February 26, 2021

Happy Forgings Limited: Long-term rating upgraded to [ICRA]A+(Stable) and short-term rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term Loans	62.38	143.83	[ICRA]A+ (Stable); Upgraded from [ICRA]A (Stable)
Fund-based – Working Capital Facilities	147.00	137.00	[ICRA]A+ (Stable); Upgraded from [ICRA]A (Stable)
Unallocated Limits	85.62	14.17	[ICRA]A+ (Stable)/[ICRA]A1; Long term rating upgraded from [ICRA]A (Stable);Short term rating reaffirmed at[ICRA]A1
Total Bank Facilities	**295.00**	**295.00**	

**Instrument details are provided in Annexure-1*

Rationale

The rating upgrade takes into account the continuation of Happy Forgings Limited's (HFL) strong operational performance, benefitting from its established relationships and strong share of business with reputed tier-I automotive ancillaries and original equipment manufacturers (OEMs). Even as the company's scale of operations was significantly impacted in Q1 FY2021 by the enforced lockdowns, the company's revenues have improved sequentially over the past couple of quarters post the relaxation in lockdowns, aided by the recovery in demand for its end-user segments.

The company reported a strong ~54% growth in revenues in Q3 FY2021 (on a YoY basis), with revenues from one of the key end-user segments (i.e., agri-machinery) reporting a significant improvement. Moreover, with increasing proportion of sales from the relatively profitable machining segment as well as heavy forged components, the company's operating profitability remained at robust levels (i.e., 26.2% in 9M FY2021 over 25.7% in FY2020), despite the curtailed scale of operations (~11% decline in revenues during the same period). The company remains well positioned to benefit from a recovery in demand in the automotive segments, especially commercial vehicles (CVs), with its established relationships and strong share of business with various customers likely to help it record a moderate to healthy revenue growth over the medium term.

The assigned ratings continue to favourably factor in HFL's strong financial risk profile. Aided by healthy accretion to reserves and pre-payment of long-term debt post infusion of equity funds from a private equity player (Rs. 200.0 crore in FY2019), the company has maintained a conservative capital structure (gearing of 0.2 time as on March 31, 2020). HFL's operating profitability metrics and reduction in debt levels have helped it in maintaining strong debt coverage indicators (Total Debt/OPBDITA of 0.8 times and NCA/Total Debt of 84.8% in FY2020).

The company's liquidity profile also remains adequate, characterised by healthy cash flow from operations, presence of healthy cash and liquid investments (~Rs. 25 crore as of December 31, 2020) and moderate utilisation of working capital facilities. Despite the ongoing capex programme, an expectation of healthy operating performance is likely to help in limiting HFL's dependence on external debt to fund its substantial capital expenditure plans (~Rs. 470 crore over the FY2019-FY2022 period), while helping it maintain strong return indicators and debt metrics.

The assigned ratings remain constrained by the susceptibility of HFL's revenue generation to the cyclicality in the CV and agri-machinery segments, as they contribute ~70-75% to the company's revenues. While dependence on these segments is expected to remain high over the medium term, HFL's established relationships and strong share of business with various customers provides comfort.

ICRA has previously taken note of the commercial dispute between HFL and the State Bank of India (SBI), related to the right to recompense the relief extended to the company during the debt restructuring undertaken in 2013; via a press release in August 2020. ICRA had noted that SBI had debited the company's account for the disputed amount (RoR) in May 2020. In FY2021, the company has entered into settlement for the RoR dispute with the banks (State Bank of India, IDBI Bank and Punjab and Sind Bank) and has paid off the entire demand (~Rs. 15 crore total fund outflow). Accordingly, ICRA understands that as on date, there are no outstanding disputes pertaining to the demand.

The Stable outlook reflects ICRA's view that HFL is likely to maintain a comfortable credit profile, with an expectation of healthy cash flows to keep its dependence on external debt low, even as it continues with its substantial capital expenditure plans towards expanding capacity.

Key rating drivers and their description

Credit strengths

Established relationships and strong share of business with tier-I component manufacturers and OEMs – HFL is a Ludhiana-based manufacturer of forged and machined components that are mainly supplied to the CV and tractor segments of the automotive industry. The promoters have over 35 years of extensive experience in the forging industry. The company enjoys established relationships and a strong share of business with reputed tier-I automotive ancillaries, such as Graziano Transmission India Private Limited, along with reputed OEMs such as Ashok Leyland Limited, VE Commercial Vehicles Limited, and Escorts Limited, which provide revenue visibility.

