# Happy Forgings Limited

**August 14, 2018**

## Summary of rated instruments

| Instrument* | Previous Rated Amount (Rs. crore) | Current Rated Amount (Rs. crore) | Rating Action |
|---|---|---|---|
| Fund-based -Term Loan | 143.57 | 171.0 | [ICRA]A (Stable); upgraded from [ICRA]A- (Stable) |
| Fund-based - Working Capital Facilities | 75.0 | 123.5 | [ICRA]A (Stable); upgraded from [ICRA]A- (Stable) |
| Non-fund Based - Working Capital Facilities | 31.44 | 0.5 | [ICRA]A1; upgraded from [ICRA]A2+ |
| Unallocated bank limits | 19.99 | 0.0 | - |
| **Total** | **270.0** | **295.0** | |

*Instrument details are provided in Annexure-1

## Rating action

ICRA has upgraded the long-term rating from [ICRA]A- (pronounced ICRA A minus) to [ICRA]A (pronounced ICRA A) and the short-term rating from [ICRA]A2+ (pronounced ICRA A two plus) to [ICRA]A1 (pronounced ICRA A one) for the Rs. 295.0-crore[1] (earlier Rs. 270.0 crore) bank lines of Happy Forgings Limited (HFL)[2]. The outlook on the long-term rating is Stable.

## Rationale

The ratings upgrade factors in the consistent improvement in HFL's operating income (from Rs. 433-crore in FY2017 to Rs. 550-crore in FY2018 provisional) following the increase in manufacturing capacities and improvement in capacity utilisation. Further, the operating profitability has also witnessed improvement (from 20.8% in FY2017 to 24.0% in FY2018 provisional) driven by the rise in contribution from the relatively more profitable machining division and heavy forged components. HFL continues to grow its business from the existing reputed clientele like Ashok Leyland Limited, VE Commercial Vehicles Limited, Mahindra & Mahindra Limited, Escorts Limited, etc, in addition to business from new clients. The ratings also consider the adequate liquidity position of the company, as reflected by the cushion in the working capital limits and healthy cash flow generation, which has enabled it to prepay some of its high cost debt. Although the debt levels have increased with the debt-funded capex, the coverage indicators continue to remain strong as reflected by an interest coverage of 6.01 times, debt/OPBDITA of 1.55 times and NCA/Debt of 42% as on March 31, 2018 (provisional). The ratings continue to factor in HFL's experienced promoters, its established position in the forged and machined components industry and its strong relations with the reputed original equipment manufacturers (OEMs) in the automobile industry.

The ratings, however, continue to be constrained by the susceptibility of HFL's revenue generation to the cyclicality in the commercial vehicles (CV) and tractor segments as these contribute more than 70% of the total sales of the company. Although the company has been making efforts to diversify its revenue streams by adding new customers, the customer-concentration risks remain high as the top-10 customers contribute more than 75% of its total revenue. The ratings also

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

[2] *For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications*

take into account the fragmented nature of the domestic forging industry, which adds to the competitive pressure. However, the increasing proportion of machined components in HFL's operating income (OI) 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 the debt levels. However, ICRA expects HFL's cash flow position and capital structure to 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 the anticipated revenue growth as well as maintain the profitability level, along with working capital intensity would be the key rating sensitivities.

## Outlook: Stable

ICRA believes that HFL would continue to register a strong growth with healthy margins, going forward, benefitting from capacity expansions, its healthy product portfolio and steady demand in the domestic commercial vehicles and tractors industry. The outlook may be revised to Positive if the company is able to achieve a meaningful diversification of the revenue base and the operating income growth remains healthy with sustainability of operating margins. The outlook may be revised to Negative if the proposed debt-funded capex adversely impacts the capital structure or if there is a significant reversal in the industry dynamics, leading to slowdown in sales growth.

## Key rating drivers

## Credit strengths

**Extensive experience of promoters in the forging industry -** HFL is a Ludhiana-based manufacturer of forged and machined components that are largely supplied to commercial vehicles and the tractors segment of the automotive industry. The promoters have more than 35 years of experience in the forging industry.

**Established relations with Tier-I component manufacturers and OEMs** - Over the years, HFL has established relations with reputed Tier-I automotive ancillaries like Graziano Transmission India Private Limited along with reputed OEMs like Ashok Leyland Limited, VE Commercial Vehicles Limited, Escorts Limited, etc, which ensures repeat business for the company.

**Healthy market positioning due to consistent growth in manufacturing capacities** - HFL has been consistently increasing its manufacturing capacities and the same currently stands at 60,000 TPA in the forging division and 23,500 TPA in the machining division, which makes HFL a recognisable player in the industry. Further, the company is planning a capex to further increase its capacities.

**Consistent improvement in operating income and profitability** - With a consistent increase in production volumes following the increase in capacities, the company's OI grew by 27% in FY2018. Moreover, with high proportion of sales from relatively profitable machining segment as well as heavy forged components, the profitability has witnessed improvement from 20.8% in FY2017 to 24.0% in FY2018 (provisional)

**Improvement in capital structure and debt-coverage indicators** – With strong accretion to reserves following consistently healthy profitability, the net worth has witnessed healthy growth and despite addition in debt post the debt-funded capex, the capital structure has witnessed improvement as reflected by a gearing of 1.16 times as on March 31, 2018 (provisional) vis-à-vis 1.33 times as on March 31, 2017.

