August 18, 2020

Happy Forgings Limited: Update

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term Loans	62.38	62.38	[ICRA]A (Stable); Outstanding
Fund-based – Working Capital Facilities	147.00	147.00	[ICRA]A (Stable); Outstanding
Unallocated Limits	85.62	85.62	[ICRA]A (Stable)/[ICRA]A1; Outstanding
Total	**295.00**	**295.00**	

**Instrument details are provided in Annexure-1*

Background

ICRA has previously noted the commercial dispute between Happy Forgings Limited (HFL) and the State Bank of India (SBI), related to the right to recompense as part of the relief extended to the company during the debt restructuring undertaken in 2013. SBI had raised a demand in October 2018 for payment of 'Right to Recompense' (RoR) related to HFL's debt restructuring in 2013. However, HFL's management has maintained that the clause for RoR in the joint documents executed with the lead banker, State Bank of Bikaner and Jaipur (later merged with SBI), was not incorporated and, hence, no amount was payable by the company. Subsequently, the company had filed a case with the Punjab and Haryana High Court against SBI in relation to the demand for RoR and pre-payment penalty raised by the bank. In February 2020, the honourable High Court had dismissed the petition, following which the company had raised a review petition in March 2020. Since the functioning of the court has remained impacted by the Covid-19 pandemic, no hearing date has yet been fixed for the review petition.

Update

The management has indicated that on May 13, 2020, SBI had debited the company's account for the disputed amount (RoR), and the same continues to be outstanding as on date.

ICRA continues to treat the above as a commercial dispute and would accordingly continue to monitor any further developments in this regard. ICRA draws comfort from the fact that the outflow of funds related to the demand is not likely to have any material impact on HFL's credit profile, with the company continuing to maintain adequate liquidity in the form of ~Rs. 50 crore of fixed deposits as on July 31, 2020, besides adequate buffer in working capital limits.

Key rating drivers and their description

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 CV and the tractors segments of the automotive industry. The promoters have over 35 years of experience in the forging industry. The company enjoys established relationships and a strong share of business with reputed tier-I automotive ancillaries such as Graziano Transmission India Private Limited, along with reputed OEMs such as 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, HFL's operating margin improved significantly to 27.7% in FY2019 from 17.5% in FY2014, with supplies for heavier components post the commercialisation of 8,000-MT press line aiding its profitability. Improving operating margins, coupled with healthy asset sweating has aided the company in reporting enhanced return metrics, with RoCE improving to 34.2% in FY2019 from 10.9% in FY2014. Despite moderation in demand in FY2020, and consequent decline in capacity utilisation leading to deterioration in profitability margin, it is expected to have remained at healthy levels, benefitting from an increasing proportion of higher value-added products. HFL recorded an operating margin of ~25.6% in 9M FY2020 (provisional financials). A lower capacity utilisation, coupled with investments towards setting up new press lines (8,000 MT and 14,000 MT), are likely to lead to a moderation in RoCE, over the next two years. The extent of moderation would remain contingent on the tenure of the ongoing lockdown and the overall impact of the same on demand in the segments catered.

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 the company's books declined to ~Rs. 156.1 crore as on March 31, 2019 from Rs. 300.5 crore as on March 31, 2018. As per provisional financials, the same further declined to ~Rs. 112.6 crore as on February 29, 2020. Its operating profitability metrics, coupled with reduced debt levels, resulted in 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. Despite witnessing a moderation in demand in FY2020 and the impact of the same on the company's profitability, the debt coverage indicators are expected to remain healthy.

Credit challenges

Agri-machinery and CV segments vulnerable to cyclicality; weak demand outlook due to poor macro environment and Covid-19 pandemic impact – HFL is primarily a supplier of forged and machined components to the CVs and the tractor segments of the automotive industry. Together, these two sectors constitute ~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. Despite the management's focus 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. A recovery in demand in the one of the key segments catered (CV) is not likely over the short term due to the ongoing lockdown and the uncertainty regarding the tenure of the same. However, HFL's established relationships and strong share of business with various customers provides comfort.

Moderate customer concentration risk – The revenue contribution from the top 10 clients remains at ~75-80%, resulting in moderate concentration risk. The risk is mitigated to an extent by its strong relationships with the clients and the share of business enjoyed by HFL. Additionally, over the years, the company has strived to de-risk its business considerably by adding new customers and enhancing the products supplied (contents/vehicle) to the existing customers, thereby trying to make HFL more entrenched in the 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. The capex would be completed in two phases. In the first phase, a new 8,000-MT press line is being 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. While a predominant share of its capex is likely to be funded through the internal accruals and the funds received from private equity infusion, timely completion of the same 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. 50 crore as of July 31, 2020) and low utilisation of working capital facilities (buffer of ~Rs. 80-90 crore). Even as lockdowns undertaken to contain the Covid-19 pandemic has impacted short-term cash flows, HFL continues to have sufficient liquidity to meet its fixed overheads and debt repayments. It may revise/defer its ongoing capex programme to an extent (~Rs. 230-240 crore over FY2021-FY2022) for enhancing the forging and machining capabilities, contingent upon the demand prospects in the industry.

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 – A rating downgrade could be triggered if weakness in demand in segment catered, on account of the Covid-19 pandemic is more prolonged than currently expected, consequently impacting the company's debt coverage indicators. 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. Its day-to-day operations 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

		Current Rating (FY2021)						Chronology of Rating History for the Past 3 Years			
					Date & Rating		Date & Rating in FY2020	Date & Rating in FY2019		Date & Rating in FY2018	
	Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	18-Aug-2020	11-May-2020	30-Oct-2019	28-Feb-2019	14-Aug-2018	07-Nov-2017	31-May-2017
1	Term Loans	Long Term	62.38	34.0	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Positive)	[ICRA]A (Positive)	[ICRA]A (Stable)	[ICRA]A- (Stable)	[ICRA]BBB + (Positive)
2	Fund-based – Working Capital Facilities	Long Term	147.00	-	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Positive)	[ICRA]A (Positive)	[ICRA]A (Stable)	[ICRA]A- (Stable)	[ICRA]BBB + (Positive)
3	Non-fund Based – Working Capital Facilities	Short Term	0.0	-	-	-	-	[ICRA]A1	[ICRA]A1	[ICRA]A2+	[ICRA]A2
4	Unallocated Limits	Long / Short Term	85.62	-	[ICRA]A (Stable)/ [ICRA]A1	[ICRA]A (Stable)/ [ICRA]A1	[ICRA]A (Positive)/ [ICRA]A1	[ICRA]A (Positive)/ [ICRA]A1	-	[ICRA]A- (Stable)/ [ICRA]A2+	[ICRA]BBB + (Positive)/ [ICRA]A2

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	3.83	[ICRA]A (Stable)
NA	Term Loan 2	Nov-17	-	Mar-26	16.95	[ICRA]A (Stable)
NA	Term Loan 3	Nov-17	-	Mar-26	18.80	[ICRA]A (Stable)
NA	Term Loan 4	Feb-18	-	Jan-23	22.80	[ICRA]A (Stable)
NA	Fund Based Limits	NA	NA	NA	147.00	[ICRA]A (Stable)
NA	Unallocated Limits	NA	NA	NA	85.62	[ICRA]A (Stable)/[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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