Strong operating profitability and return indicators – Aided by a ramp up in capacity utilisation of the press lines and machining facilities, HFL's operating margin improved significantly to 27.7% in FY2019 from 17.5% in FY2014, with supplies for heavier components post the commercialisation of an 8,000-MT press line aiding its profitability. Despite the moderation in demand in FY2020, and consequent decline in capacity utilisation, the company continued to report healthy operating margins (25.7%). Strong operating margins coupled with high asset sweating has aided it in reporting healthy return metrics, with core RoCE of 24.1% in FY2020.

Even as the lockdowns, induced by the Covid-19 pandemic, impacted the company's prospects significantly in Q1 FY2021, it has recorded an operating margin of ~26.2% in 9M FY2021 (provisional financials) by benefitting from a demand recovery since the relaxation of lockdowns and an increasing proportion of higher value-added products. A relatively lower capacity utilisation, coupled with investments towards setting up press lines (8,000 MT and 14,000 MT), would lead to a moderation in RoCE over the next two years; while the extent of moderation would remain dependent on the ability of the company to achieve a ramp up in capacity utilisation for the new capacities added. The return indicators are expected to remain at healthy levels.

Healthy financial risk profile, aided by infusion of funds by private equity player – MOPE Investment Advisors Private Limited invested Rs. 200.0 crore as equity in HFL in FY2019, acquiring a stake of 11.76% in the process. Aided by healthy accretion to reserves and prepayment of long-term debt post infusion of funds from the PE player, the company's capital structure witnessed a considerable improvement. Benefitting from its stable operating performance and consequent accruals, the total debt on the company's books declined to ~Rs. 118.4 crore as of March 31, 2020 from Rs. 300.5 as of March 31, 2018 (provisional financials). The debt on its books as of December 31, 2020 was ~Rs. 125.8 crore. The company's operating profitability metrics, coupled with reduced debt levels, have helped it to report robust debt coverage indicators, with a Total Debt/OPBDITA of 0.8 time and NCA/Total Debt of 85% in FY2020. Even after a demand moderation in its end-user segments in FY2020 and the adverse impact of the pandemic on its revenue prospects in the current fiscal, the debt coverage indicators are expected to continue to remain at healthy levels, going forward.

Credit challenges

Key end-user segments of agri-machinery and CVs remain exposed to cyclicality – HFL is primarily a supplier of forged and machined components to the CV and the tractor segments of the automotive industry. Together these two segments constitute ~70-75% of its total revenues. Both these industries are inherently cyclical in nature, with the demand for CVs being impacted by industrial, agricultural production and freight dynamics, while tractor demand remains closely linked to monsoon performance and agricultural income. Despite the management's focus on expanding its customer and product portfolio (across other segments), the company's dependence on these segments is expected to remain high over the medium term. HFL's established relationships and strong share of business with various customers, however, provide comfort.

Substantial capacity expansion plans and foray into relatively new product categories – The company is currently in the midst of a capacity expansion programme, wherein the forging and machining capacities would increase to ~1,00,000 TPA and 60,000 TPA levels, respectively, by FY2023. The capex would be completed in two phases. In the first phase, a new 8,000-MT press line is being installed (along with machining facilities), while a 14,000-MT press line will be installed (along with machining facilities) in the second phase, which will help to cater to relatively new product categories. While a predominant share of its capex is likely to be funded through internal accruals and from funds received from private equity infusion, timely completion of the same and HFL's ability to achieve healthy capacity utilisation levels for the enhanced capacity would remain key rating sensitivities.

Liquidity position: Adequate

The liquidity position remains adequate, supported by sizeable cash balances (~Rs. 25 crore as of December 31, 2020), moderate utilisation of working capital facilities (buffer of ~Rs. 50-60 crore) and expectation of strong cash accruals (~Rs. 120-150 crore per annum) over the next three years. The entity is expected to maintain sufficient liquidity to meet its debt repayments (~Rs. 14 crore in FY2022) and ongoing capex programme (~Rs. 140-150 crore in FY2022) for enhancing its forging and machining capabilities.

Rating sensitivities

Positive factors – An upgrade could be triggered if there is an uptick in volumes in the segments catered, which favourably impacts HFL's accruals and helps it maintain healthy credit metrics in the context of its substantial capex plans. Further, material revenue diversification by way of a sustained scale up in supplies to export markets, which helps to offset any weakness in domestic OEM supplies, would be favourably considered for a rating upgrade.

