Happy Forgings Limited

February 28, 2019

Summary of rated instruments

Instrument*	Previous Rated Amount(Rs. crore)	Current Rated Amount(Rs. crore)	Rating Action
Term Loans	171.0	174.5	[ICRA]A reaffirmed; outlook revised from Stable to Positive
Fund-based – Working Capital Facilities	123.5	100.0	[ICRA]A reaffirmed; outlook revised from Stable to Positive
Non-fund Based – Working Capital Facilities	0.5	0.5	[ICRA]A1; reaffirmed
UnallocatedLimits	0.0	20.0	[ICRA]A/[ICRA]A1 reaffirmed; outlook revised from Stable to Positive
Total	**295.0**	**295.0**	

**Instrument details are provided in Annexure-1*

Rationale

The revision in outlook takes into the account an expected improvement in the financial risk profile of Happy Forgings Limited (HFL) following the infusion of Rs. 200.0 crore by a private equity player in the current fiscal. The funds infused, coupled with an expectation of strong operating performance and consequent cash accruals is likely to help in limiting its dependence on external debt to fund its substantial capital expenditure plans (~Rs. 350-400 crore over the next three years). This is likely to lead to an improvement in the company's return indicators and debt metrics over the medium term. HFL'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 would remain the key rating sensitivities.

The ratings assigned continue to favourably factor in HFL's established relations and strong share of business with reputed tier-I automotive ancillaries and reputed OEMs like Ashok Leyland Limited, VE Commercial Vehicles Limited, Escorts Limited, etc. It has consistently enhanced its manufacturing capacities over the years. With a consistent increase in production volume following the increase in capacities, the company has recorded a healthy growth in revenues over the past few years. Moreover, with high proportion of sales from the relatively profitable machining segment as well as heavy forged components, the operating profitability also improved to 24.9% in FY2018 from 20.8% in FY2017. The ratings also take into account the company's healthy financial risk profile and adequate liquidity position, as reflected by the cushion in the working capital limits and healthy cash flow generation.

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 ~70% of the company's total sales. Although it has been making efforts to diversify its revenue streams by adding new customers, the customer concentration remains moderately high. The ratings also take into account the fragmented nature of the domestic forging industry, which leads to stiff competition despite the increasing proportion of machined components in HFL's revenues mitigating the risk to an extent.

ICRA also takes note of the ongoing dispute between HFL and the State Bank of India, related to the right to recompense the relief extended to the company during the debt restructuring undertaken in 2013. Even as the outflow of funds related to the demand is not likely to significantly impact the credit profile of HFL, ICRA would continue to monitor the developments in this regard.

Outlook: Positive

ICRA believes that HFL's return indicators and debt metrics would improve over the medium term, aided by steady cash accruals and funds infused by the private equity player. HFL is expected to 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 ratings may be revised upwards 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 Stable if there is a delay in completion of the proposed capex programme or if there is a significant reversal in the industry dynamics, leading to pressure on its capacity utilisation and profitability metrics.

Key rating drivers

Credit strengths

Established relations 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 CVs and the tractors segment of the automotive industry. The promoters have more than 35 years of experience in the forging industry. It enjoys established relations and a strong share of business 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 provides revenue visibility for the company.

Strong revenue growth; consistent improvement in operating profitability - HFL has been consistently increasing its manufacturing capacities over the years and the same at present stands at 60,000 TPA in the forging division and 32,500 TPA in the machining division, making HFL a recognisable player in the industry. With a consistent increase in production volume following the increase in capacities, it recorded a healthy growth in revenues over the past few years. Moreover, with high proportion of sales from the relatively profitable machining segment as well as heavy forged components, its operating profitability witnessed an improvement to 24.9% in FY2018 from 20.8% in FY2017.

Infusion of funds by a private equity player has strengthened its financial risk profile - MOPE Investment Advisors Private Limited invested Rs. 200.0 crore in HFL in the current fiscal, acquiring a stake of 11.76% in the process. HFL plans to utilise the funds infused to fund its medium-term growth plans, wherein the company is undertaking a sizeable capex of around ~Rs. 350-400 crore for enhancing its forging and machining capacities (over the next three years). In the interim, aided by strong cash accruals, some of the proceeds from the equity infusion would be utilised to reduce its debt obligations over the next two years. The reduction in debt, coupled with an expectation of strong operating performance is likely to result in an improvement in HFL's credit metrics, with an expected total debt/OPBDITA of 1.4-1.6 times by FY2021.