**Adequate liquidity position** – The liquidity position of the company has witnessed improvement with the improvement in cash-flow generation which has aided the company in prepaying some of its high cost debt. Moreover, there is cushion of more than Rs. 20 crore in the working capital limits which provide a fillip to the liquidity position of the company.

## Credit challenges

**Exposure to cyclicality in commercial vehicles and tractors segment of the automobile industry** – HFL derives more than 70% of its sales from the commercial vehicles and tractors industry. Both these industries are inherently cyclical as the CV demand is affected by industrial and agricultural production and freight dynamics, while the tractor demand is dependent on monsoon and agricultural income.

**Client concentration risk -** The revenue contribution of the top 10 clients of the company is in excess of 70% which indicate concentration risks. However, the client profile is reputed with tier 1 auto ancillaries and OEMs, which mitigate the risk to a certain extent.

**Fragmented nature of the domestic forging industry -** The domestic forging industry is highly fragmented leading to intense competition. However, the increasing proportion of machined products and heavy forged products mitigates this risk to a large extent.

**Debt-funded capex to result in increase in debt levels** - The company is in process of completing a capex for enhancing the forging and machining capacities. Post this, another debt-funded capex for forging capacities is planned which will result in increase in debt levels. However, given the healthy cash-flow generation, the increase in debt is not likely to impact the coverage indicators.

**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

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 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. The company has a total forging capacity of 60,000 MT (both hammer and press forging) and a machining capacity of 23,500 MT.

In FY2018 (provisional), the company reported a net profit of Rs.50.6 crore on an OI of Rs. 549.6 crore compared with a net profit of Rs. 34.2 crore on an OI of Rs. 432.6 crore in the previous year.

## Key financial indicators (provisional)

| | FY2017 (Audited) | FY2018 (Provisional) |
|---|---|---|
| Operating Income (Rs. crore) | 432.6 | 549.6 |
| PAT (Rs. crore) | 34.2 | 50.6 |
| OPBDIT/OI (%) | 20.8% | 24.0% |
| RoCE (%) | 20.9% | 29.9% |
| | | |
| Total Debt/TNW (times) | 1.33 | 1.16 |
| Total Debt/OPBDIT (times) | 1.87 | 1.55 |
| Interest coverage (times) | 4.51 | 6.01 |

## Status of non-cooperation with previous CRA: Not applicable

## Any other information: None

## Rating history for last three years

| | | Current Rating (FY2019) | | | | Chronology of Rating History for the Past 3 Years | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | Date & Rating | Date & Rating in FY2018 | | Date & Rating in FY2017 | Date & Rating in FY2016 |
| | Instrument | Type | Amount Rated (Rs. crore) | Amount Outstanding (Mar 2018) (Rs. crore) | Aug 2018 | Nov 2017 | May 2017 | Aug 2016 | - |
| 1 | Term Loans | Long Term | 171.0 | 262.25 | [ICRA]A (Stable) | [ICRA]A- (Stable) | [ICRA]BBB+ (Positive) | [ICRA]BBB (Stable) | - |
| 2 | Fund Based Limits | Long Term | 123.5 | - | [ICRA]A (Stable) | [ICRA]A- (Stable) | [ICRA]BBB+ (Positive) | [ICRA]BBB (Stable) | |
| 3 | Non-fund Based Limits | Short Term | 0.5 | - | [ICRA]A1 | [ICRA]A2+ | [ICRA]A2 | [ICRA]A3+ | - |
| 4 | Unallocated Limits | Long/ Short Term | 0.0 | - | | [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

| ISIN No | Instrument Name | Date of Issuance / Sanction | Coupon Rate | Maturity Date | Amount Rated (Rs. crore) | Current Rating and Outlook |
|---|---|---|---|---|---|---|
| NA | Term Loan 1 | Sep-14 | 10.75% | Mar-22 | 22.94 | [ICRA]A (Stable) |
| NA | Term Loan 2 | Sep-15 | 10.75% | Mar-24 | 37.95 | [ICRA]A (Stable) |
| NA | Term Loan 3 | Sep-14 | 10.00% | Mar-22 | 11.01 | [ICRA]A (Stable) |
| NA | Term Loan 4 | Nov-17 | 8.60% | Mar-26 | 33.5 | [ICRA]A (Stable) |
| NA | Term Loan 5 | Nov-17 | 8.55% | Mar-26 | 33.5 | [ICRA]A (Stable) |
| NA | Term Loan 6 | Dec-17 | 8.60% | Jan-23 | 32.1 | [ICRA]A (Stable) |
| NA | Fund Based CC | NA | NA | NA | 123.5 | [ICRA]A (Stable) |
| NA | Non-fund Based Limits | NA | NA | NA | 0.5 | [ICRA]A1 |

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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