Negative factors – A rating downgrade could be triggered by a weakness in demand from end-user segments and a consequent inability to achieve healthy capacity utilisation post capacity expansion, which could materially impact the company's return and debt coverage indicators. Specific credit metrics that could result in a downgrade include Debt/OPBDITA being greater than 2.0 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Auto Component Suppliers
Parent/Group Support	Not Applicable
Consolidation/Standalone	Standalone

About the company

HFL was incorporated in 1979 by Mr. Paritosh Kumar Garg as a private limited company, which was converted into a public limited company later in 1988. The company manufactures forged and machined transmission as well as engine components that are supplied mainly to the automotive sector. Its product range includes automotive crankshafts, steering knuckles, transmission gears, pinions, shafts, and forged/machined components for the Indian Railways. It has a total forging capacity of 60,000 MT (hammer and press forging combined) and a machining capacity of 34,500 MT. Its day-to-day operations are overseen by Mr. Ashish Garg (managing director), son of Mr. Paritosh Kumar Garg. MOPE Investment Advisors Private Limited, a private equity player, invested Rs. 200.0 crore as equity in HFL in FY2019, acquiring a stake of 11.76% in the process.

Key financial indicators (audited)

HFL	FY2019	FY2020
Operating Income (Rs. crore)	750.3	558.8
PAT (Rs. crore)	95.4	79.9
OPBDIT/OI (%)	27.7%	25.7%
PAT/OI (%)	12.7%	14.3%
Total Outside Liabilities/Tangible Net Worth (times)	0.5	0.4
Total Debt/OPBDIT (times)	0.7	0.8
Interest Coverage (times)	9.1	5.7*
Adjusted Interest Coverage (times)**	9.1	12.4

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation

** Interest expenses in FY2020 included provision of ~Rs. 13.8 crore for settlement of RoR disputes with banks; **Adjusted for provision related to RoR demand*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2021)							Chronology of Rating History for the past 3 years			
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of Feb 20, 2021 (Rs. crore)	Date & Rating			Date & Rating in FY2020	Date & Rating in FY2019		Date & Rating in FY2018	
					26-Feb-2021	18-Aug-2020	11-May-2020	30-Oct-2019	28-Feb-2019	14-Aug-2018	07-Nov-2017	31-May-2017
1	Term Loans	Long Term	143.83	33.74	**[ICRA]A+ (Stable)**	**[ICRA]A (Stable)**	**[ICRA]A (Stable)**	**[ICRA]A (Positive)**	**[ICRA]A (Positive)**	**[ICRA]A (Stable)**	**[ICRA]A- (Stable)**	**[ICRA]BBB+ (Positive)**
2	Fund-based – Working Capital Facilities	Short Term	137.00	-	**[ICRA]A+ (Stable)**	**[ICRA]A (Stable)**	**[ICRA]A (Stable)**	**[ICRA]A (Positive)**	**[ICRA]A (Positive)**	**[ICRA]A (Stable)**	**[ICRA]A- (Stable)**	**[ICRA]BBB+ (Positive)**
3	Non-fund Based – Working Capital Facilities	Long Term/ Short Term	0.0	-	-	-	-	-	**[ICRA]A1**	**[ICRA]A1**	**[ICRA]A2+**	**[ICRA]A2**
4	Unallocated Limits	Long Term/ Short Term	14.17	-	**[ICRA]A+ (Stable)/ [ICRA]A1**	**[ICRA]A (Stable)/ [ICRA]A1**	**[ICRA]A (Stable)/ [ICRA]A1**	**[ICRA]A (Positive)/ [ICRA]A1**	**[ICRA]A (Positive)/ [ICRA]A1**	-	**[ICRA]A- (Stable)/ [ICRA]A2+**	**[ICRA]BBB+ (Positive)/ [ICRA]A2**

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (RS Crore)	Current Rating and Outlook
NA	Term Loan 1	Dec-17	-	Mar-26	17.61	[ICRA]A+(Stable)
NA	Term Loan 2	Jan-21	-	Mar-28	60.00	[ICRA]A+(Stable)
NA	Term Loan 3	Jan-21	-	Mar-27	40.00	[ICRA]A+(Stable)
NA	Term Loan 4	Nov-17	-	Mar-26	16.13	[ICRA]A+(Stable)
NA	Proposed Term Loan	-	-	-	10.09	[ICRA]A+(Stable)
NA	Fund Based Limits	NA	NA	NA	137.00	[ICRA]A+(Stable)
NA	Unallocated Limits	NA	NA	NA	14.17	[ICRA]A+(Stable)/ [ICRA]A1

Source: *Company*

Annexure-2: List of entities considered for consolidated analysis – Not applicable

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About ICRA Limited:

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