

April 29, 2021

Hindustan Aeronautics Limited: Long-term rating upgraded to [ICRA]AA+; outlook revised to Positive

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long Term- Fund-Based/Cash Credit	10,000.00	10,000.00	[ICRA]AA+; upgraded from [ICRA]AA and Outlook revised to Positive from Stable
Short Term- Non-Fund Based	2,050.00	2,050.00	[ICRA]A1+; reaffirmed
Commercial Paper	2,500.00	2,500.00	[ICRA]A1+; reaffirmed
Total	14,550.00	14,550.00	

*Instrument details are provided in Annexure-1

Rationale

The upgrade in long term rating and change in outlook factors in the significant improvement in Hindustan Aeronautics Limited's (HAL or the company) business risk profile supported by new order inflows and significant collections from customers in FY2021 resulting in negative net debt position for the company at the end of last fiscal. The growth in order book was supported by the recent order for 83 Light Combat Aircraft (LCA) with total value aggregating to Rs. 36,486 crore (excluding taxes and other pass-through components), resulting in its closing order book position increasing to Rs. 84,665 crore (3.73 times FY2021 operating income). The cash flows and liquidity profile of HAL also improved significantly in FY2021 with collections from customers (including advances) increasing to Rs. 35,000 crore resulting in nil bank borrowings and a cash balance of Rs. 7,315 crore as on March 31, 2021 as against borrowings of Rs. 5,775 crore as on March 31, 2020. In addition to the strong order book position, the ratings also positively factors in the expected build-up in the order book in FY2022 with many large orders expected to be secured in the current fiscal. The new order inflows provide high revenue visibility in the medium to long term while also indicating HAL's strong competitive and strategic positioning.

The ratings continue to draw comfort from the majority ownership held by the Government of India (GOI) in Hindustan Aeronautics Limited as well as HAL's strategic position as a dominant supplier of aircrafts, helicopters, engines, avionics and accessories as well as main provider of maintenance, repair and overhaul services to the Indian defence forces. The company faces limited competition from the private sector due to the high capital intensity and long gestation periods for developing manufacturing capabilities in the sector. While competition from the private sector is likely to intensify in the long-term, HAL's long-standing relationship with the Indian defence forces and R&D agencies, established manufacturing facilities, and manpower base will continue to be strong mitigating factors. The GoI's increased focus on indigenisation with the Make in India policy and the establishment of defence corridors and mandatory offset policy for defence procurement by GoI, augur well for the company's future growth. HAL's financial profile is further supported by its diversified revenue mix covering sale of products, spares and services for multiple aircraft programmes, as well as the healthy profitability arising from the cost-plus nature of majority of contracts. Due to its large scale and consistently improving operating profitability, the debt coverage metrics remain strong.

The ratings are, however, constrained by HAL's high dependence on contracts received from Ministry of Defence (MoD), which contributes to more than 90% of the revenues. In the past, delays in timely realization of payments from its largest customer has led to build-up of receivables and reliance on external debt. Though, the receivable position has improved in FY2021 with substantial collections realised during the year, the company remains susceptible to timely receipt of funds or change in prioritisation in the defence budget which can have an adverse impact on the growth potential, sales momentum and liquidity of the company. Nonetheless, the company has a strong liquidity cushion as sanction limits remain unutilised as on FY2021-

end. The rating is also constrained by the company's exposure to time and cost overruns as order execution has stiff timelines and has predefined margins on orders. Further, the company will be dependent on vendors, OEMs and technology licensors for timely execution of the supply orders. ICRA notes that the company also has significant contingent liabilities, primarily relating to sales tax demands from various states, aggregating to Rs 11,361 crore as on March 2020. While, the same has been resolved with many state governments and any outflows pertaining to the sales tax demands would be reimbursed by HAL's customers, the risk remains in terms of any intermittent funding requirements.

Key rating drivers and their description

Credit strengths

Majority ownership held by GoI; strategically important to the Indian defence forces – The GoI is HAL's majority shareholder, holding a 75.15% stake at present. It is a defence PSU which was conferred Navaratna status in 2007. The company is of strategic importance to the Indian defence forces comprising of the Indian Army, Indian Airforce, Indian Navy and Indian Coast Guard, on account of it being the sole domestic supplier of aircrafts, helicopters, engines, avionics and other accessories. It occupies a leadership position in the Indian aerospace and defence industry. The company is also engaged in providing maintenance, repair and overhaul (MRO) services for aircrafts and helicopters for its products as well as those which are directly purchased by the MoD from foreign OEMs.

