

January 14, 2022

Hindustan Aeronautics Limited: Long-term rating upgraded to [ICRA]AAA; outlook revised to Stable; short-term rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-Based Limits	10,000.00	10,000.00	[ICRA]AAA; upgraded from [ICRA]AA+ and Outlook revised to Stable from Positive
Non-Fund Based Facilities	2,050.00	2,050.00	[ICRA]A1+; reaffirmed
Commercial Paper	2,500.00	2,500.00	[ICRA]A1+; reaffirmed
Total	14,550.00	14,550.00	

*Instrument details are provided in Annexure-1

Rationale

The upgrade in the long-term rating factors in the sustained improvement in Hindustan Aeronautics Limited's (HAL) working capital position in H1FY2022 while maintaining healthy revenues and profitability. HAL realised significant payments from its clients in FY2021 which continued in H1FY2022. Consequently, the external debt has been fully repaid with healthy cash balances of Rs. 13,541 crore as on September 30, 2021. The order book remains strong, supported by the order for 83 Light Combat Aircraft (LCA) with total value aggregating to Rs. 36,486 crore (excluding taxes and other pass-through components) received in Q4FY2021, resulting in closing order book position of Rs. 79,467 crore (3.54 times FY2021 operating income) as on September 30, 2021. The new order inflows provide high revenue visibility in the medium to long term while also indicating HAL's strong competitive and strategic positioning.

The ratings continue to draw comfort from the majority ownership held by the Government of India (GOI) in HAL and its strategic position as a dominant supplier of aircrafts, helicopters, engines, avionics and accessories as well as main provider of maintenance, repair and overhaul (MRO) services to the Indian defence forces. 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 R&D agencies, 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 mandatory offset policy for defence procurement by GoI, augur well for the company's future growth. The company's financial profile remains 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 healthy operating profitability, the debt coverage metrics remain strong.

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. In the past, delays in timely realization of payments from its largest customer has led to build-up of receivables and reliance on external debt. Though, the receivable position has improved in FY2021 and H1FY2022 with substantial collections realised during the period, the company remains susceptible to timely receipt of funds or change in prioritisation in the defence budget which can have an adverse impact on its growth potential, sales momentum and liquidity position. Nonetheless, the company has a strong liquidity cushion as sanctioned bank lines remain unutilised as on date. The rating is also constrained by the company's exposure to risk of time and cost overruns as orders have stiff execution timelines and predefined margins. Any material cost overruns attributable to delays on HAL's front could impact overall profitability. The company manages its working capital intensity partly by aligning its payables to contract receivables

and availing mobilisation advances, reflecting in high total outside liabilities/tangible net worth (TOL/TNW) ratio of 2.4 times as of March 31, 2021. Nevertheless, long-standing relationship with key vendors/OEMs with back to back arrangements and majority orders being backed by MoD wherein advances are provided without any financial bank guarantees, provides comfort. ICRA notes that the company also has significant contingent liabilities, primarily relating to sales tax demands from various states, aggregating to Rs. 12,312 crore as on March 31, 2021. While the same has been resolved with many state governments and any outflows pertaining to the sales tax demands would be reimbursed by HAL's customers, the risk remains in terms of any intermittent funding requirements. Any prolonged exposure to increased debtor levels and significant future outflows in terms of buy-back of shares or dividend, that can adversely impact the liquidity of the company, remains a key monitorable.

The Stable outlook on the [ICRA]AAA rating reflects ICRA's opinion that HAL will continue to benefit from its strategic importance to the Indian defence forces, strong financial flexibility, high entry barriers and long track record of operations.

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 75.15% stake as on Sep 30, 2021. 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.

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. Further, in Q4FY2021, the company has secured its largest ever contract of 83 LCA Tejas Mk1A aircraft with MoD for Rs. 36,486. 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 experienced manpower base will continue to be strong mitigating factors.

Strong order book with healthy future order pipeline – The company has a strong order pipeline as reflected by the unexecuted order book of around Rs. 79,467 crore as on September 30, 2021, significantly boosted from the recent 83 LCA aircraft contract of Rs. 36,486 crore. Further, there is a strong visibility of future orders with new orders anticipated for LUH, LCH, Su-30, HTT-40 in the near to medium term.

Strong financial profile; continued improvement in working capital position – HAL realised significant payments from its clients in FY2021 which continued in H1FY2022. Consequently, the external debt has been fully repaid with healthy cash balances of Rs. 13,541 crore as on September 30, 2021. The company has received healthy collections of about Rs. 35,000 crore and Rs. 20,000 crore from its customers in FY2021 and H1FY2022 respectively, backed by receipt of substantial mobilisation advances. The company's debtor levels moderated from Rs. 11,235 crore as on March 31, 2020 to Rs. 5,487 crore as on September 30, 2021. The company's operating income in FY2021 stood at Rs. 22,407 crore, registering a y-o-y growth of 5%. 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 healthy operating profitability, the debt coverage metrics remain strong.

