June 18, 2024

Tata Hitachi Construction Machinery Company Private Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based/ Non-fund based – Interchangeable facilities	900.00	900.00	[ICRA]AA (Stable)/[ICRA]A1+; reaffirmed
Total	**900.00**	**900.00**	

**Instrument details are provided in Annexure-I*

Rationale

The reaffirmation of ratings factors in Tata Hitachi Construction Machinery Company Private Limited's (THCM) established position in the domestic mining and construction equipment (MCE) industry, driven by its widespread service network and capabilities. The ratings consider the strong technological and operational support from its promoter, Hitachi Construction Machinery Company Limited (HCMC; one of the global leaders in the hydraulic excavator industry) and comfortable interest cover of over 7 times and TD/OPBIDTA of 1.1 times in FY2024. Moreover, it enjoys substantial financial flexibility being a part of the Hitachi and the Tata Groups, which helps in raising funds at competitive rates. While the volumes are expected to decline YoY in FY2025 (impacted by slowdown in project award activity around the General Elections and the monsoons in H1), the demand prospects remain favourable over the medium to long term, aided by the Government's continued thrust on infrastructure development, improving mechanisation levels in projects and upcoming change in emission norms (CEV IV to V w.e.f., January 2025), which are likely to be favourable for the excavator segment (lowering price differential with backhoe loaders). The operating profit margin (OPM) for THCM witnessed sequential recovery to 9.1% in FY2024 from 6.5% and 2.9% in FY2023 and FY2022, respectively, (benefiting from cost rationalisation and improvement in sales realisation) though the same remains lower to historical levels of over 10%. The OPM is expected to range within 7-8% p.a., given the anticipated decline in volumes in FY2025.

The strengths are partially offset by the intense competition in the MCE industry and susceptibility of THCM's performance to the cyclicality in the construction industry. The market share has declined over the last five years owing to stiff competition. The ratings factor in the vulnerability of the company's operations to fluctuations in input prices as well as forex movement and limited ability to pass on the same to the end users, thereby keeping the profitability margins volatile. It is also exposed to product concentration risk, given that 80% of revenues are generated from the excavators.

With high import content of ~35%, the company remains exposed to supply chain issues and foreign currency fluctuations, to the extent unhedged. Given the high forex volatility and hedging cost, THCM had changed its working capital policy in FY2024 by making faster payments to its import creditors and keeping its forex position open instead of earlier mechanism of availing long tenure foreign currency denominated buyer's credit and hedging it. Resultantly, its working capital intensity increased, with NWC/OI inching up to 10% in FY2024 from 6% in FY2023. However, the rise in working capital gap was largely met through internal accruals, thereby resulting in only marginal increase in total debt levels to Rs. 470 crore (Rs. 369 crore excluding lease liabilities) as on March 31, 2024, vs Rs. 438 crore (Rs. 368 crore excluding lease liabilities) as on March 31, 2023). With planned capex of Rs. 240-260 crore, which is likely to be partly debt funded (as seen in FY2024), and expected moderation in OPM, the coverage metrics are anticipated to be impacted in FY2025. Over the medium term, the company's ability to sustainably improve its operating margins, maintain its coverage metrics at a comfortable level and improve its working capital cycle will be crucial from the credit perspective.

The Stable outlook on the long-term rating reflects ICRA's opinion that THCM will likely sustain its leading position in the domestic MCE industry even as volumes may witness a de-growth in the near term. Further, the outlook underlines ICRA's expectation that the incremental capex will be funded in a manner such that it is able to durably maintain its debt protection metrics.

Key rating drivers and their description

Credit strengths

Established track record and market position in excavator segment, strong technical support from HCMC – THCM has a track record of over 25 years in the domestic MCE market. It has an established position in the MCE earthmoving segment with a leading market share in the excavators, driven by its widespread service network and capabilities and strong technological and operational support from its promoter, HCMC, one of the global leaders in the hydraulic excavator industry. Moreover, it enjoys substantial financial flexibility being part of the Hitachi and the Tata Groups, which helps in raising funds at competitive rates.

Comfortable coverage indicators – THCM's financial profile remains comfortable, backed by healthy scale of operations, moderate revenue growth (11% in FY2024), improvement in operating margins (to 9.1% in FY2024 from 6.5% in FY2023), and comfortable interest cover of over 7 times and TD/OPBIDTA of 1.1 times in FY2024. Despite YoY improvement, the TOL/TNW remained high at 1.4 times in FY2024 (Vs. 1.9 times in FY2023), given the reliance on creditors for funding the working capital. It had changed its working capital policy in FY2024 viz. making faster payments to its import creditors, partly to reduce its forex exposure and hedging costs. Resultantly, THCM's working capital intensity increased, with NWC/OI at 10% in FY2024 from 6% in FY2023. However, the rise in working capital gap was largely met through internal accruals thereby resulting in only marginal increase in total debt levels to Rs. 470 crore (Rs. 369 crore excluding lease liabilities) as on March 31, 2024, vs Rs. 438 crore (Rs. 368 crore excluding lease liabilities) as on March 31, 2023. With planned capex of Rs. 240-260 crore, which is likely to be partly debt funded (as seen in FY2024), and expected moderation in OPM, the coverage metrics are anticipated to be impacted in FY2025. Over the medium term, the company's ability to sustainably improve its operating margins, maintain its coverage metrics at a comfortable level and improve its working capital cycle will be crucial from the credit perspective.