Long track record and significant entry barriers - Over the years, HAL has showcased its research, design and development capabilities with the successful development of military aircraft and helicopters such as the Ajeet, Marut, HPT-32, Kiran and Advanced Light Helicopter. The company also manufactures aircrafts under license such as the MiG-21, MiG-27, Avro, Jaguar, Dornier 228, Su-30 MKI and Hawk Mk 132 and helicopters such as the Cheetah and Chetak. Further, the company has recently secured its largest ever contract of 83 LCA Tejas Mk1A aircraft with MoD for Rs. 36,486 crore which further demonstrates its strong position in the defence avionics sector. The company also provides MRO services for these indigenous and license manufactured aircraft and helicopters, as well as for aircraft and helicopters procured directly by the Indian defence services. The company faces limited competition from the private sector due to the high capital intensity and long gestation periods for developing manufacturing capabilities in the sector. While competition from the private sector is likely to intensify in the long-term, HAL's long-standing relationship with the Indian defence forces and the DRDO, established manufacturing facilities, and experienced manpower base will continue to be strong mitigating factors.

Strong order book with healthy future order pipeline; strong financial profile – The company has a strong order pipeline as reflected by the unexecuted order book of around Rs. 84,665 crore as on March 31, 2021, significantly boosted from the recent 83 LCA aircraft contract of Rs. 36,486 crore. Further, there is a strong visibility of future orders with new orders anticipated for LUH, LCH, Su-30, HTT-40 in the near to medium term. The company's operating income in FY2021 stood at Rs. 22,700 crore (provisional), registering a y-o-y growth of 7%. Owing to significant collections of Rs. 35,000 crore from customers in FY2021, HAL repaid all the working capital borrowings outstanding and ended the year with nil debt from banks and a cash balance of Rs. 7,135 crore as on March 31, 2021 as against borrowings of Rs. 5,775 crore as on March 31, 2020. HAL's financial profile is further supported by its diversified revenue mix covering sale of products, spares and services for multiple aircraft programmes, as well as the healthy profitability arising from the cost-plus nature of majority of contracts. Due to its large scale and consistently improving operating profitability, the debt coverage metrics remain strong.

Credit challenges

High dependence on contracts from MoD – More than 90% of the revenue of the company is derived from sales to the Indian defence forces. These contracts depend on the budgetary support extended to MoD, which in turn allocates the amounts to the various Indian defence Forces. Any reduction in availability of funds or change in prioritisation of the defence budget can have an adverse impact on the growth potential, sales momentum and liquidity of the company. Over the past years, the amount of defence allocation towards modernisation of aircrafts and aero-engines has not seen much growth. The company has faced issues of delayed payments from MoD in the past, leading to build-up of receivables and reliance on external debt.

Though, the same has improved with significant reduction in receivables in FY2021, the company remains susceptible to timely receipt of funds or change in prioritisation in the defence budget which can have an adverse impact on the growth potential, sales momentum and liquidity of the company.

Susceptibility to time and cost overruns in order execution, high dependence on vendors, OEMs and technology licensors –

The company's operations and profitability remain exposed to time and cost overruns as order execution has stiff timelines and also has predefined margins on orders. In case of delays in delivery, the company is subject to various penalties including liquidated damages. The company had been making provisions for liquidated damages for delays in manufacturing aircraft and ROH orders, however, actual outflow has always remained lower than provision, therefore there have been no payments made more than provisions in any of the past years. Further, its dependence on vendors, OEMs and technology licensors remains as HAL intends to focus mostly on assembly and testing of the aircrafts.

Liquidity position: Strong

HAL's liquidity is Strong, evidenced by its cash balance of Rs. 7,135 crore as on March 31, 2021 (post debt repayments and interim dividend payment), undrawn working capital facilities and absence of any major debt repayment obligations over the near-term. Further, the capex commitments are expected to be met through internal accruals and no debt funded capex is envisaged in the near-term. ICRA notes that, significant quantum of buy-back of shares and distribution of dividends in the past lead to reduction in cash and bank balances and increased reliance on working capital borrowings. Therefore, any significant future outflows in terms of buy-back of shares or dividend can adversely impact the liquidity of the company and remains a key monitorable.

