November 07, 2017

Happy Forgings Limited

Summary of rated instruments

Instrument*	Rated Amount (in crore)	Rating Action
Fund-based – Cash Credit	75.0	[ICRA]A- (Stable); Revised from [ICRA]BBB+ (Positive)
Fund-based – Term Loan	143.57	[ICRA]A- (Stable); Revised from [ICRA]BBB+ (Positive)
Non fund-based limits	31.44	[ICRA]A2+; Revised from [ICRA]A2
Unallocated limits	19.99	[ICRA]A- (Stable)/[ICRA]A2+; Revised from [ICRA]BBB+ (Positive)/[ICRA]A2
Total	**270.0**	

*Instrument details are provided in Annexure-1

Rating action

ICRA has revised the ratings for the Rs. 270.0-crore[1] fund-based limits, non-fund based limits, term loans and unallocated limits of Happy Forgings Limited (HFL) from [ICRA]BBB+ (pronounced ICRA triple B plus) and [ICRA]A2 (pronounced ICRA A two) to [ICRA]A- (pronounced ICRA A minus) and [ICRA]A2+ (pronounced ICRA A two plus). The outlook on the long-term rating has been revised from 'Positive' to 'Stable'.

Rationale

The revision in the ratings take into account consistent improvement in HFL's operating and financial performance, as reflected by improvement in its operating income (from Rs. 376 crore in FY2016 to Rs. 433 crore in FY2017 and further to Rs. 252 crore in H1 FY2018) and profitability (from 20.2% in FY2016 to 20.8% in FY2017 and further to 22.6% in H1 FY2018). These follow the increase in manufacturing capacities, improved utilization and increasing contribution to revenues from the relatively more profitable machining division in. The company has continued to grow business from its existing reputed client base such as Ashok Leyland Limited, VE Commercial Vehicles Limited, Mahindra & Mahindra Limited, etc as well as add new clients. The rating action also factors in the reduction in working capital intensity of operations primarily on the back of reduction in inventory levels. This, coupled with the improvement in profitability resulted in a strong cash flow position, which enabled lower dependence on working capital debt and continued prepayment of debt obligations during FY2017 and H1 FY2018, despite the capex. The debt coverage indicators also improved as reflected by interest coverage of 6.9 times, debt/OPBDITA of 1.65 times and NCA/Debt of 43% as on September 30, 2017 (provisional). The ratings continue to factor in HFL's experienced promoters, its established position in the forged and machined components industry and its long standing relations with the reputed original equipment manufacturers (OEMs) in the automobile industry.

[1] *100 lakh = 1 crore = 10 million*

The ratings, however, continued to be constrained by the susceptibility of HFL's revenue generation to the cyclicality in the commercial vehicles (CV) and tractor segments, as these segments contribute around 70% of the total sales of the company. Although the company has consistently made efforts to diversify its revenue streams by adding new customers, the customer concentration risks remain high as the top ten customers contribute more than 75% of its total revenues. The ratings also take into account the fragmented nature of the domestic forging industry, which adds to the competitive pressure, however, increasing proportion of machined components in HFL's operating income mitigates the risk to an extent. The company is undertaking a relatively large, debt-funded capex towards additional forging capacity, which is expected to result in an increase in debt levels. However, ICRA expects that HFL's cash flow position and capital structure would remain comfortable over the medium term, despite the proposed capex.

The company's ability to successfully commence the proposed capex in a timely manner and generate anticipated revenue growth while maintaining the profitability levels along with working capital intensity would be the key rating sensitivities.

Key rating drivers

Credit strengths

- **Experienced promoters with established track record of operations in the forging industry -** HFL is a Ludhiana-based manufacturer of forged and machined components which are largely supplied to commercial vehicles and tractors segment of the automotive industry. The promoters have more than 35 years of experience in the forging industry
- **Relations with Tier I component manufacturers and OEMs –** Over the years the company has established relationships with reputed tier 1 automotive ancillaries and original equipment manufacturers which have given repeat business to the company
- **Healthy market positioning on the back of consistent growth in manufacturing capacities** – HFL has increased its manufacturing capacities steadily which now stand at 46,000 TPA in the forged division, while in the machining division it is 20,500 TPA. Further the company is undertaking capex to increase its forging capacity further to 60,000 TPA
- **Consistent improvement in operating income and profitability -** With increase in sales volumes and increase in proportion of sales from the high value added machining segment, the operating income and profitability have witnessed consistent improvement. The operating income increased from Rs. 375.6 crore in FY2016 to Rs. 432.6 crore in FY2017 and to Rs. 252.1 crore in H1 FY2018, while the profitability improved from 20.2% to 20.8% and further to 22.6% over the same period
- **Improvement in capital structure and debt coverage indicators** – Improvement in profitability and working capital intensity of operations has lowered the reliance on external debt, which coupled with prepayment of long-term debt has resulted in improvement in capital structure as reflected by gearing of 1.24 times as on September 30, 2017 from 1.33 times as on March 31, 2017 and 2.12 times as on March 31, 2016. The coverage indicators have been consistently improving as reflected by interest coverage of 6.90 times, debt/OPBDITA of 1.65 times and NCA/Debt of 43% as on September 30, 2017
- **Decline in working capital intensity of operations –** There has been consistently improvement in working capital intensity of operations as reflected by NWC/OI of 22% as on September 30, 2017 vis-à-vis 26% as on March 31, 2017

