

August 01, 2022

## ZF Hero Chassis Systems Private Limited: Ratings reaffirmed

### Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
<b>Fund-based Limits</b>	30.00	30.00	[ICRA]A- (Stable); Reaffirmed
<b>Non-fund Based Facilities</b>	4.00	4.00	[ICRA]A2+; Reaffirmed
<b>Total</b>	<b>34.00</b>	<b>34.00</b>	

\*Instrument details are provided in Annexure-I

### Rationale

The rating reaffirmation favourably factors in the stable operational profile of ZF Hero Chassis Systems Private Limited (ZF Hero), wherein the company is a chassis systems supplier to BMW. The company is a 50:50 joint venture (JV) between ZF India Private Limited (100% subsidiary of ZF Friedrichshafen AG, Germany) and Hero Cycles Limited (HCL), India. It benefits from its strong parentage in terms of access to latest technologies, as well as operational support in the form of access to an established customer base. The strong relationships enjoyed by the ZF Group with European passenger vehicle (PV) original equipment manufacturers (OEMs) globally, including BMW, and its strong technical capabilities in car-chassis technology have supported ZF Hero in securing business from BMW in India.

ZF Hero primarily undertakes assembly operations of key chassis components such as front suspension, rear axle and corner module for BMW and is present in all major existing and upcoming models of the OEM, thereby improving its revenue visibility and growth prospects. Albeit on a low base of FY2021 (which was impacted by the pandemic), ZF Hero reported healthy revenue growth of ~46% YoY and volume growth of ~35% YoY in FY2022, aided by healthier than expected revival in the luxury vehicle market and healthy demand for BMW's models. Aided by benefits of operating leverage and cost control measures, the company's profit margins reported a strong improvement with operating profit margin increasing to 18.2% and RoCE to 30%. Going forward, being a single-customer company, its revenue growth will remain linked to the demand for BMW's models in the domestic market.

The ratings assigned continue to favourably factor in the strong financial risk profile of the entity, characterised by debt-free balance sheet, comfortable cash generation from operations, strong liquidity and limited capital expenditure plans. With no debt obligations on its balance sheet and minimal capex requirements in the near term, the credit metrics and coverage indicators are likely to remain at healthy levels in the near to medium term. Even as ICRA expects ZF Hero to meet its cash outflow requirements from its internal cash accruals and available line of credit, in the event of any contingencies, the JV partners are also expected to financially support the company, which provides additional comfort.

The ratings assigned remain constrained by the company's high customer concentration with BMW being its only customer. The company's efforts to diversify its customer base by adding new OEMs have not fructified so far. Consequently, the company's performance remains linked to the demand for BMW's models in the domestic market. However, the sole supplier status of ZF Hero for chassis assemblies for the OEM and its established global relationships with the ZF Group mitigate business risks to a large extent.

ICRA also notes that the company faces significant import dependence as most of the components are sourced from ZF Group's global supply chain. This exposes the company to fluctuations in foreign exchange rates, but its prudent hedging practices mitigate this risk to a large extent. Additionally, ZF Hero has a modest scale of operations because of its niche product and clientele segment. As the scope of its operations is limited to the assembly of front and rear axles, the company's business profile is also characterised by relatively low value addition along with limited opportunities to backward integrate its operations. Nonetheless, the business derives strength from India's duty structure, which favours OEMs to localise manufacturing and even assemble key vehicle aggregates locally. Going forward, any change in the duty structure for imports, or BMW's decision to move assembly operations in-house, would impact ZF Hero's business viability and the same would remain a key rating sensitivity.

The Stable outlook on the long-term rating reflects ICRA's opinion that ZF Hero will continue to benefit from its strong parentage in terms of technical and financial support, and would continue to earn steady business from BMW, given the established relationship of the ZF Group with BMW globally. Aided by steady supplies, the company is expected to maintain a comfortable financial risk profile.

## Key rating drivers and their description

### Credit strengths

**Strong parentage, as JV between ZF India Private Limited and HCL India ensures access to technical and financial support** - ZF Hero benefits from its strong parentage as a 50:50 JV between the ZF Group and HCL. The company is able to procure business because of the strong relationship enjoyed by ZF Germany with European car OEMs. Additionally, the JV partners supported the company by periodically infusing equity during the initial years of operations, thereby minimising its dependence on external borrowings and keeping the capital structure healthy. Going forward, although the company is expected to be self-sustaining in meeting its funding requirements, the JV partners are expected to support it in the event of any contingencies.

