

May 04, 2020

Tata Hitachi Construction Machinery Company Private Limited: Ratings reaffirmed and outlook on long-term rating revised to Negative from Stable

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund based/ non-fund based (interchangeable) facilities	900.0	900.0	[ICRA]AA/[ICRA]A1+ Reaffirmed; outlook on long-term rating revised Negative from Stable
Total	900.0	900.0	

*Instrument details are provided in Annexure-1

Rationale

The revision in outlook on the long-term rating factors in the ongoing slowdown in the domestic Construction Equipment (CE) which resulted in the industry volumes contracting sharply by ~22-24%+ during FY2020. Demand disruption during the General Election of May 2019 stretched into the rest of the year owing to a tight financing environment and lower infrastructure spending. Consequently, THCM's volumes declined by ~23% during FY2020, impacting the company's operating margins. Further, absence of sales during the last 10 days of the fiscal (which is seasonally a high-volume period for the company) given the outbreak of Covid-19 pandemic in India has resulted in significant inventory build-up as on March 31, 2020 necessitating high working capital debt on the company's books. The company's TD/OPBDITA stood at 3.9x as on March 31, 2020 as against 0.8x as on March 31, 2019 while the interest cover is estimated to have deteriorated to ~3-4x during FY2020 as against 16.8x during FY2019.

The ongoing lockdown in India is expected to incrementally dampen the demand for construction equipment during FY2021. With construction activities completely coming to a halt during the lockdown and most migrant workers returning to their hometowns, the disruption is likely to have an adverse impact on the cash flow position of the industry players in the near-term. Additionally, with the Government's focus on containing the pandemic amid fiscal challenges, there could be a delay in the release of funds to contractors, which in turn could lead to further elongation of contractor receivables and consequently demand for CE. However, given the significant target spends (towards the National Infrastructure Pipeline) across sectors, demand is likely to revive once the medium term as the industry situation normalizes. Overall, ICRA anticipates the company's financial performance to weaken in the near term, and the extent of the same would be a function of various factors such as the duration of the lockdown, the pace at which normal business activity resumes and the quantum of fiscal support.

Given the uncertain environment, the liquidity cushion between cash balances and available lines of credit, and debt servicing requirements are key rating drivers. In this respect, THCM's liquidity position is adequate with cash balances of ~Rs. 7.0 crore and undrawn working limits of ~Rs. 250 crore as on March 31, 2020. Against this, the company has monthly interest payments of Rs. 1-2 crore for the next three months and a long-term debt repayment of USD 24 million October 2020. The company also continues to operate under its mining services

segment (with steel and coal mining segment being classified as essential services) which is expected to contribute to revenues and accruals even as the lockdown is in place. ICRA also notes that THCM has taken steps to reduce its fixed expenses given the reduction in manufacturing output. Overall, ICRA believes that the company's current liquidity buffer is adequate for servicing the debt obligations and interest payments over the near term. However, the same could deteriorate in the event of prolonged production shutdown or significantly lower demand. Accordingly, ICRA would continue to monitor the developments in this regard and would review the company's financial performance in case the situation prolongs.

The company also remains exposed to intense competition (in both excavator and backhoe loader segment) and foreign exchange fluctuations (imports account for ~47-48% of its raw material costs). The depreciation of the Rupee towards second fortnight of March 2020 resulted in an MTM loss equivalent to 1.6% of FY2020 turnover which affected THCM's net margins adversely. Further, ICRA also notes the high product concentration risk with excavators contributing to more than 90% of the company's revenues during FY2020; the balance comes from backhoe loaders and other equipment and spare sales.

The ratings continue to take into account THCM's established position in the domestic CE industry with high market share of 35-40% in the excavator segment. The company enjoys strong technology support from its parent, Hitachi Construction Machinery Company Limited (HCMC, rated Baa1 / Stable by Moody's). HCMC is the world's third largest construction equipment manufacturer and the largest manufacturer of hydraulic excavators in the world.

Key rating drivers and their description

Credit strengths

Dominant market position of company in excavators – THCM's enjoys an established position in the domestic MCE industry with strong market share of 35-40% in the excavator segment. That said, THCM derives ~86% of its revenues from excavators indicating high product concentration.

Strong global major promoter lends considerable technological support– The company derives considerable technological and trade support from the promoter group, HCMC, one of the largest players in the global excavator market.

Credit challenges

Negative outlook for the CE industry impacted THCM's volumes during FY2020 – In line with steep volume de-growth in the run-up to the general elections and slow project awarding, the domestic CE industry is estimated to have de-grown by ~22-24%+ during FY2020. THCM's volume de-growth during FY2020 is estimated to be in line with industry trends.

