January 09, 2020

Hindustan Aeronautics Limited: [ICRA]AA(Stable)/[ICRA]A1+ assigned

Summary of rating action

Instrument*	Current Rated Amount (Rs. crore)	Rating Action
Fund Based – Working Capital Facilities	5250.00	[ICRA]AA(Stable); Assigned
Non-fund Based – Working Capital Facilities	2050.00	[ICRA]A1+; Assigned
Commercial Paper	1000.00	[ICRA]A1+; Assigned
Total	**8,300.00**	

**Instrument details are provided in Annexure-1*

Rationale

The assigned rating draws comfort from the majority ownership held by the Government of India (GOI) in Hindustan Aeronautics Limited (HAL, the company) as well as HAL's strategic position as a dominant supplier of aircrafts, helicopters, engines, avionics and accessories as well as main provider of maintenance, repair and overhaul services to the Indian defence forces. The assigned rating also considers the strong order pipeline as reflected by the unexecuted order book of Rs 58,588 crore as on March 31, 2019. The company faces limited competition from the private sector due to the high capital intensity and long gestation periods for developing manufacturing capabilities in the sector. While competition from the private sector is likely to intensify in the long-term, HAL's long-standing relationship with the Indian defence forces and the DRDO, established manufacturing facilities, and manpower base will continue to be strong mitigating factors. The GoI's increased focus on indigenisation with the Make in India policy and the establishment of defence corridors and mandatory offset policy for defence procurement by GoI, augur well for the company's future growth. HAL's financial profile is supported by its diversified revenue mix covering sale of products, spares and services for multiple aircraft programmes, as well as the healthy profitability arising from the cost-plus nature of majority of contracts. Due to its large scale and consistently improving operating profitability, the debt coverage metrics remain strong, notwithstanding the recent increase in short term borrowings.

The ratings are, however, constrained by HAL's high dependence on contracts received from Ministry of Defence (MoD), which contributes to more than 90% of the revenues and the reduced release of funds in contracts derived from MoD during FY2019. The delay has led to build-up of receivables, which increased from Rs 6,752 crore as on March 31, 2018 to Rs 14,028 crore as on March 31, 2019. As a result, the company's reliance on working capital borrowings has increased from Rs 764 crore as on March 31, 2018 to Rs 4,058 crore as on March 31, 2019, accompanied with reduction in cash and liquid investments from Rs 6,546 crore as on March 31, 2018 to Rs 140 crore as on March 31, 2019. Significant quantum of buy-back of shares and distribution of dividends in the past have also contributed to the reduction in cash and bank balances of the company. Notwithstanding the reduction in debt following part-release of funds during H1FY2020, receivables have reduced to only Rs 10,573 crore as on September 30, 2019, with corresponding working capital borrowings of Rs 1,425 crore. In case of any further delay in release of due payments in the second half of FY2020, the company would require enhancement in its working capital borrowing limit beyond Rs 5,250 crore, which is the current limit approved by its board. ICRA notes that the timely realization of receivables and improvement in liquidity will be a key rating sensitivity. Due to the high dependence on contracts derived from MoD, any reduction in availability of funds or change in prioritisation in the defence budget can have an adverse impact on the growth potential, sales momentum and liquidity of the company. The company also has significant contingent liabilities, primarily relating to sales tax demands from various states, aggregating to Rs 10,572 crore as on March 2019; nonetheless, it is expected that any outflows pertaining to the sales tax demands would be reimbursed by HAL's customers thereby negating any impact on HAL's profitability.

The Stable outlook on the [ICRA]AA rating reflects ICRA's opinion that HAL will continue to benefit from its strategic importance to the Indian defence forces and long track record of operations, as well as the majority ownership by Government of India.

Key rating drivers and their description

Credit strengths

Majority ownership held by GoI; strategically important to the Indian defence forces – The GoI is HAL's majority shareholder, holding a 89.97% stake at present. It is a defence PSU which was conferred Navaratna status in 2007. The company is of strategic importance to the Indian defence forces comprising of the Indian Army, Indian Airforce, Indian Navy and Indian Coast Guard, on account of it being the sole domestic supplier of aircrafts, helicopters, engines, avionics and other accessories. It occupies a leadership position in the Indian aerospace and defence industry. The company is also engaged in providing maintenance, repair and overhaul (MRO) services for aircrafts and helicopters for its products as well as those which are directly purchased by the MoD from foreign OEMs.