**Established relationships with BMW and strong share of business ensure revenue visibility over medium term** - ZF Hero enjoys a high share of business with BMW across all its major models in the domestic market. It has also gained business for supplying chassis assemblies for several new models of BMW India. This strong relationship with the customer and comfortable position of BMW in the Indian luxury car segment ensures revenue visibility over the medium term and reduce business risks for the company.

**Strong capital structure with nil debt and healthy coverage indicators** - Supported by healthy cash accruals from operations over recent years, the company has minimal dependence on external borrowings, resulting in a comfortable capital structure. With no debt obligations on its balance sheet and low capex requirements over the medium term, the credit metrics are likely to remain at healthy levels in the near to medium term.

### Credit challenges

**High customer concentration risk with BMW as sole customer; established relationship with OEM mitigates risk to some extent** - ZF Hero is a single-customer company, undertaking chassis assembly services for BMW. The company's efforts to diversify with new OEMs have not fructified so far. Consequently, customer concentration risks remain significant, with its performance linked to the demand for BMW's models in the domestic market. However, ZF Hero's sole supplier status for chassis assemblies for the OEM and its established global relationships with the ZF Group mitigate business risks to a large extent.

**Significant import dependence exposes company to foreign exchange fluctuations** - ZF Hero imports almost its entire requirement of raw materials from global vendors, who form part of ZF Group's and BMW's global supply chains, thereby

exposing the company to foreign exchange rate related risks, especially during periods of sharp fluctuations. However, hedging practices undertaken by the company mitigate this risk to an extent.

**Modest scale of operations and limited scope for value addition** - The company's scale of operations remains modest because of its niche product and clientele segment. As the scope of its operations is limited to the assembly of front and rear axles, with entire components being imported and limited manufacturing being done in-house, the company's business profile is also characterised by relatively low value addition along with limited opportunities to backward integrate its operations. Nonetheless, the business derives strength from India's import duty structure, which encourages OEMs to localise manufacturing and even assemble key vehicle aggregates locally. Going forward, any change in the duty structure for imports, or BMW's decision to move assembly operations in-house, would impact ZF Hero's business viability and the same would remain a key rating sensitivity.

### Liquidity position: Strong

ZF Hero's liquidity position remains strong, characterised by expected cash flow generation of Rs. 25-30 crore in FY2023, cash and bank balances of Rs. 64 crore as on March 31, 2022 and undrawn working capital limits of Rs. 30 crore. In relation to these sources of cash, ZF Hero has minimal capex plans and no debt repayments over the medium term. Overall, ICRA expects ZF Hero to be able to meet its near-term commitments through internal sources of cash and yet be left with sufficient cash surpluses.

### Rating sensitivities

**Positive factors** – The company's ability to scale up its business and strengthen its business profile by securing new customers will be considered favourably for a rating upgrade. A continued strengthening of the financial risk profile aided by healthy operating performance may also lead to an improvement in rating.

**Negative factors** – Negative pressure on the rating could arise in case of loss of business from BMW or weakening of financial risk profile due to any large debt-funded capex or pressure on the profitability margins with core RoCE below 16% on a sustained basis. Negative pressure on the ratings could also arise in case of deterioration in the credit profile of the parent companies or weaker than expected support from them.

### Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	<a href="#">Corporate Credit Rating Methodology</a> <a href="#">Impact of Parent or Group Support on an Issuer's Credit Rating</a> <a href="#">Rating Methodology for Auto Component Suppliers</a>
Parent/Group support	<b>Parent/Holding Company: ZF India Private Limited and Hero Cycles Limited</b> ICRA expects ZF Hero's parents, ZF India Private Limited and Hero Cycles Limited, to be willing to extend financial support to it, should there be a need, given the high strategic importance that ZF Hero holds for its parents for meeting their diversification objectives.
Consolidation/Standalone	The ratings are based on the standalone financial profile of the company.