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. Over the past years, the amount of defence allocation towards modernisation of aircrafts and aero-engines has not seen much growth. The company has faced issues of delayed payments from MoD in the past, leading to build-up of receivables and reliance on external debt. Though, the same has improved with significant reduction in receivables in FY2021 and H1FY2022, the company remains susceptible to timely receipt of funds or change in prioritisation in the defence budget which can have an adverse impact on the growth potential, sales momentum and liquidity of the company. Nonetheless, the company has a strong liquidity cushion as sanctioned bank lines remain unutilised as on date.

Susceptibility to time and cost overruns in order execution – The company's operations and profitability remain exposed to time and cost overruns as orders have stiff execution timelines and predefined margins. Any material cost overruns attributable to delays on HAL's front could impact overall profitability. In case of delays in delivery, the company is subject to various penalties including liquidated damages. The company had been making provisions for liquidated damages for delays in manufacturing aircraft and ROH orders, however, actual outflow has always remained lower than provision, therefore there have been no payments made more than provisions in any of the past years.

Liquidity position: Strong

HAL's liquidity is Strong, as evidenced by its cash balance of Rs. 13,541 crore as on September 30, 2021, undrawn working capital facilities and absence of debt repayment obligations over the near-term. Further, the capex commitments are expected to be met through internal accruals and no debt funded capex is envisaged in the near-term. The liquidity profile remains supported by the healthy financial flexibility demonstrated by HAL in the past, by way of timely and adequate access to bank credit to tide over times of delays in collection receipts.

Rating sensitivities

Positive factors – Not Applicable.

Negative factors – Negative pressure on HAL's rating could arise in case of adverse impact on liquidity due to stretched debtors or crystallization of contingent liabilities leading to higher-than-expected dependence on external borrowings. Any change in strategic importance of HAL to GoI reflecting in lower order inflows and revenues or any delay in timely execution of orders in hand could also increase pressure on ratings.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating approach – implicit support from parent or Group
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	For arriving at the ratings, ICRA has considered the consolidated financials of HAL. As on March 31, 2021, the company had 14 joint ventures and two subsidiaries, which are all enlisted in Annexure-2.

About the company

HAL, a defence public sector undertaking (DPSU), was established on October 1, 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 75.15%. 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, Hyderabad, Kasargod and Korwa); along with a Design complex (R&D centres jointly located with the related manufacturing divisions).

Key financial indicators (audited)

HAL Consolidated	FY2020	FY2021	H1FY2022
Operating Income (Rs. crore)	21,260	22,407	7,167
PAT (Rs. crore)	2,876	3,234	1,041
OPBDIT/OI (%)	23.3%	22.8%	20.7%
PAT/OI (%)	13.5%	14.4%	14.5%
Total Outside Liabilities/Tangible Net Worth (times)	3.0	2.4	2.6
Total Debt/OPBDIT (times)	1.3	0.1	0.0
Interest Coverage (times)	13.8	19.2	96.7

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation

Source: Company, ICRA research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2022)				Chronology of Rating History for the past 3 years				
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of Sep 30, 2021 (Rs. crore)	Date & Rating in		Date & Rating in FY2021		Date & Rating in FY2020	
					Jan 14, 2022	Apr 29, 2021	July 02, 2020	Mar 13, 2020	Jan 9, 2020	Date & Rating in FY2019
1	Fund-based Limits	Long term	10,000.00	Nil	[ICRA]AAA (Stable)	[ICRA]AA+ (Positive)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	-
2	Non-fund Based facilities	Short term	2050.00	NA	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	-
3	Commercial Paper	Short term	2,500.00	Nil	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Fund-based Limits	Simple
Non-fund Based facilities	Very Simple
Commercial Paper	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 analyzing 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, is available on ICRA's website: www.icra.in

Annexure-1: Instrument details

ISIN No/Banker Name	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. Crore)	Current Rating and Outlook
NA	Fund-based Limits	NA	NA	NA	10,000.00	[ICRA]AAA (Stable)
NA	Non-fund Based facilities	NA	NA	-	2,050.00	[ICRA]A1+
Not placed	Commercial Paper	NA	NA	7-365 days	2,500.00	[ICRA]A1+

Source: Company

Annexure-2: List of entities considered for consolidated analysis

Company Name	HAL 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

Source: HAL annual report FY2021

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