Long track record and significant entry barriers - Over the years, HAL has showcased its research, design and development capabilities with the successful development of military aircraft and helicopters such as the Ajeet, Marut, HPT-32, Kiran and Advanced Light Helicopter. The company also manufactures aircrafts under license such as the MiG-21, MiG-27, Avro, Jaguar, Dornier 228, Su-30 MKI and Hawk Mk 132 and helicopters such as the Cheetah and Chetak. In addition, the company also provides MRO services for these indigenous and license manufactured aircraft and helicopters, as well as for aircraft and helicopters procured directly by the Indian defence services. The company faces limited competition from the private sector due to the high capital intensity and long gestation periods for developing manufacturing capabilities in the sector. While competition from the private sector is likely to intensify in the long-term, HAL's long-standing relationship with the Indian defence forces and the DRDO, established manufacturing facilities, and manpower base will continue to be strong mitigating factors.

Strong order book and healthy profitability – The company has a strong order pipeline as reflected by the unexecuted order book of Rs 58,588 crore as on March 31, 2019. The company faces limited competition from the private sector due to the high capital intensity and long gestation periods for developing manufacturing capabilities in the sector. HAL's financial profile is supported by its diversified revenue mix covering sale of products, spares and services for multiple aircraft programmes, as well as the healthy profitability arising from the cost-plus nature of majority of contracts. Due to its large scale and consistently improving operating profitability, the debt coverage metrics remain strong, notwithstanding the recent increase in short term borrowings.

Credit challenges

High dependence on contracts from MoD – More than 90% of the revenue of the company is derived from sales to the Indian defence forces. These contracts depend on the budgetary support extended to MoD, which in turn allocates the amounts to the various Indian defence Forces. Any reduction in availability of funds or change in prioristisation of the defence budget can have an adverse impact on the growth potential, sales momentum and liquidity of the company. Over the past years, the amount of defence allocation towards modernisation of aircrafts and aero-engines has not seen much growth.

Delay in payments from customers leading to increase in leverage levels– There have been delays in receiving payments from HAL's customers during FY2019. This has resulted in a build-up of receivables from Rs 6,752 crore as on March 31, 2018 to Rs 14,028 crore as on March 31, 2019, respectively. There has also been a decline in advances received from customers during this period.

As a result, there has been an increase in the working capital borrowings of the company from Rs 764 crore as on March 31, 2018 to Rs 4,058 crore as on March 31, 2019, accompanied with reduction in cash and liquid investments from Rs 6,546 crore as on March 31, 2018 to Rs 140 crore as on March 31, 2019. Significant quantum of buy-back of shares and distribution of dividends in the past have also contributed to the reduction in cash and bank balances of the company. Notwithstanding the reduction in debt following part-release of funds during H1FY2020, receivables have reduced to only Rs 10,573 crore as on September 30, 2019, with corresponding working capital borrowings of Rs 1,425 crore. In case of any further delay in release of due payments in the second half of FY2020, the company would require enhancement in its working capital borrowing limit beyond Rs 5,250 crore, which is the current limit approved by its board. ICRA notes that the timely realization of receivables and improvement in liquidity will be a key rating sensitivity.

Liquidity position: Adequate

The company's liquidity position is adequate, backed by availability of sanctioned fund based working capital limits which are in the process of being enhanced. The company has been facing delays in receipt of payments from MoD. With partial release of payments during H1FY2020, the utilization has reduced to around 36% of the sanctioned limit as on September 2019. Timely release of additional payments during the second half of the year will be critical for the company's liquidity profile. Nonetheless, ICRA expects that owing to its strong parentage and healthy accruals, HAL would be able to access additional bank credit, if required.

Rating sensitivities

Positive triggers – Healthy revenue growth and sustained growth in order book accompanied by reduction in receivables leading to sustained improvement in leverage to less than Total Debt/ OPBITDA to 0.5 times.

Negative triggers – Further delays in receiving payments from customers leading to increase in leverage levels (Debt / OPBITDA higher than 1.5 times on sustained basis) or significant weakening of profitability or accruals due to reduction in order inflows and execution.

Analytical approach

Analytical Approach	**Comments**
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	Parent/Group Company: Government of India (GoI) The assigned rating factors in the strategic importance that HAL holds for the GoI, which we expect should induce it to extend timely financial support to the rated entity, should there be a need.
Consolidation/Standalone	The ratings are based on the consolidated financial statements of the issuer.