Rating sensitivities

Positive factors – Steady improvement in scale of operations supported by healthy order inflow, timely execution of orders in hand along with sustenance of current level of working capital intensity and liquidity could lead to a rating upgrade.

Negative factors – Negative pressure on HAL's rating could arise in case of increase in working capital intensity or adverse impact on liquidity due to stretched debtors or crystallization of contingent liabilities leading to higher-than-expected dependence on external borrowings.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	Parent/Group Company: Government of India (GoI) The assigned rating factors in the strategic importance that HAL holds for the GoI, which we expect should induce it to extend timely financial support to the rated entity, should there be a need.
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of HAL. As on March 31, 2020, the company had 14 joint ventures and two subsidiaries, which are all enlisted in Annexure-2.

About the company

HAL, a defence public sector undertaking (DPSU), was established on October 1, 1964 when Hindustan Aircraft Limited and Aeronautics India Limited were amalgamated. The principal business of HAL is to undertake design, development, manufacturing, maintenance, repair and overhaul of aircrafts, helicopters, engines and other related systems like avionics, instruments and accessories. It also engages with the Indian Space Research Organisation (ISRO) to contribute to the space

programmes of the country. The GoI remains HAL's largest shareholder current shareholding of 75.15%. HAL was conferred with the Navratna PSU status in June 2007. HAL's primary consumers are the Indian Defence Forces comprising of the Indian Air Force, Indian Army, Indian Navy along with the Indian Coast Guard. The company has four production complexes- Bangalore complex, MiG complex (located in Nasik and Koraput), Helicopter complex (located in Bangalore and Barrackpore) and Accessories Complex (located in Kanpur, Lucknow, Hyderabad, Kasargod and Korwa); along with a Design complex (R&D centres jointly located with the related manufacturing divisions).

Key financial indicators (audited)

HAL Consolidated	FY2019	FY2020	H1FY2021
Operating Income (Rs. crore)	19,761	21,253	6,590
PAT (Rs. crore)	2,329	2,866	765
OPBDIT/OI (%)	23.3%	23.3%	21.7%
PAT/OI (%)	11.8%	13.5%	11.6%
Total Outside Liabilities/Tangible Net Worth (times)	3.6	3.0	2.8
Total Debt/OPBDIT (times)	1.0	1.2	1.5
Interest Coverage (times)	25.9	13.8	8.1

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

Source: Company, ICRA research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2022)				Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of March 31, 2021 (Rs. crore)	Date & Rating in	Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2019
					Apr 29, 2021			
1	Cash Credit	Long term	10,000.00	Nil	[ICRA]AA+ (Positive)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	-
2	Non-fund Based Limits	Short term	2050.00	NA	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	-
3	Commercial Paper	Short term	2,500.00	Nil	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	-

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	Cash Credit	NA	NA	NA	10,000.00	[ICRA]AA+ (Positive)
NA	Non-fund Based Limits	NA	NA	-	2,050.00	[ICRA]A1+
Not placed	Commercial Paper Programme	NA	NA	7-365 days	2,500.00	[ICRA]A1+

Source: Company

Annexure-2: List of entities considered for consolidated analysis

Company Name	HAL Ownership	Consolidation Approach
Naini Aerospace Limited	100.00%	Full Consolidation
Indo Russian Helicopters Limited	50.5%	Proportionate Consolidation
BaeHAL Software Ltd.	49.0%	Equity Method
Indo Russian Aviation Ltd.	48.0%	Equity Method
Safran HAL Aircraft Engines Pvt. Ltd.	50.0%	Equity Method
Samtel HAL Display System Ltd.	40.0%	Equity Method
HAL-Edgewood Technologies Pvt. Ltd.	50.0%	Equity Method
HALBIT Avionics Pvt. Ltd.	50.0%	Equity Method
Infotech HAL Ltd.	50.0%	Equity Method
HATSOFF Helicopter Training Pvt. Ltd.	50.0%	Equity Method
TATA-HAL Technologies Ltd	50.0%	Equity Method
International Aerospace Manufacturing Pvt. Ltd.	50.0%	Equity Method
Multi-Role Transport Aircraft Ltd.	50.0%	Equity Method
Aerospace & Aviation Sector Skill Council (AASSC)	50.0%	Equity Method
Helicopter Engines MRO Private Ltd.	50.0%	Equity Method
Defence Innovation Organisation	50.0%	Equity Method

Source: HAL annual report FY2020

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