May 20, 2022

Happy Forgings Limited: Ratings reaffirmed; outlook revised to Positive from Stable; rated amount enhanced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term Loans	143.83	245.00	[ICRA]A+ (Positive); reaffirmed and outlook revised to Positive from Stable; Assigned for the enhanced amount
Fund Based Limits	137.00	185.00	[ICRA]A+ (Positive); reaffirmed and outlook revised to Positive from Stable; Assigned for the enhanced amount
Unallocated Limits	14.17	55.00	[ICRA]A+ (Positive)/[ICRA]A1; reaffirmed and outlook revised to Positive from Stable; Assigned for the enhanced amount
Total Bank Facilities	**295.00**	**485.00**	

**Instrument details are provided in Annexure-1*

Rationale

The revision in outlook to Positive from Stable reflects 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). The company's scale of operations had been adversely impacted during FY2020-FY2021 due to slowdown in the commercial vehicle (CV) industry and disruptions caused by the Covid-19 pandemic; however, its revenues improved significantly in FY2022 (~48% growth in revenues on YoY basis) aided by recovery in demand for its key end-user segment (CV), amid an improvement in the economy post-abatement of infections and relaxation in lockdowns.

With increasing proportion of sales emanating from the relatively profitable machining segment and heavy forged components, the company's operating profitability remained at robust levels (i.e., 27% in FY2022), despite the significant hardening in raw material prices. The company remains well positioned to benefit from a recovery in demand in the automotive segments, especially 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. In the recent past, the company has gained business from multiple new customers (including some in the non-automotive segments); a ramp-up in supplies for these customers is expected to help augment the company's cash accruals and improve its credit profile.

The assigned ratings continue to favourably factor in HFL's strong financial risk profile. The company has maintained a conservative capital structure (estimated gearing of 0.3 times as on March 31, 2022), 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). HFL's operating profitability metrics and low debt levels have helped it maintain strong debt coverage indicators (estimated total Debt/OPBDITA of 1.0 times and NCA/total debt of ~74% in FY2022). Despite the ongoing capex programme (~Rs. 150 crore project capex still to be incurred over FY2023-FY2024 towards commissioning of 14,000-MT press and its associated machining lines), 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, 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 ~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 also notes that while the new 14,000-MT press line being set up will help the company cater to relatively new product categories, thereby leading to diversification of revenue profile, timely completion of the project capex and HFL's ability to achieve healthy capacity utilisation levels for the enhanced capacity would remain monitorables.

Key rating drivers and their description

Credit strengths

Established relationships 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 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. The established relationships provide healthy revenue visibility for the company. In addition to its existing customers, the company has gained business from multiple new customers over the recent past (some in the non-automotive segments), thereby leading to further strengthening of its operational profile and revenue growth prospects.

Strong operating profitability and return indicators – HFL's operating margin improved significantly to 27.7% in FY2019 from 17.5% in FY2014, aided by a ramp-up in capacity utilisation of the press lines and machining facilities with supplies for heavier components post the commercialisation of an 8,000-MT press line aiding its profitability. Despite the weak demand scenario amid the adverse impact of the pandemic over the past two fiscals, and hardening of raw material prices, the company continues to report robust operating profitability (estimated EBIDTA margin of ~27% with absolute EBIDTA of Rs. 235 crore in FY2022), aided by an improved product mix (higher % of pressed components as opposed to hammer-based components) and operational efficiency measures undertaken. The strong operating margins, coupled with high asset sweating has aided it in reporting healthy return metrics, with a core RoCE of ~24% in FY2022.

A relatively moderate capacity utilisation, coupled with investments towards setting up press lines (ongoing capex for 14,000 MT), is likely to lead to a moderation in RoCE over the next two years; while the extent of moderation would remain dependent on the company's ability to ramp-up 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. The company's capital structure witnessed a considerable improvement, aided by healthy accretion to reserves and pre-payment of long-term debt post-infusion of funds from the PE player. Benefitting from its stable operating performance and consequent accruals, the company's total debt had declined to ~Rs. 118.4 crore as of March 31, 2020 from Rs. 300.5 crore as of March 31, 2018; however, as per provisional financials, the debt on the company's books as of March 31, 2022 increased to ~Rs. 240 crore, as a result of the ongoing capex programme and an increase in blockage of funds in the working capital requirements. The company's strong operating profitability metrics, coupled with moderate debt levels, have helped it report robust debt coverage indicators with an estimated total debt/OPBDITA of 1.0 times and NCA/total debt of ~74% in FY2022. The debt coverage indicators are expected to remain at healthy levels, going forward, aided by an expectation of strong cash accruals and consequent decline in debt levels.

