Harsha Engineers International Limited
(Erstwhile Harsha Abakus Solar Private Limited)

March 07, 2022

Ratings

Facilities	Amount (Rs. crore)	Ratings[1]	Rating Action
Long Term Bank Facilities	127.19 (Enhanced from 10.50)	**CARE A+; Stable (Single A Plus; Outlook: Stable)**	**Revised from CARE BB (Double B) and removed from Credit watch with Positive Implications; Stable outlook assigned**
Long Term / Short Term Bank Facilities	270.00	**CARE A+; Stable /CARE A1+ (Single A Plus; Outlook: Stable / A One Plus)**	**Assigned**
Long Term / Short Term Bank Facilities	99.87 (Enhanced from 69.57)	**CARE A+; Stable / CARE A1+ (Single A Plus; Outlook: Stable / A One Plus)**	**Revised from CARE BB / CARE A4 and removed from Credit watch with Positive Implications; Stable outlook assigned**
Total Facilities	**497.06 (Rs. Four Hundred Ninety-Seven Crore and Six Lakh Only)**		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of Harsha Engineers International Limited (HEIL) have been removed from 'Credit watch with positive implications' upon completion of large part of the composite schemes of amalgamation and arrangement among Harsha Group companies as per the order of the Honourable National Company Law Tribunal (NCLT).

The revision in the ratings assigned to the bank facilities of HEIL takes into account significant improvement in the credit profile of the company consequent to amalgamation of the significantly stronger bearing cage manufacturing business of erstwhile Harsha Engineers Limited (HEL) in to HEIL. Simultaneously, the rating of 'CARE A+/CARE A1+; under credit watch with developing implications' for the bank facilities of HEL have been withdrawn as these bank facilities have been transferred to HEIL consequent to the aforesaid scheme of amalgamation.

The ratings assigned to the bank facilities of HEIL derive strength from its established operations in bearing cage business with state-of-the-art manufacturing facilities which ensures high quality standards, its status as the largest manufacturer of bearing cages in India, geographically diversified manufacturing facilities and its long-standing relationship with reputed clientele in the bearing industry. The ratings further draw comfort from recovery in performance of HEIL post Covid-19 pandemic induced lockdown, improved performance of its Chinese operations, gradually increasing presence in industrial bearing cage segment along with its comfortable debt coverage indictors, moderate capital structure and adequate liquidity.

The long-term rating is, however, constrained on account of its concentrated clientele dominated by three large players in the global bearing industry resulting in limited bargaining power for HEIL, susceptibility of its profitability to volatility associated with raw material prices and foreign exchange fluctuation risk, inherent cyclicality due to its linkages with the end-user automobile industry and subdued performance of its European subsidiary. Its long-term rating is further constrained by its presence in the competitive and fragmented solar power Engineering Procurement and Construction (EPC) business which has low entry barriers along with the long pending receivables associated with its solar power EPC business.

Rating Sensitivities

Positive Factors – Factors that could lead to positive rating action/upgrade:

- Volume-backed growth in its scale of operations through greater client and product profile diversification with TOI of more than Rs.1,500 crore (at prevailing raw material prices in 9MFY22) along with improvement in its PBILDT margin to more than 18% on a sustained basis
- Improvement in its Total Debt/PBILDT to less than unity and overall gearing to below 0.50 times on a sustained basis
- Significantly improved performance of its overseas subsidiaries on a sustained basis aiding its consolidated performance

Negative Factors – Factors that could lead to negative rating action/downgrade:

- Volume based decline in its scale of operations marked by TOI of less than Rs.1000 crore (at prevailing raw material prices in 9MFY22) on a sustained basis
- Reduction in its PBILDT margin to less than 12% on a sustained basis along with major adverse impact on its debt coverage indicators
- Elongation in its operating cycle to beyond 150 days affecting its liquidity

[1]Complete definitions of the ratings assigned are available at www.careedge.in and in other CARE Ratings Ltd.'s publications.

Schemes of amalgamation and arrangement
The Harsha group had announced two schemes of amalgamation and arrangement out of which one scheme (the major one) is concluded and another is under process. Under the first scheme, two subsidiaries of HEL viz. Harsha Engineers (India) Private Limited and Aastha Tools Private Limited were merged with HEL and thereafter HEL along-with Helianthus Solar Power Private Limited was merged with Harsha Abakus Solar Private Limited (HASPL, engaged in solar EPC business) as per the order of the Honourable NCLT dated December 23, 2021 with an appointed date of April 01, 2020. Subsequently, the name of HASPL was changed to HEIL in January 2022. Under the second scheme (which is currently under process), Harsha Engineers B.V., Netherlands (currently a subsidiary of HEIL) would be merged with HEIL.
The main objective of the schemes of business restructuring was to create a lean corporate structure wherein entire domestic operations (bearing cage manufacturing as well as solar EPC) were brought under one entity viz. HEIL which in turn has three major overseas subsidiaries in China, Romania and USA.

