December 21, 2022

Happy Forgings Limited: Ratings upgraded to [ICRA]AA-/ [ICRA]A1+; outlook revised to Stable

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long term Term Loans	245.00	245.00	[ICRA]AA-(Stable); Upgraded from [ICRA]A+; Outlook revised to Stable from Positive
Long-term/ Short-term Fund Based Limits	0.00	240.00	[ICRA]AA-(Stable)/ [ICRA]A1+; Upgraded from [ICRA]A+/ [ICRA]A1; Outlook revised to Stable from Positive
Long term Fund Based Limits	185.00	0.00	-
Long-term/ Short-term Unallocated Limits	55.00	0.00	-
Total	**485.00**	**485.00**	

**Instrument details are provided in Annexure-I*

Rationale

The rating upgrade takes into account the continuation of Happy Forgings Limited's (HFL) strong operational performance, benefitting from its established relationships and strong share of business (SOB) with reputed tier-I automotive ancillaries and original equipment manufacturers (OEMs). The rating upgrade also factors in the sustained healthy financial risk profile of the company, despite its ongoing capex programme.

HFL's revenues grew by ~47% in FY2022 and by ~36% in H1 FY2023, driven by a recovery in demand for its key end-user segment (commercial vehicles, or CVs), amid an improvement in the economy post-abatement of infections and relaxation in lockdowns. Aided by an improving proportion of sales emanating from the relatively profitable machining segment and heavy forged components, the company's operating profitability continues to remain at robust levels (26.4% in H1 FY2023). The company remains well positioned to benefit from a recovery in demand in the automotive segments, especially CVs, with its established relationships and strong SOB with various customers likely to help it record a moderate to healthy revenue growth over the medium term. The company has recently gained business from multiple new customers (including some non-automotive ones); a ramp-up in supplies for these customers is expected to help diversify the company's business profile, augment its company's cash accruals and improve its credit profile.

The company continues to maintain a conservative capital structure (gearing of 0.3 time as on March 31, 2022), aided by healthy accretion to reserves and pre-payment of long-term debt post equity infusion from a private equity player (Rs. 200.0 crore in FY2019). HFL's operating profitability metrics and low debt levels have helped it maintain strong debt coverage indicators (total debt/OPBDITA of 1.0 time and NCA/total debt of ~76% in FY2022). Despite the ongoing capex programme (~Rs. 130 crore project capex still to be incurred over H2 FY2023–H1 FY2024 for commissioning machining lines associated with its new 14,000-MT press), an expectation of healthy operating performance is likely to help limit HFL's dependence on external debt to fund its substantial capex plans, while helping it maintain strong return indicators and debt metrics.

The ratings remain constrained by the susceptibility of HFL's revenue generation to the cyclicality in the CV and agri-machinery segments, as they contribute ~75% to the company's revenues. While dependence on these segments is expected to remain high over the medium term, HFL's established relationships and strong SOB with various customers provides comfort. ICRA also notes that while the new 14,000-MT press line will help the company cater to relatively new product categories, thereby leading to diversification of its revenue profile, HFL's ability to achieve healthy capacity utilisation levels for the enhanced capacity would remain monitorable.

The Stable outlook reflects ICRA's view that HFL is likely to maintain a comfortable credit profile over the medium term, with an expectation of healthy cash accruals, which will help keep its dependence on external debt low, even as it continues with its substantial capex plans towards expanding capacity. Further, the company's business prospects are expected to be supported by its strong SOB with customers and expectation of ramp up in supplies for its new customers.

Key rating drivers and their description

Credit strengths

Established relationships 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 tractor 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 SOB with reputed OEMs such as Ashok Leyland Limited, VE Commercial Vehicles Limited, and Escorts Limited as well as reputed tier-I automotive ancillaries, such as Graziano Transmission India Private Limited. The established relationships provide healthy revenue visibility for the company. In addition to its existing customers, the company has recently gained business from multiple new customers (some from non-automotive segments), thereby leading to further strengthening of its operational profile and revenue growth prospects.

Strong operating profitability and return indicators – HFL's operating margin improved significantly to 27.7% in FY2019 from 17.5% in FY2014, aided by a ramp-up in capacity utilisation of the press lines and machining facilities with supplies for heavier components post the commercialisation of an 8,000-MT press line aiding its profitability. Despite the weak demand scenario amid the adverse impact of the pandemic over the past two fiscals, and hardening of raw material prices, the company continues to report robust operating profitability (OPM of ~26.8% in FY2022 and 26.4% in H1 FY2023), aided by an improved product mix (higher percentage of pressed components as opposed to hammer-based components) and operational efficiency measures. The strong operating margins, coupled with high asset sweating, has aided it in reporting healthy return metrics with a core RoCE of ~26% in FY2022. A relatively moderate capacity utilisation, coupled with investments towards setting up press lines, is likely to lead to a moderation in RoCE over the next two years. While the extent of moderation would remain dependent on the company's ability to ramp-up capacity utilisation for the new capacities, the return indicators are expected to remain at healthy levels.

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. The company's capital structure witnessed a considerable improvement, aided by healthy accretion to reserves and pre-payment of long-term debt post-infusion of funds from the PE player. Benefitting from its stable operating performance and consequent accruals, the company's total debt had declined to ~Rs. 118.4 crore as of March 31, 2020 from Rs. 300.5 crore as of March 31, 2018; however, the debt on the company's books as of March 31, 2022, increased to ~Rs. 240 crore, as a result of the ongoing capex programme and an increase in blockage of funds in working capital requirements. The company's strong operating profitability metrics, coupled with moderate debt levels, have helped the company report robust debt coverage indicators, with Total Debt/OPBDITA of 1.0 time and NCA/Total Debt of 76% in FY2022. The debt coverage indicators are expected to continue to remain at healthy levels going forward, aided by an expectation of strong cash accruals and consequent decline in debt levels.