Margins remain vulnerable to volatility in both foreign exchange and raw material prices – With high import content of ~47-48% and borrowings in foreign currency, the company continues to remain exposed to foreign currency fluctuations. However, the risk is mitigated to some extent by the foreign currency exposure management policy wherein majority of its yen-rupee exposure is hedged. The depreciation of the INR towards second fortnight of March 2020 resulted in an MTM loss equivalent to 1.6% of FY2020 turnover which affected

THCM's net margins adversely. Further, with steel forming major part of the company's raw material costs, the margins are vulnerable to fluctuations in steel prices.

Increased working capital borrowings on account of inventory build-up resulting in deterioration in THCM's credit metrics – Weak volume offtake and absence of sales during last 10 days of the fiscal (seasonally a high-volume period for the company) given the outbreak of Covid-19 pandemic in India has resulted in significant inventory build-up as on March 31, 2020 necessitating high working capital debt on the company's books. While the company had healthy debt protection metrics with TD/OPBDITA of 0.8x as on March 31, 2019 and interest coverage of 16.8x during FY2019, debt metrics have deteriorated to TD/OPBDITA of 3.9x as on March 31, 2020 and interest coverage of ~3-4.0x during FY2020.

Intense competition – Although the company is the leader in the Indian excavator segment, it faces intense competition, thereby constraining its pricing flexibility to a certain extent. THCM also faces competition from strong incumbents in the backhoe loader segment, where it is a marginal player despite healthy yoy growth in its backhoe loader volumes during FY2020.

Liquidity position: Adequate

Despite moderation in cash flow from operations during FY2020, THCM's liquidity is **adequate** with cash balances of ~Rs. 7.0 crore and undrawn working limits of ~Rs. 250 crore as on March 31, 2020. Against this, the company has monthly interest payments of Rs. 1-2 crore for the next three months and a long-term debt repayment of USD 24 million during October 2020. The company also continues to operate under its mining services segment (with steel and coal mining segment being classified as essential services) which is expected to contribute to revenues and accruals even as the lockdown is in place. ICRA also notes that THCM has taken steps to reduce its fixed expenses given the reduction in manufacturing output. Overall, ICRA believes that the company's current liquidity buffer is adequate for servicing the debt obligations and interest payments over the near term. However, the same could deteriorate in the event of prolonged production shutdown or significantly lower demand. Accordingly, ICRA would continue to monitor the developments in this regard and would review the company's financial performance in case the situation prolongs.

Rating sensitivities

Positive triggers – Given the negative outlook, a rating upgrade is less likely in the near term. The long-term rating of the company could be upgraded if the company's revenue growth and improve accompanied by the company's TD/OPBDITA being less than 1.25x on a sustainable basis.

Negative triggers – Negative pressure on THCM's ratings could arise if there is higher than expected decline in top line and margins due to persistent slowdown in demand. Further, delay in liquidation of inventory which in turn could lead to further deterioration in the company's liquidity position and credit profile will also lead to downgrade of ratings.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	Not applicable
Consolidation/Standalone	The ratings are based on standalone financial statements of the issuer

About the company

Tata Hitachi Construction Machinery Company Private Limited (THCM), formerly Telco Construction Equipment Company Limited, is one of the major players in the Indian mining and construction equipment (MCE) industry with a healthy share in the excavator market in India. Although 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 manufacturing facilities in Dharwad and Kharagpur.

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, 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. Currently, THCM is a joint venture between HCMC (60% stake) and Tata Motors Limited (40% stake). As per information available in the public domain, TML is engaging with HCMC to look at a stake sale in the company.

Key financial indicators

	FY2018	FY2019
Operating Income (Rs. crore)	3,823.2	4,337.0
PAT (Rs. crore)	288.1	235.9
OPBDIT/OI (%)	14.3%	9.8%
RoCE (%)	63.0%	44.7%
Total Outside Liabilities/Tangible Net Worth (times)	2.5	2.0
Total Debt/OPBDIT (times)	0.4	0.8
Interest Coverage (times)	19.7	16.8
DSCR	16.0	13.7

Source: Company

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2021)			Chronology of Rating History for the Past 3 Years				
		Type	Amount Rated (Rs. crore)	Amount Outstanding as on March 31, 2020 (Rs. crore)	Date & Rating	Date & Rating in FY2020	Date & Rating in FY2019	Date & Rating in FY2018	
					May 04, 2020	October 4, 2019	September 10, 2018	March 5, 2018	August 10, 2017
1	Fund based/ non-fund based (interchangeable) facilities	Long Term/ Short term (interchangeable)	900.0	656.0	[ICRA]AA (Negative)/ [ICRA] A1+	[ICRA]AA (Stable)/ [ICRA] A1+	[ICRA]AA+ (Stable) / [ICRA]A1+	[ICRA]AA- (Stable) / [ICRA]A1+	[ICRA]A+ (Positive) /A1+

Amount in Rs. crore

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 (Rs. crore)	Current Rating and Outlook
NA	Fund-based/non- fund based (interchangeable) facilities	-	-	-	900.0	[ICRA]AA (Negative) /A1+

Source: Company

Annexure-2: List of entities considered for consolidated analysis – Not applicable

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