March 13, 2020

Bharat Forge Limited: Ratings reaffirmed with revision in outlook

Summary of rating action

Instrument*	Previous Rated Amount	Current Rated Amount	Rating Action
Term Loan/ECB	USD35 Million	USD35 Million	[ICRA]AA+ Reaffirmed; outlook revised from Stable to Negative
Fund-based Facilities	Rs.2100.00 crore	Rs.2100.00 crore	[ICRA]AA+ Reaffirmed; outlook revised from Stable to Negative
Non-fund Based Facilities	Rs.700.00 crore	Rs.700.00 crore	[ICRA]A1+ Reaffirmed

**Instrument details are provided in Annexure-1*

Rationale

The long-term outlook revision from Stable to Negative reflects ICRA's expectation that Bharat Forge Limited's (BFL) credit profile is likely to witness pressure in the near term due to ongoing slowdown in automotive space (mainly commercial vehicles segment (CVs)) as well as the industrial segment across geographies including India, the USA and Europe coupled with possible impact of corona virus spread.

The company reported a decline of over 25% in operating income (OI) in Q3 FY2020, when compared to Q3 FY2019 due to low offtake from its key customers because of weak demand across segments globally. Subsequently, operational deleverage had a bearing on the company's operating profitability and PAT margins. Given a sharp decline in crude prices, the industrial segment – especially the oil and gas segment also witness pressure over the next few quarters. Decline in operating profitability, along with moderation in asset turnover, will also have a bearing on its return indicators as well as coverage indicators. ICRA expects the overall performance to remain weak over the next two to three quarters.

Given the ongoing slowdown, BFL is working on cost-reduction measures through various ways, along with restructuring of its German operation. Moreover, capex and investment plans are reduced, for FY2020 and FY2021. The ratings continue to draw comfort from BFL's strong liquidity position with unencumbered cash and liquid investments of around Rs. 1,900 crore as of December 2019 on a consolidated basis, coupled with unutilised bank lines and healthy cash accruals from operations. Moreover, the rating reaffirmation reflects BFL's comfortable coverage indicators supported by its leading position in the global automotive forgings industry, especially in the CV chassis and engine component space. The ratings note its large scale of operations, diversified business portfolio with a strong customer base across auto and industrial segments across geographies, and its technical capabilities.

While diversification across industrial segments have helped in mitigating some impact of the cyclicality in the CV segment during the recent downturn, BFL's dependence on the CV segment (44% of consolidated turnover in FY2019) remains high over the medium term. It is continuously working on diversifying its business portfolio by increasing the share of industrial segment, passenger car segment and aluminium content in its overall revenue pie. However, ICRA believes that the industrial segment revenue, especially in the oil and gas sector may witness pressure over the next two to three quarters. The same will have a bearing on industrial segment revenue in the near term. Going forward, the company's ability to maintain its cost structure and profitability level, despite headwinds in the underlying end-user industries such as the CV and O&G segments remain a key monitorable.

Key rating drivers

Credit strengths

Leadership position in CV engine and chassis components segment; strong customer base in domestic and international markets facilitated by strategic acquisitions – BFL is a market leader in the domestic chassis and engine component segments for CV by the virtue of being the main supplier to the leading domestic CV OEMs. Along with its subsidiaries, the company supplies forged components to all major global CV OEMs. Over the years, it has added new customers and geographies to diversify its business profile and clientele.

Diversified product profile and dual shore capabilities; strong engineering, design and fully-integrated manufacturing capabilities help in maintaining steady share of business with leading OEMs and improved traction in new platform development programmes - BFL's strong market position reflects its large scale of operations (with facilities to supply entire range of auto-components). Its research and development infrastructure allows the company to enjoy the status of a complete solution provider right from conceptualisation and designing stage to manufacturing and validation stage.

Diversification through investments in industrial components business and favourable demand prospects especially in efence, aerospace and locomotive sector support long-term growth -To de-risk its business model from the cyclicality of the automobile industry, BFL has been increasingly focussing on its industrial business with a varied product mix including forged and machined products. The company has been supplying to industrial segments for applications in oil and gas, wind energy and a range of heavy engineering applications, which accounted for 44% of its consolidated turnover in FY2019.