Credit challenges

Key end-user segments of agri-machinery and CVs remain exposed to cyclicality – HFL is primarily a supplier of forged and machined components to the CV and tractor segments of the automotive industry. Together, these two segments 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. HFL's established relationships and strong SOB with various customers, however, provide comfort.

Ongoing capacity expansion plans and foray into relatively new product categories – At present**,** the company is in the midst of a capacity expansion programme, where the forging and machining capacities would increase to ~1,00,000 TPA and 60,000 TPA levels, respectively, by FY2023–FY2024 (total capex outlay of ~Rs. 450-500 crore). In the first phase of the project, a new 8,000-MT press line along with machining facilities was installed. In the second phase, a 14,000-MT press line has been installed and commercialised from October 2022 (machining facilities yet to be installed). The new press line will help the company cater to relatively new product categories, thereby leading to diversification of its revenue profile. While a predominant share of its capex is likely to be funded through internal accruals, timely completion of the same and HFL's ability to achieve healthy capacity utilisation levels for the enhanced capacity would remain key rating sensitivities.

Liquidity position: Adequate

The liquidity position remains adequate, supported by moderate utilisation of the working capital facilities (average buffer of ~Rs. 55-60 crore), undrawn term loans of ~Rs. 155 crore and expectation of strong cash accruals (~Rs. 190-220 crore per annum) over the next three years. The entity is expected to maintain sufficient liquidity to meet its debt repayments (~Rs. 4.6 crore in FY2023 and ~Rs. 28 crore in FY2024) and ongoing capex programme (~Rs. 100 crore in FY2023 and Rs. 50-60 crore in FY2024) for enhancing its forging and machining capabilities.

Rating sensitivities

Positive factors – ICRA could upgrade HFL's ratings if there is an uptick in volumes in the segments catered, which favourably impacts the company's accruals and helps it maintain healthy credit metrics. Further, material revenue diversification with a sustained scale-up in supplies to the export market, which helps to offset any weakness in the domestic OEM supplies, would be favourably considered for an upgrade.

Negative factors – ICRA could downgrade HFL's ratings if a weakness in demand in the segments catered and a consequent inability to achieve healthy capacity utilisation post-capacity expansion, materially impacts the company's return and debt coverage indicators. A specific credit metric that could trigger a downgrade is debt/OPBDITA greater than 1.5 times, on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating Methodology for Auto Component Suppliers
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 in 1988. The company manufactures forged and machined transmission along with 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 74,000 MT (hammer and press forging combined) and a machining capacity of 45,500 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, a 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 (audited)

HFL Standalone	FY2021	FY2022	H1 FY2023*
Operating income	585.0	860.0	579.0
PAT	86.4	142.3	90.0
OPBDIT/OI	27.1%	26.8%	26.4%
PAT/OI	14.8%	16.5%	15.5%
Total outside liabilities/Tangible net worth (times)	0.4	0.4	-
Total debt/OPBDIT (times)	1.0	1.0	-
Interest coverage (times)	13.5	32.3	25.5

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

*Source: Company, ICRA Research; * Provisional numbers; 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	Current rating (FY2023)					Chronology of rating history for the past 3 years			
		Type	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
					Dec 21, 2022	May 20, 2022	-	Feb 26, 2021	Aug 18, 2020 May 11, 2020	Oct 30, 2019
1	**Term Loans**	Long term	245.00	78.5	**[ICRA]AA- (Stable)**	**[ICRA]A+ (Positive)**	-	**[ICRA]A+ (Stable)**	**[ICRA]A (Stable)**	**[ICRA]A (Positive)**
2	**Fund Based Limits**	Long term and short term	240.00	NA	**[ICRA]AA- (Stable)/ [ICRA]A1+**	-	-	-	-	-
3	**Fund Based Limits**	Long term	0.00	-	-	**[ICRA]A+ (Positive)**	-	**[ICRA]A+ (Stable)**	**[ICRA]A (Stable)**	**[ICRA]A (Positive)**
4	**Unallocated Limits**	Long term and short term	0.00	-	-	**[ICRA]A+ (Positive)/ [ICRA]A1**	-	**[ICRA]A+ (Stable)/ [ICRA]A1**	**[ICRA]A (Stable)/ [ICRA]A1**	**[ICRA]A (Positive)/ [ICRA]A1**

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long term Term Loans	Simple
Long-term/ Short-term Fund Based Limits	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: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loan-I	2021	-	2027	40.0	[ICRA]AA- (Stable)
NA	Term Loan-II	2018	-	2026	17.0	[ICRA]AA- (Stable)
NA	Term Loan-III	2018	-	2026	58.0	[ICRA]AA- (Stable)
NA	Term Loan-IV	2018	-	2026	15.0	[ICRA]AA- (Stable)
NA	Term Loan-V	2021	-	2028	60.0	[ICRA]AA- (Stable)
NA	Term Loan-VI	2021	-	2027	55.0	[ICRA]AA- (Stable)
NA	Fund Based Limits	NA	NA	NA	240.00	[ICRA]AA- (Stable)/ [ICRA]A1+

Source: Company

Please click here to view details of lender-wise facilities rated by ICRA

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

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