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 tractor segments of the automotive industry. Together, these two segments constitute ~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.

Ongoing capacity expansion plans and foray into relatively new product categories – At present**,** the company is amid a capacity expansion programme, where the forging and machining capacities would increase to ~1,00,000 TPA and 60,000 TPA levels, respectively, by FY2023/FY2024 (total capex outlay of ~450-500 crore). The first phase of the project has been completed, and a new 8,000-MT press line was commercialised along with machining facilities in March 2022, while a 14,000-MT press line is being installed (along with machining facilities) in the second phase. The new press line will help the company cater to relatively new product categories, thereby leading to diversification of its revenue profile. While a predominant share of its capex is likely to be funded through internal accruals, 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 moderate utilisation of the working capital facilities (buffer of ~Rs. 60-70 crore) and expectation of strong cash accruals (~Rs. 170-200 crore per annum) over the next three years. The entity is expected to maintain sufficient liquidity to meet its modest debt repayments (~Rs. 7.6 crore in FY2023) and ongoing capex programme (~Rs. 100 crore in FY2023) for enhancing its forging and machining capabilities.

Rating sensitivities

Positive factors – ICRA could upgrade HFL's ratings if there is an uptick in volumes in the segments catered, which favourably impacts the company's accruals and helps it maintain healthy credit metrics amid its ongoing capex plans. Further, material revenue diversification with a sustained scale-up in supplies to the export market, which helps to offset any weakness in the domestic OEM supplies, would be favourably considered for an upgrade.

Negative factors – ICRA could downgrade HFL's ratings if a weakness in demand in the segments catered and a consequent inability to achieve healthy capacity utilisation post-capacity expansion, materially impacts the company's return and debt coverage indicators. A specific credit metric that could trigger a downgrade is debt/OPBDITA 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 in 1988. The company manufactures forged and machined transmission along with 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 74,000 MT (hammer and press forging combined) and a machining capacity of 45,500 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	FY2020	FY2021	9m FY2022*
Operating Income (Rs. crore)	558.8	585.0	649.0
PAT (Rs. crore)	79.9	86.4	102.0
OPBDIT/OI (%)	25.7%	27.1%	26.2%
PAT/OI (%)	14.3%	14.8%	
Total Outside Liabilities/Tangible Net Worth (times)	0.4	0.4	
Total Debt/OPBDIT (times)	0.8	1.0	
Interest Coverage (times)	5.7*	13.5	21.3

*Source: Company Annual Reports; ICRA Research; PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; *Provisional financials*

Status of non-cooperation with previous CRA: Not Applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2023)				Chronology of Rating History for the past 3 years				
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of March 31, 2022 (Rs. crore)	Date & Rating	Date & Rating in FY2022	Date & Rating in FY2021			Date & Rating in FY2020
					20-May-2022	-	26-Feb-2021	18-Aug-2020	11-May-2020	30-Oct-2019
1	Term Loans	Long Term	245.0	81.3	[ICRA]A+ (Positive)	-	[ICRA]A+ (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Positive)
2	Fund Based Limits	Long Term	185.0	-	[ICRA]A+ (Positive)	-	[ICRA]A+ (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Positive)
3	Unallocated Limits	Long Term/ Short Term	55.0	-	[ICRA]A+ (Positive)/ [ICRA]A1	-	[ICRA]A+ (Stable)/ [ICRA]A1	[ICRA]A (Stable)/ [ICRA]A1	[ICRA]A (Stable)/ [ICRA]A1	[ICRA]A (Positive)/ [ICRA]A1