Strong liquidityProfile,with company having unencumbered cash & liquid investments of around Rs 1,900 crore-BFL's liquidity position remains strong, supported by sizeable liquid investments and healthy cash accruals and unutilised credit lines of over Rs. 700 crore.

Credit challenges

High working capital intensity and moderately leveraged capital structure-Owing to high exports, BFL's receivable cycle is stretched, which resulted in high working capital intensity. To improve cash flows, the company discounts invoices of its overseas customers, as discounting rate is substantially lower than the domestic funding rate. Due to sharp decline in turnover, there will be short-term aberration in working capital cycle (NWC/OI) because of relatively higher receivable cycle compared to its creditor cycle. Consequently, the working capital intensity is likely to deteriorate in the current fiscal.

Challenging operating environment across geographies; though manpower rationalisation efforts has helped in improving break-even levels - With its lean cost structure and superior product mix, BFL has been able to sustain healthy operating margin, despite a decline in volume, amid the challenging demand environment in its end-user industries in the past. Going forward, the company's ability to maintain its cost structure and profitability level, despite headwinds in the underlying end-user industries such as CV and O&G segments remain a key monitorable.

Despite diversification plans, exposure to highly cyclical CV segment both in India and international markets remains high. Anti-dumping duty or any other customs duty on the US auto-component imports can have a bearing on BFL's

performance-BFL's revenue can be broadly divided into CV (44% of consolidated revenue), PV (12%) and industrial segment (44%). It is working on diversifying its product base by increasing exposure to passenger vehicle, locomotive, defence and aerospace components, where the demand is relatively stable compared to the cyclical M&HCV segment. It aims to diversify its business portfolio through product diversification and focussing on the industrial business segment. The auto-component industry remains vulnerable to pricing pressures from the large OEMs.

Liquidity position: Strong

The company's liquidity profile is **strong**, supported by large unencumbered cash and liquid investments of over Rs. 1,900 crore as of December 2019 and undrawn bank lines of over Rs. 700 crore as of December 2019. Despite headwinds in the key end-user industry as well as sizeable capex and investment plans, its liquidity profile is expected to remain healthy due to strong cash accruals. The management has guided to maintain cash and liquid investments to the tune of Rs. 1,000 – 1,200 crore on a sustained basis.

Rating sensitivities

Positive triggers – Given the Negative outlook on the long-term rating, rating upgrade from the current level is unlikely. The outlook on the long-term rating can be revised to Stable in case of sustained improvement in profitability and coverage indicators. The short-term rating is already at the highest level.

Negative triggers – Negative pressure on BFL's rating could arise in case of sustained slowdown in key end-user industry, thereby exerting pressure on profitability and coverage indicators. Moreover, large debt-funded acquisition or capacity expansion, which could adversely impact capital structure, would trigger a negative rating action. Specific credit metrics that may lead to a downgrade of BFL's rating include Net Debt/ OPBITDA above 1.5 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	For arriving at the ratings, ICRA has considered the consolidated financials of Bharat Forge Limited. As on December 31, 2019, the company had 29 subsidiaries including direct as well as step down subsidiaries, which are all enlisted in Annexure-2.

About the company

Incorporated in 1961, BFL is the flagship company of the Pune-based Kalyani Group, which has interest in forging, auto components, speciality steels, infrastructure, renewable energy and speciality chemicals business. BFL is the largest forging company in India and amongst the largest player in the world second only to Thyssen Krupp in terms of its installed capacity and revenues. It has a diversified global customer base including the top five CV and PV manufacturers in the world. BFL's customer base includes virtually every global automotive OEM and tier-I supplier.

The company's business broadly comprises two segments – (i) auto components (56% of consolidated revenue) and (ii) non-automotive components (44% of consolidated revenue). Within the auto-components segment, BFL primarily manufactures forging-based engine and chassis components with focus on crankshafts and front-axle beams. It is one the leading suppliers of crankshafts and front-axle beams to CV OEMs in India, Europe and North America and enjoys a sizeable share of business with leading OEMs. In terms of its geographical mix, America is the largest market for BFL in term of turnover followed by India and Europe. Over the years, BFL has followed a two-pronged diversification strategy. During the first phase, the company diversified its presence across markets through a series of overseas acquisitions and transformed its business model from being a forgings-based auto-components company with domestic market presence to an entity with global scale and customer base. Over the next phase, it has diversified its presence in the non-automotive applications.