About the company

HAL, a defence public sector undertaking (DPSU), was established on October 1st, 1964 when Hindustan Aircraft Limited and Aeronautics India Limited were amalgamated. The principal business of HAL is to undertake design, development, manufacturing, maintenance, repair and overhaul of aircrafts, helicopters, engines and other related systems like avionics, instruments and accessories. It also engages with the Indian Space Research Organisation (ISRO) to contribute to the space programmes of the country. The GoI remains HAL's largest shareholder current shareholding of 89.97%. HAL was conferred with the Navratna PSU status in June 2007. HAL's primary consumers are the Indian Defence Forces comprising of the Indian Air Force, Indian Army, Indian Navy along with the Indian Coast Guard. The company has four production complexes- Bangalore complex, MiG complex (located in Nasik and Koraput), Helicopter complex (located in Bangalore and Barrackpore) and Accessories Complex (located in Kanpur, Lucknow, Kyderabad, Kasargod and Korwa); along with a Design complex (R&D centres jointly located with the related manufacturing divisions.

Key financial indicators (audited)

	FY2018	FY2019
Operating Income (Rs. crore)	18,318	19,761
PAT (Rs. crore)	1,976	2,264
OPBDIT/OI (%)	18.3%	23.3%
RoCE (%)	25.9%	28.9%
Total Outside Liabilities/Tangible Net Worth (times)	4.0	3.6
Total Debt/OPBDIT (times)	0.4	1.0
Interest Coverage (times)	96.7	25.9
DSCR	28.1	15.9

Status of non-cooperation with previous CRA: CRISIL in its rationale published on February 1, 2019 had reviewed the ratings of HAL and revised the long-term rating to CRISIL AAA/Stable (ISSUER NOT COOPERATING) and short-term rating to CRISIL A+ (ISSUER NOT COOPERATING). Subsequently, at the company's request and on receipt of no-objection certificate(s) from the bankers, CRISIL withdrew the ratings after revising the long-term rating to CRISIL AA-/Negative (ISSUER NOT COOPERATING) and short-term rating to CRISIL A1+ (ISSUER NOT COOPERATING).

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2020)				Rating History for the Past 3 Years		
		Type	Amount Rated	Amount Outstanding	Rating	FY2019	FY2018	FY2017
					09-Jan-20	-	-	-
1	Cash Credit	Long Term	5,250	-	[ICRA]AA (Stable)	-	-	-
2	Letter of Credit & Bank Guarantee	Short Term	2,050	-	[ICRA]A1+	-	-	-
3	Proposed Commercial Paper Programme	Short Term	1,000	-	[ICRA]A1+	-	-	-

Amount in Rs. crore

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	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Cash Credit	NA	NA	NA	5,250.00	[ICRA]AA(Stable)
NA	Letter of Credit & Bank Guarantee	NA	NA	-	2,050.00	[ICRA]A1+
NA	Proposed Commercial Paper Programme	NA	NA	7-365 days	1,000.00	[ICRA]A1+

Source: Hindustan Aeronautics Limited

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Naini Aerospace Limited	100.00%	Full Consolidation
Indo Russian Helicopters Limited	50.5%	Proportionate Consolidation
BAeHAL Software Ltd.	49.0%	Equity Method
Indo Russian Aviation Ltd.	48.0%	Equity Method
Safran HAL Aircraft Engines Pvt. Ltd.	50.0%	Equity Method
Samtel HAL Display System Ltd.	40.0%	Equity Method
HAL-Edgewood Technologies Pvt. Ltd.	50.0%	Equity Method
HALBIT Avionics Pvt. Ltd.	50.0%	Equity Method
Infotech HAL Ltd.	50.0%	Equity Method
HATSOFF Helicopter Training Pvt. Ltd.	50.0%	Equity Method
TATA-HAL Technologies Ltd	50.0%	Equity Method
International Aerospace Manufacturing Pvt. Ltd.	50.0%	Equity Method
Multi-Role Transport Aircraft Ltd.	50.0%	Equity Method
Aerospace & Aviation Sector Skill Council (AASSC)	50.0%	Equity Method
Helicopter Engines MRO Private Ltd.	50.0%	Equity Method
Defence Innovation Organisation*	50.0%	Equity Method

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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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