October 30, 2019

Happy Forgings Limited: Rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term Loans	174.5	72.0	[ICRA]A (Positive) reaffirmed
Fund-based – Working Capital Facilities	100.0	140.0	[ICRA]A (Positive) reaffirmed
Non-fund Based – Working Capital Facilities	0.5	0.0	-
Unallocated Limits	20.0	83.0	[ICRA]A (Positive)/[ICRA]A1 reaffirmed
Total	**295.0**	**295.0**	

**Instrument details are provided in Annexure-1*

Rationale

The rating reaffirmation considers Happy Forgings Limited's (HFL) healthy operational performance, benefitting from its established relations and strong share of business with reputed tier-I automotive ancillaries and reputed original equipment manufacturers (OEM). Aided by an enhanced manufacturing capacity and forward integration into machining capabilities, HFL has recorded a strong growth in revenues over the past few years (CAGR of 22% over FY2015-FY2019). Moreover, with increasing proportion of sales from the relatively profitable machining segment as well as heavy forged components, the company's operating profitability improved to 27.7% in FY2019 from 18.7% in FY2015. Weakness in demand across the segments catered has led to a decline in its volumes and revenues by ~30% and ~20%, respectively, in H1 FY2020 and a recovery in demand in the segments catered is not likely over the near-term. However, HFL's established relationships and strong share of business with various customers, is likely to help it record a moderate revenue growth over the medium term.

The assigned ratings favourably factor in HFL's strong financial risk profile and adequate liquidity position. Aided by healthy accretion to reserves and prepayment of long-term debt post infusion of funds from a private equity player (Rs. 200.0 crore in FY2019), the company's capital structure witnessed a considerable improvement, with gearing reducing to 0.3 times as on March 31, 2019 from 1.6 times as on March 31, 2018. HFL's operating profitability metrics and reduction in debt levels helped in maintaining strong debt coverage indicators (Total Debt/OPBDITA of 0.8 times in FY2019). Its liquidity profile remains adequate, characterised by healthy cash flow from operations, presence of healthy cash and liquid investments (~Rs. 35.0 crore as of October 6, 2019) and low utilisation of working capital facilities.

However, the assigned ratings are constrained by the susceptibility of HFL's revenue generation to the cyclicality in the commercial vehicles (CV) and tractor segments, as these sectors contribute to ~75% of the company's revenues. Although it has been making efforts to diversify its business profile by adding new customers, the customer concentration remains moderately high (top 10 clients constitute ~75-80% of revenues).

The Positive outlook reflects ICRA's view that HFL's strong credit profile is likely to help it withstand the current demand slowdown in the automotive segments. Despite the ongoing slowdown, 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 (~Rs. 470 crore over the period FY2019-FY2022), thereby helping it maintain strong return indicators and debt metrics. The company remains well positioned to benefit from a recovery in demand in the automotive segments catered, which is likely to help in recording a healthy revenue growth over the medium term.

ICRA also takes note of the commercial 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 have material impact on HFL's credit profile, ICRA would continue to monitor the developments in this regard.

Key rating drivers

Credit strengths

Established relationships 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 over 35 years of experience in the forging industry. The company enjoys established relations and a strong share of business with reputed tier-I automotive ancillaries such as Graziano Transmission India Private Limited along with reputed OEMs like Ashok Leyland Limited, VE Commercial Vehicles Limited, Escorts Limited, etc, which provide revenue visibility.

Strong operating profitability and return indicators – Aided by a ramp up in capacity utilisation of the press lines and machining facilities, the company has recorded a significant improvement in performance over the past five years. With realisation being significantly higher for pressed and machined parts as opposed to hammer forged-based parts, HFL's operating margin has improved significantly to 27.7% in FY2019 from 17.5% in FY2014, with supplies for heavier components post the commercialisation of 8,000T press line also aiding its profitability. Improving operating margins, coupled with healthy asset sweating has aided the company in reporting improved return metrics, with RoCE improving to 34.2% in FY2019 from 10.9% in FY2014. Even with a moderation in demand in the current fiscal and consequent decline in capacity utilisation likely leading to deterioration in profitability and return indicators, it is expected to remain at healthy levels, benefitting from an increasing proportion of higher value-added products (expected to range between 16-20% over the next three to four years).

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. Aided by healthy accretion to reserves and prepayment of long-term debt post infusion of funds from the PE player, the company's capital structure witnessed a considerable improvement in FY2019, with the gearing reducing to 0.3 times as on March 31, 2019 from 1.6 times as on March 31, 2018. The total debt on its books declined to ~Rs. 156.1 crore as on March 31, 2019 from Rs. 300.5 crore as on March 31, 2018. Its operating profitability metrics, coupled with reduced debt levels have helped in maintaining robust debt coverage indicators, with a Total Debt/OPBDITA of 0.8 times, interest coverage of 9.1 times and NCA/Total Debt of 86% in FY2019.