Credit challenges

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

Moderate customer concentration risk - The revenue contribution from the company's top 10 clients remains at ~70%, which indicates moderate concentration risk. ICRA notes that HFL's client profile remains reputed with tier-1 auto ancillaries and OEMs, which mitigate the risk to a certain extent. Its efforts to attain business from various new customers over the medium term are likely to help in reducing the customer concentration going forward.

Substantial capacity expansion plans - The company has plans to incur capex of ~Rs. 350-400 crore over the next three years for enhancing its forging and machining capacities. Even though a predominant share of the capex is likely to be funded through the internal accruals and the funds received from private equity infusion, timely completion of the capex programme and HFL's ability to achieve healthy capacity utilisation levels for the enhanced capacity would remain a rating sensitivity.

Liquidity position

The company's liquidity position remains comfortable, aided by the proceeds received from the private equity infusions. The liquidity profile remained supported by a consistent improvement in cash flow generation, which aided HFL in prepaying some of its high-cost debt. It has generally maintained a cushion of more than Rs. 30-40 crore in the working capital limits (expected to increase in the short to medium term on the back of private equity fund infusion), which further provides comfort.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Auto Component Manufacturers
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. 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 32,500 MT. The current day to day operations of the entity are overseen by Mr. Ashish Garg (Managing Director, son of Mr. Paritosh K. Garg), who has been instrumental in enhancing HFL's share of business with various OEMs. MOPE Investment Advisors Private Limited invested Rs. 200.0 crore in HFL in FY2019, acquiring a stake of 11.76% in the process.

Key financial indicators (Audited)

	FY2017	FY2018
Operating Income (Rs. crore)	435.6	550.5
PAT (Rs. crore)	29.4	58.3
OPBDIT/OI (%)	21.3%	24.9%
RoCE (%)	21.5%	29.8%
Total Debt/TNW (times)	1.5	1.6
Total Debt/OPBDIT (times)	2.0	2.2
Interest Coverage (times)	4.0	6.3

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

	Instrument	Type	Current Rating (FY2019) Amount Rated (Rs. crore)	Amount Outstanding (Mar 2018) (Rs. crore)	Date & Rating Feb 2019	Date & Rating Aug 2018	Chronology of Rating History for the Past 3 Years: Date & Rating in FY2018 Nov 2017	Date & Rating in FY2018 May 2017	Date & Rating in FY2017 Aug 2016	Date & Rating in FY2016 -
1	Term Loans	Long Term	174.5	174.5	[ICRA]A (Positive)	[ICRA]A (Stable)	[ICRA]A- (Stable)	[ICRA]BBB+ (Positive)	[ICRA]BBB (Stable)	-
2	Fund-based – Working Capital Facilities	Long Term	100.0	-	[ICRA]A (Positive)	[ICRA]A (Stable)	[ICRA]A- (Stable)	[ICRA]BBB+ (Positive)	[ICRA]BBB (Stable)	
3	Non-fund Based – Working Capital Facilities	Short Term	0.5	-	[ICRA]A1	[ICRA]A1	[ICRA]A2+	[ICRA]A2	[ICRA]A3+	-
4	Unallocated Limits	Long/ Short Term	20.0	-	[ICRA]A (Positive)/ [ICRA]A1	-	[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-13	-	Mar-22	38.6	[ICRA]A (Positive)
NA	Term Loan 2	Sep-16	-	Mar-24	29.4	[ICRA]A (Positive)
NA	Term Loan 3	Sep-13	-	Mar-22	33.5	[ICRA]A (Positive)
NA	Term Loan 4	Nov-17	-	Mar-26	33.5	[ICRA]A (Positive)
NA	Term Loan 5	Nov-17	-	Mar-26	9.0	[ICRA]A (Positive)
NA	Term Loan 6	Feb-18	-	May-23	30.5	[ICRA]A (Positive)
NA	Fund Based Limits	NA	NA	NA	100.0	[ICRA]A (Positive)
NA	Non-fund Based Limits	NA	NA	NA	0.5	[ICRA]A1
NA	Unallocated Limits	NA	NA	NA	20.0	[ICRA]A (Positive)/[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.

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