Key financial indicators

Consolidated	FY2018	FY2019
Operating Income (Rs. crore)	8357.7	10145.7
PAT (Rs. crore)	754.4	1044.6
OPBDIT/OI (%)	20.6%	20.0%
RoCE (%)	17.7%	21.4%
Total Debt/TNW (times)	0.7	0.7
Total Debt/OPBDIT (times)	1.9	2.0
Interest Coverage (times)	16.2	16.0

OI: Operating Income; PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; ROCE: PBIT/Avg (Total Debt + Tangible Net-Worth + Deferred Tax Liability - Capital Work - in Progress)

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

	Instrument	Current Rating (FY2020)				Chronology of Rating History for the Past 3 Years			
		Type	Amount Rated	Amount Outstanding *	Date & Rating in FY2020 March 2020	Date & Rating in FY2020 September 2019	Date & Rating in FY2019 July 2018	Date & Rating in FY2018 July 2017	Date & Rating in FY2017 July 2016
1	Term Loan	Long-term	USD35 Million	USD 35 Million	[ICRA]AA+ (Negative)	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)
2	Fund-based Facilities	Long-term	Rs.2100.00 crore	Rs.1363.00 crore	[ICRA]AA+ (Negative)	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)
3	Non-fund Based Facilities	Short-term	Rs.700.00 crore	Rs.262.00 crore	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+

*Source: The company; *: Amount outstanding as on December 31, 2019*

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	Current Rating and Outlook
NA	Term Loan/ECB	March 2015	3M Libor+65 to 225 bps	March 2021	USD 35 Million	[ICRA]AA+(Negative)
NA	Fund-based Facilities	-	NA	-	2100.00	[ICRA]AA+(Negative)
NA	Non-fund Based Facilities	-	NA	-	700.00	[ICRA]A1+

Source: The company

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Direct Subsidiaries		
Bharat Forge Global Holding GmBH	100.00%	Full Consolidation
Bharat Forge International Limited	100.00%	Full Consolidation
Bharat Forge America Inc.	100.00%	Full Consolidation
BF Infrastructure Limited	100.00%	Full Consolidation
Kalyani Strategic Systems Limited	51.00%	Full Consolidation
Analogic Controls India Limited	100.00%	Full Consolidation
BF Elbit Advanced Systems Private Limited	51.00%	Full Consolidation
Indigenous Limited	NA	Full Consolidation
Tork Motors Private Limited	45.30%	Equity Method
Step Down Subsidiaries		
Bharat Forge Holding GmBH	100.00%	Full Consolidation
Bharat Forge AluminiumtechnikGmBH	100.00%	Full Consolidation
Bharat Forge Kilsta AB	100.00%	Full Consolidation
Bharat Forge CDP GmBH	100.00%	Full Consolidation
Bharat Forge DaunGmBH	100.00%	Full Consolidation
Bharat Forge CDP Trading	100.00%	Full Consolidation
MecaniqueGeneraleLangroise	100.00%	Full Consolidation
Bharat Forge Hong Kong Limited	100.00%	Full Consolidation
Bharat Forge PMT Technologies LLC	100.00%	Full Consolidation
Bharat Forge Tennessee Inc.	100.00%	Full Consolidation
BFIL-CEC JV	100.00%	Full Consolidation
Kalyani Rafael Advanced Systems Private Limited	50.00%	Full Consolidation
Lycan Electric Private Limited	100.00%	Equity Method
BF Premier Energy SystemsPrivate Limited	50.00%	Equity Method
BF NTPC Energy Systems Limited (under liquidation)	51.00%	Equity Method
TalbahnGmBH	35.00%	Equity Method
FerroviaTransrail Solutions Private Limited	49.00%	Equity Method
Hospet Bellary Highways Private Limited	35.00%	Equity Method
Tevva Motors (Jersey) Limited	36.21%	Equity Method

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About ICRA Limited:

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