Complexity level of the rated instruments

Instrument	Complexity Indicator

Term Loans	Simple
Fund Based Limits	Simple
Unallocated Limits	NA

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments, are available on ICRA’s 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	2021	-	2027	40.0	[ICRA]A+ (Positive)
NA	Term Loan 2	2018	-	2026	17.0	[ICRA]A+ (Positive)
NA	Term Loan 3	2018	-	2026	58.0	[ICRA]A+ (Positive)
NA	Term Loan 4	2018	-	2026	15.0	[ICRA]A+ (Positive)
NA	Term Loan 5	2021	-	2028	60.0	[ICRA]A+ (Positive)
NA	Term Loan 6	2021	-	2027	55.0	[ICRA]A+ (Positive)
NA	Fund Based Limits	NA	NA	NA	185.0	[ICRA]A+ (Positive)
NA	Unallocated Limits	NA	NA	NA	55.0	[ICRA]A+ (Positive)/ [ICRA]A1

Source: Company

Please click here to view details of lender-wise facilities rated by ICRA

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

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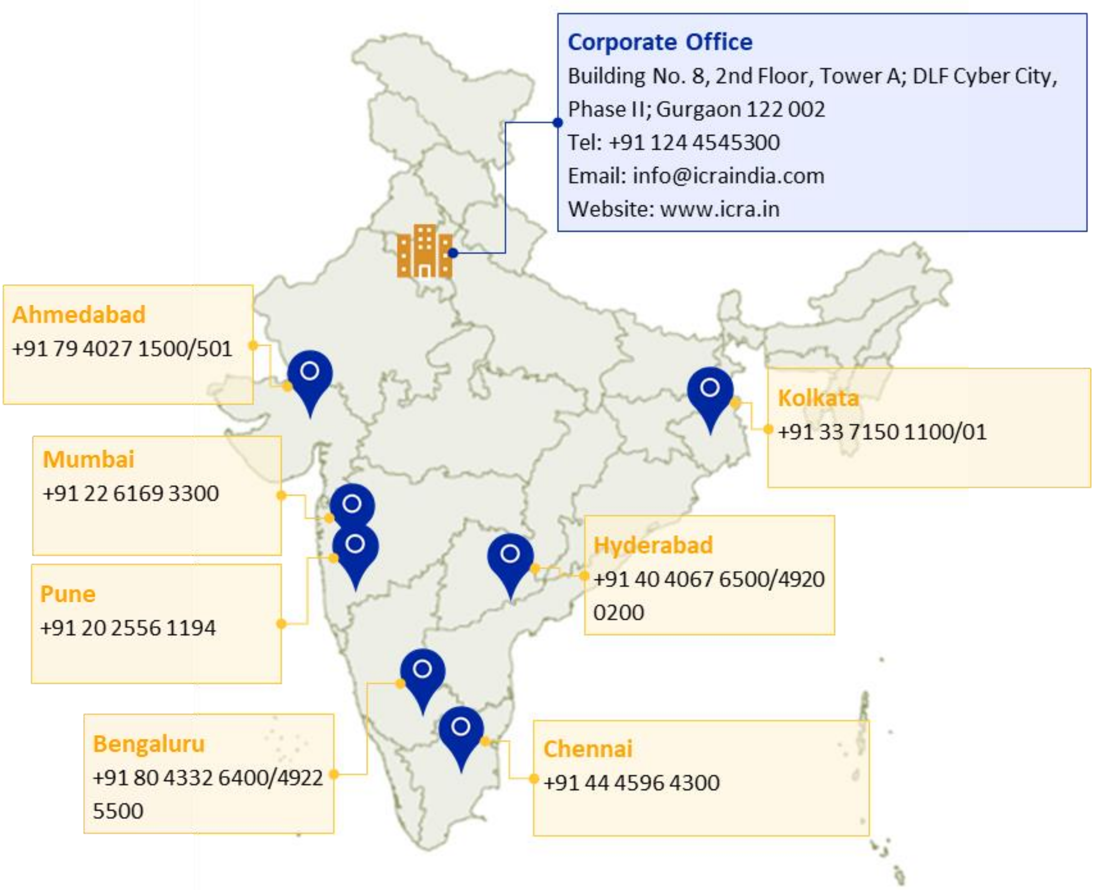

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