Favourable long-term demand prospects – Notwithstanding the decline in volumes expected in FY2025 (impacted by slowdown in project award activity around the General Elections and monsoons in H1), the demand prospects remain favourable over the medium to long term. It is aided by the Government's continued thrust on infrastructure development, improving mechanisation levels in projects and upcoming change in emission norms (CEV IV to V w.e.f., January 2025), which are likely to be favourable for the excavator segment (lowering price differential with backhoe loaders).

Credit challenges

Cyclical demand for MCE, increased competition and high product concentration creates earnings volatility – MCE is a cyclical industry, prone to sharp swings in demand. The growth in excavator segment is directly related to infrastructure investment and to domestic economic growth. In addition, India is a growing market, with new players entering the market and increasing the competition. The stiff competition has led to a decline in THCM's market share over the last five years. Moreover, it has a high product concentration with over 80% of the revenue generated from excavators. All these factors limit THCM's ability to pass on any adverse input price hikes to its customers. THCM faces competition from strong incumbents in the backhoe loader segment, where it is a marginal player despite YoY growth.

Margins vulnerable to volatility in raw material costs and foreign exchange rates – THCM's profitability remains vulnerable to any increase in prices of raw materials (mainly steel) as the same accounts for ~80% of the cost structure. Further, with a high import content (~35%), the company is exposed to risk of supply chain disruptions (as witnessed in FY2024) and foreign currency fluctuations, to the extent unhedged.

Liquidity position: Adequate

THCM's liquidity is likely to remain adequate, with positive cash flows from operations. It is supported by undrawn working capital limits (~Rs. 621 crore) and free cash balance of ~Rs. 76 crore as on March 31, 2024. The company's average working capital utilisation stood at ~62% of the sanctioned limits during the 12 months ending in March 2024. Its current liquidity buffer and expected cash flows from operations are adequate to service the debt obligations of ~Rs. 90 crore in FY2025 and the capex of Rs. 240-260 crore in FY2025.

Rating sensitivities

Positive factors – The company's ratings can be upgraded if there is a sustained healthy growth in revenues, along with a significant improvement in profitability, which results in better liquidity and debt protection metrics. Its ability to substantially improve the leverage with TOL/TNW below 1.0 times, on a consistent basis, is crucial for any upward revision in the ratings.

Negative factors – Negative pressure on THCM's ratings could arise with a sustained pressure on margins or if the leverage or coverage metrics deteriorate on account of stretched working capital or higher-than-expected capex spend. Specific credit metrics that could lead to a rating downgrade include TOL/TNW above 1.75 times on a consistent basis.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Construction Vehicles
Parent/Group support	Not Applicable
Consolidation/Standalone	The ratings are based on the standalone financial statements of the company

About the company

Tata Hitachi Construction Machinery Company Private Limited, formerly Telco Construction Equipment Company Limited, is one of the major players in the Indian Mining and Construction Equipment (MCE) industry with a healthy market share of ~25% (FY2024) in the hydraulic excavator segment. The company's product range primarily consists of hydraulic excavators. It also sells other products like crawler cranes, wheel loaders, backhoe loaders, off-highway dumpers, motor graders, soil compacters, dumpers, and hydraulic cranes albeit in low quantities. THCM has its manufacturing facilities in Dharwad (Karnataka) and Kharagpur (West Bengal).

THCM started off as the construction equipment division of Tata Engineering in 1961 and was incorporated as Telco Construction Equipment Company Limited in 1998 under the ownership of Tata Group. In 2000, Hitachi Construction Machinery Company Limited (HCMC) acquired a 20% stake in THCM, subsequently raising it to 40% in December 2005 and 60% in March 2010. In December 2012, the company's name was changed to Tata Hitachi Construction Machinery Company Limited and subsequently to Tata Hitachi Construction Machinery Company Private Limited. At present, THCM is a joint venture between HCMC (60% stake) and Tata Motors Limited (40% stake).

Key financial indicators (audited)

Standalone	FY2023	FY2024*
Operating income (Rs. crore)	4,401.2	4,875.2
PAT (Rs. crore)	49.1	240.0
OPBDIT/OI (%)	6.5%	9.1%
PAT/OI (%)	1.1%	4.9%
Total outside liabilities/Tangible net worth (times)	1.9	1.4
Total debt/OPBDIT (times)	1.5	1.1
Interest coverage (times)	9.5	7.1

*Source: Company, ICRA Research; * Provisional numbers; All ratios as per ICRA's calculations*

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

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2025)				Chronology of rating history for the past 3 years		
		Type	Amount rated (Rs. crore)	Amount outstanding as on March 31, 2024 (Rs. crore)	Date & rating in FY2025	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022
					Jun 18, 2024	Jul 18, 2023	Apr 07, 2022	-
1	**Fund-based/ Non-fund based – Inter-changeable facilities**	Long term/Short term	900.00	278.7	**[ICRA]AA (Stable)/ [ICRA] A1+**	**[ICRA]AA (Stable)/ [ICRA] A1+**	**[ICRA]AA (Stable)/ [ICRA] A1+**	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Fund-based/Non-fund based – Interchangeable facilities	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	**Fund-based/Non-fund based – Interchangeable facilities**	NA	NA	NA	900.00	[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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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.

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