Credit challenges

Key segments catered - Agri-machinery and commercial vehicles, remain exposed to cyclicality – HFL is primarily a supplier of forged and machined components to the CVs and the tractors segment of the automotive industry with the two segments together constituting ~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. Even as the management has focused 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.

Moderate customer concentration risk – The revenue contribution from the company's top 10 clients remains at ~75-80%, resulting in moderate concentration risk. The risk is mitigated to an extent by the strong relationships and share of business enjoyed by HFL in supplies to its customers. Additionally, over the years, the company has strived to de-risk its business to an extent by adding new customers and enhancing products supplied (contents/vehicle) to existing customers, thereby trying to make HFL more entrenched in their supplier network.

Substantial capacity expansion plans and foray into relatively new product categories – The company is, at present, in the midst of a capacity expansion programme, wherein the forging and machining capacities would increase to levels of ~1,00,000 TPA and 50,000 TPA, respectively, by FY2022 (at a total capex outlay of ~Rs. 470 crore). The capex would be completed in two phases. In the first phase, a new 8,000 MT press line would be installed (along with machining facilities), while a 14,000 MT press line would be installed (along with machining facilities) in the second phase, which would help to cater to relatively new product categories. 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 key rating sensitivity.

Liquidity position: Adequate

The liquidity position remains **adequate**, supported by sizeable cash balances (Rs. 35 crore as of October 2019), low utilisation of working capital facilities (as on October 6, 2019, the utilisation remained low at levels of ~11-12%, providing a buffer of ~Rs. 95 crore).and expectation of strong cash accruals (~Rs. 105-140 crore per annum) over the next three years.

Rating sensitivities

Positive triggers – An upgrade could be triggered if there is a sustainable recovery in volumes in the segments catered, which favourably impacts HFL's accruals and helps the company maintain healthy credit metrics in the context of its substantial capex plans. Further, material revenue diversification by ways of a sustained scale up in supplies to the export market, which helps to offset the weakness in domestic OEM supplies, would be favourably considered for rating upgrade.

Negative triggers – The ratings could be downgraded if there is a sharp volume contraction in the segments catered over the near-to-medium term, which leads to a deterioration in the company's capacity utilisation levels and significantly impacts profitability and return metrics. Specific credit metrics that could result in a downgrade would include 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 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. The company 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. It has a total forging capacity of 60,000 MT (hammer and press forging combined) and a machining capacity of 34,500 MT. The current day-to-day operations of the entity are overseen by Mr. Ashish Garg (Managing Director), son of Mr. Paritosh Kumar Garg. MOPE Investment Advisors Private Limited, 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

	FY2018	FY2019
Operating Income (Rs. crore)	550.5	750.3
PAT (Rs. crore)	58.3	95.4
OPBDIT/OI (%)	24.9%	27.7%
RoCE (%)	29.8%	34.2%
Total Outside Liabilities/Tangible Net Worth (times)	2.1	0.5
Total Debt/OPBDIT (times)	2.2	0.8
Interest Coverage (times)	6.3	9.1
DSCR	3.7	5.1

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

	Instrument	Current Rating (FY2020)				Chronology of Rating History for the Past 3 Years				
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating	Date & Rating in FY2019		Date & Rating in FY2018		Date & Rating in FY2017
					30-Oct-2019	28-Feb-2019	14-Aug-2018	07-Nov-2017	31-May-2017	17-Aug-2016
1	Term Loans	Long Term	72.0	72.0	[ICRA]A (Positive)	[ICRA]A (Positive)	[ICRA]A (Stable)	[ICRA]A- (Stable)	[ICRA]BBB+ (Positive)	[ICRA]BBB (Stable)
2	Fund-based – Working Capital Facilities	Long Term	140.0	-	[ICRA]A (Positive)	[ICRA]A (Positive)	[ICRA]A (Stable)	[ICRA]A- (Stable)	[ICRA]BBB+ (Positive)	[ICRA]BBB (Stable)
3	Non-fund Based – Working Capital Facilities	Short Term	0.0	-	-	[ICRA]A1	[ICRA]A1	[ICRA]A2+	[ICRA]A2	[ICRA]A3+
4	Unallocated Limits	Long/ Short Term	83.0	-	[ICRA]A (Positive)/ [ICRA]A1	[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	6.0	[ICRA]A (Positive)
NA	Term Loan 2	Nov-17	-	Mar-26	20.0	[ICRA]A (Positive)
NA	Term Loan 3	Nov-17	-	Mar-26	20.0	[ICRA]A (Positive)
NA	Term Loan 4	Feb-18	-	Jan-23	26.0	[ICRA]A (Positive)
NA	Fund Based Limits	NA	NA	NA	140.0	[ICRA]A (Positive)
NA	Unallocated Limits	NA	NA	NA	83.0	[ICRA]A (Positive)/[ICRA]A1

Source: Happy Forgings Limited

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

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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.

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