunities and challenges.

In the financial year, the Company supported the capital expenditure required to execute projects awarded in the Projects and Manufacturing business segment. Going forward, the Company will continue to support the growth of new businesses, including green energy, data centers, and semiconductors.

In line with its stated strategy to monetise non-core assets, the Company concluded the divestment of its roads concessions and transmission line business (L&T IDPL), which resulted in the release of capital to the tune of ~₹1300 crore.

Given the recovery in the business environment and financial markets and with reduced working capital requirements in the Company's businesses and a healthier economic scenario in FY 2023-24, the Company rewarded its shareholders by executing its first-ever equity share buyback that consumed approximately ₹ 12,300 crore, including taxes. Further, this transaction has a positive impact on the Group return ratios as well.

In FY 2024-25, the Company proposes to raise long-term debt to refinance about ~₹ 5,000 crore of maturing debt and to partly fund its proposed capital expenditure.

Low gearing levels (Gross Debt to Equity ratio at 0.35x) at the parent entity level and a healthy cash buffer equips the Company with enough flexibility to deal with normal business uncertainties.

The Company has seen a significant volume of large-value contracts in the Middle East, especially from Saudi Arabia, which requires large banking facilities, primarily non-fund based. The Company is confident of tying up the required banking facilities during the year to address the upcoming requirements.

Internal Controls and Safeguards

Corporate governance is the foundation for the Company to achieve predictable growth and desired outcomes, and robust internal controls are one of the important pillars of corporate governance. The Company has adopted the globally accepted framework issued by the Committee of Sponsoring Organisations (COSO) of the Treadway Commission for Internal Controls. This framework assists in the alignment of controls with the dynamics of recent challenges and changes in risk profiles arising due to varying internal and external factors. The Company ensures integrity in conducting its business, safeguarding its assets, timely preparation of reliable financial information, accuracy & completeness in maintaining accounting records, and prevention & detection of frauds & errors through a set of detailed policies and procedures.

The Board of Directors and Management at all levels exhibit the right tone through their actions, behaviour, and directives. The 'Code of Conduct', which serves as a beacon for employees, defines the Company culture and values, and emphasises the importance of integrity and ethical values. Besides, the suppliers also have to conform to a separate 'Code of Conduct' to ensure that they align with the Company's commitment to seek sustainable growth by integrating Environment, Social and Governance (ESG) principles with its businesses. 'Whistle-blower/Vigil Mechanism' policies are available to both employees and business partners to enable them to raise genuine concerns about any actual or suspected ethical/legal violations, misconduct or fraud, with adequate safeguards against victimisation, fear of punishment or unfair treatment.

The Company has well-documented policies, procedures, and authorisation guidelines commensurate with the level of responsibility, besides standard operating procedures specific to respective businesses. This ensures the propriety of the transactions, besides authorisation at an appropriate level of Management. The Corporate Manuals on Accounting & Internal Controls prescribes the Accounting and Internal Controls Policies. Internal Financial Controls (IFC) at the entity and process level are aligned with the requirements of the Companies Act 2013. The Internal Controls teams at the corporate and business levels assist the Management in setting up appropriate internal controls and establishing and upgrading the system/procedures. Business teams ensure adherence to the documented policies, procedures, authorisation guidelines and IFC framework.

The effectiveness of Internal Controls is tested by the Statutory Auditor as well as by the Company's Corporate Audit Services (CAS) Department. CAS develops an audit plan for the Company, which covers core business operations and corporate & support functions. The Audit Committee of the Board reviews the annual internal audit plan. Significant audit observations from the independent internal audits are presented quarterly to the Audit Committee of the Board, along with the status of the Management actions and the progress of the implementation of recommended remedial measures. The Company also periodically engages independent professional firms to carry out reviews of the effectiveness of control in businesses and support functions.