### About the company

ZF Hero is primarily engaged in assembly operations of key chassis components such as front suspension, rear axle and corner module for passenger car OEMs. It has an assembly facility in Chennai for supplies to BMW, which has a production capacity of 12,500 units annually on a single-shift basis.

The company was initially set up to cater to General Motors India and had been supplying to the OEM from its plants in Halol (Gujarat) and Talegaon (Maharashtra). However, with GM's exit from the Indian market, both the plants were closed down.

The company was incorporated in March 2010 as a 50:50 joint venture between Hero Motors Limited (HML) and ZF India Private Limited (100% subsidiary of ZF Friedrichshafen AG, Germany). During FY2017, with the demerger of HML into Hero Cycles Limited, the latter became a 50% JV partner, providing added strength to the promoter profile.

### About the parent companies

**ZF Group:** ZF Group is a global leader in driveline and chassis technology as well as active and passive safety technologies. The Group reported €38.3 billion (17.5% YoY growth) in sales during 2021. The company has a global workforce of ~141,000 across approximately 271 locations in 42 countries.

**HCL:** Incorporated in 1956, HCL is the largest manufacturer of bicycles globally. The company has a manufacturing capacity of 65 lakh bicycles per year, with units in Ludhiana (Punjab), Bihta (Bihar) and Ghaziabad (Uttar Pradesh). The company has augmented its bicycle portfolio in recent years through acquisitions in the space, namely Firefox, Insync and BSH.

The company currently also manufactures automotive rims and components; however, it is transferring its auto component business to Hero Motors Limited (HML), currently a majority owned subsidiary of HCL. Following the demerger, HML will be majority held by the promoters of HCL, while the latter will continue to hold a minority stake in the company; the transaction remains subject to requisite approvals.

HCL is the flagship company of the Late O.P. Munjal fraction of the Hero Group. Following an arrangement in FY2011 among members of the Munjal family (the promoters of the Hero Group), HCL is now managed by Mr. Pankaj Munjal (son of Late O.P. Munjal) and family. As a part of the arrangement, HCL hived off its cold-rolled (CR) steel division into a separate company in May 2010.

In FY2012, HCL also forayed into the real estate sector with acquisition of an under-construction hotel property in Gurugram (Haryana), which was housed in its subsidiary, Munjal Hospitality Private Limited (MHPL). During FY2019, HCL diluted 60% stake in MHPL for a consideration of Rs. 438 crore.

### Key financial indicators (audited)

ZF Hero Standalone	FY2021	FY2022
Operating income	146.9	215.1
PAT	8.4	27.0
OPBDIT/OI	11.2%	18.2%
PAT/OI	5.7%	12.6%
Total outside liabilities/Tangible net worth (times)	0.6	0.9
Total debt/OPBDIT (times)	1.0	0.4
Interest coverage (times)	10.5	25.0

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore

Source: Company, ICRA Research; All calculations are as per ICRA Research

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

### Any other information: None

## Rating history for past three years

Instrument	Type	Current rating (FY2023)			Chronology of rating history for the past 3 years			
		Amount rated (Rs. crore)	Amount outstanding as of Mar 31, 2022 (Rs. crore)	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021	Date & rating in FY2020	
				Aug 1, 2022	Jun 23, 2021	-	Mar 12, 2020	
1 Fund-based – Cash Credit Facilities	Long term	30.0	NA	[ICRA]A-(Stable)	[ICRA]A-(Stable)	-	[ICRA]A-(Stable)	
2 Non-fund Based – Working Capital Facilities	Short term	4.0	NA	[ICRA]A2+	[ICRA]A2+	-	[ICRA]A2+	

## Complexity level of the rated instruments

Instrument	Complexity Indicator
Fund-based – Cash Credit Facilities	Simple
Non-fund Based – Working Capital Facilities	Very Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: [www.icra.in](http://www.icra.in)

**Annexure I: Instrument details**

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Cash Credit Facilities	NA	NA	NA	30.0	[ICRA]A-(Stable)
NA	Non-fund Based – Working Capital Facilities	NA	NA	NA	4.0	[ICRA]A2+

Source: Company

**Annexure II: List of entities considered for consolidated analysis – Not applicable**

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