Credit weaknesses

- **Exposed to the cyclicality in the commercial vehicles and tractors segment of the automotive industry –** More than 70% of the total sales of the company is derived from CV and tractors industry which are inherently cyclical
- **Client concentration risk -** The top 10 customers of the company contribute more than 75% of the total sales, although client profile remains reputed
- **Fragmented nature of the domestic forging industry** leading to intense competition; however, increasing proportion of machined products mitigate the risk to a large extent
- **Ongoing debt-funded capex** is expected to result in higher debt levels. The company is currently undertaking capex to the tune of Rs. 65 crore which is expected to get over by FY2018. Further capex plans cannot be ruled out going forward given the estimated cashflow generation of the company.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below.

Links to applicable criteria:
Corporate Credit Rating Methodology
Rating Methodology for Auto Component Manufacturers

About the company:
Happy Forgings Limited (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. HFL manufactures forged and machined transmission and engine components which are supplied mainly to the automotive sector. Its product range includes automotive crankshafts, steering knuckles, transmission gears, pinions, shafts, and forged/machined components for Indian Railways. The company has total forging capacity of 46,000 MT (both hammer and press forging) and machining capacity of 20,500 MT.

In H1 FY2018 (provisional), HFL reported a net profit after tax of Rs. 25.5 crore on an operating income of Rs. 252.1 crore, as compared to net profit of Rs. 34.2 crore on an operating income of Rs. 432.6 crore for FY2017 and net profit of Rs. 17.0 crore on an operating income of Rs. 375.6 crore for FY2016.

Key Financial Indicators

Rs. Crore	FY2016	FY2017
Operating Income (Rs. crore)	375.6	432.6
PAT (Rs. crore)	17.0	34.2
OPBDIT/ OI (%)	20.2%	20.8%
RoCE (%)	15.6%	20.9%
Total Debt/ TNW (times)	2.12	1.33
Total Debt/ OPBDIT (times)	2.70	1.87
Interest coverage (times)	2.64	4.51
NWC/ OI (%)	31%	26%

OI: Operating Income; PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; ROCE: PBIT/Avg (Total Debt + Tangible Net-Worth + Deferred Tax Liability - Capital Work - in Progress);
NWC: Net Working Capital

Status of non-cooperation with previous CRA:
Care Ratings has in its rationale published on Happy Forgings Limited, dated 10 April, 2017, stated the following:

"CARE has been seeking information from Happy Forgings Limited (HFL), to monitor the ratings vide e-mail communications/letters dated November 08, 2016; November 09, 2016; November 15, 2016; February 28, 2017; March 02, 2017; March 07, 2017 & March 09, 2017 and numerous phone calls. However, despite our repeated requests, the company has not provided the requisite information for monitoring the ratings. In line with the extant SEBI guidelines, CARE has reviewed the rating on the basis of the publicly available information which however, in CARE's opinion is not sufficient to arrive at a fair rating. The ratings on Happy Forgings Limited's bank facilities will now be denoted as CARE BB+/CARE A4+; ISSUER NOT COOPERATING."

Any other information: Not applicable

Rating history for last three years:
Table:

S. No.	Instrument	Current Rating (FY2018)				Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. Crore)	Date & Rating		Date & Rating in FY2017	Date & Rating in FY2016	Date & Rating in FY2015
				Nov 2017	May 2017	Aug 2016	-	-
1	Fund based limits	Long Term	75.00	[ICRA]A- (Stable)	[ICRA]BBB+ (Positive)	[ICRA]BBB (Stable)	-	-
2	Term loans	Long Term	143.57	[ICRA]A- (Stable)	[ICRA]BBB+ (Positive)	[ICRA]BBB (Stable)	-	-
3	Non fund based limits	Short Term	31.44	[ICRA]A2+	[ICRA]A2	[ICRA]A3+		
4	Unallocated limits	Long Term/ Short Term	19.99	[ICRA]A- (Stable)/ [ICRA]A2+	[ICRA]BBB+ (Positive)/ [ICRA]A2	[ICRA]BBB (Stable)/ [ICRA]A3+	-	-

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

Instrument	Date of Issuance / Sanction	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
Fund based limits	-	-	-	75.00	[ICRA]A- (Stable)
Term loans	FY2015-FY2017	-	FY2022-FY2024	143.57	[ICRA]A- (Stable)
Non fund based limits	-	-	-	31.44	[ICRA]A2+
Unallocated limits	-	-	-	19.99	[ICRA]A- (Stable)/ [ICRA]A2+

Source: Happy Forgings Limited

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit **www.icra.in**

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