Detailed description of the key rating drivers
<u>Key Rating Strengths</u>
One of the largest domestic bearing cage manufacturers with well-established, state-of-the-art manufacturing facilities and advance in-house tooling design setup along with geographically diversified manufacturing facilities
HEIL has experience of more than three decades in the bearing cage industry and it is presently one of the largest manufacturers of bearing cages in India. HEIL has a well-established state-of-the-art manufacturing facilities and advance in-house tooling design setup at Ahmedabad which is run by a team of qualified and competent engineers. HEIL also has manufacturing facilities in Romania and China through inorganically acquired subsidiaries which enables it to cater to the requirements of its existing multinational clientele in those geographies more efficiently. HEIL has also developed tool designing as well as manufacturing skills which is critical for manufacturing different bearing cages as per customers' requirements. HEIL is a TPM certified company and since 2009, HEIL has also undertaken six-sigma initiatives to achieve higher efficiency and reduce operational costs.

Long-standing relationship with the world's three largest bearing manufacturers; albeit concentrated clientele
HEIL supplies bearing cages to leading global bearing manufacturers like *Timken, Schaeffler (including FAG) and SKF* at their various worldwide locations (including India). It has long-term sales contracts with some of its customers; albeit given the dominant position of these bearing companies, HEIL's bargaining power with them is relatively lower. Sales to the above mentioned three customers constituted around 72% of the standalone net sales of HEIL during FY21 (refers to the period April 1 to March 31).

Post pandemic recovery in bearing cage manufacturing segment
Despite the impact of Covid-19 pandemic, TOI of the bearing cage manufacturing business remained largely stable in FY21 while it witnessed significant growth during H1FY22 wherein the TOI stood at Rs.594 crore (which is around 72% of its TOI in FY21). This growth in TOI was driven by higher sales volume, improved demand for industrial castings as well as due to passing on of the increase in steel prices by way of higher sales realizations to its customers. The TOI from solar EPC segment remained low during FY21 and H1FY22 and during this period solar EPC segment continued to report operating losses.

Comfortable debt coverage indicators and moderate capital structure
Upon merger of the bearing cage business of HEL with solar EPC business of HASPL (now HEIL), the capital structure of HEIL witnessed moderation marked by an overall gearing of 1.01 times as on March 31, 2021 which marginally improved to 0.92 times as on September 30, 2021. The moderation was mainly upon addition of debt related to solar EPC business without corresponding addition to the net-worth base of the merged entity. The overall gearing ratio of HEL (before its merger) stood at 0.86 times as on March 31, 2020.
Debt coverage indicators of HEIL marked by Total debt/PBILDT stood comfortable at 3.76 times as on March 31, 2021 and further improved to 2.97 times in H1FY22 on the back of improved profitability in H1FY22. Also, its interest coverage improved from 4.14 times during FY21 to 7.15 times in H1FY22.

Improved performance of its Chinese operations
Upon merger of HEL's subsidiaries in China i.e., The Harsha Engineering Components (Changshu) Company Limited (HECCL) and Harsha Precision Bearings Components (China) Company Limited (HPBCL), and shifting of their operations to a single location, there is improved synergy between two operating plants which were earlier operating at two different locations. Upon successful shifting and stabilization of the new plant, the performance of HPBCL significantly improved marked by TOI of Rs.90.27 crore (PY: Rs.79.99 crore) with PBILDT margin of 19.59% during FY21 (PY: 3.78%).

Liquidity: Adequate
HEIL has adequate liquidity position characterized by adequate cushion in its cash accruals vis-à-vis term debt repayment obligations. During H1FY22, HEIL has earned gross cash accruals (GCA) of Rs.61 crore against scheduled term debt repayment obligation of Rs.38 crore for FY23. With an overall gearing of 0.92 times as on September 30, 2021, the issuer has adequate gearing headroom to raise additional debt for its capex. Operating cycle of HEIL stood high at 164 days in FY21 mainly on the back of long pending receivables related to its solar EPC business. HEIL's average utilization of its fund based working capital limits remained low at around 41% for the trailing 12 months ended January 2022 and the unutilized limits provide sufficient

cushion for additional working capital requirements to support the future growth in its operations. Its current ratio also stood adequate at 1.39 times as on March 31, 2021.

Key Rating Weaknesses

Subdued performance of solar EPC business along-with its associated long pending receivables

As HEIL (erstwhile HASPL) had executed a large solar power EPC project of 100 MW in FY18, its solar EPC business segment reported huge increase in its TOI to Rs.449 crore during the year from TOI of Rs.102 crore in FY17. However, in FY21, TOI from this segment declined to a level of Rs.54 crore. The solar EPC business continued to incur cash losses since FY19, however with declining scale of operations losses has also reduced in solar EPC segment. The primary reason for the loss was increased overheads as well as finance cost associated with the term debt availed to fund its working capital requirement on the back of declining scale of its operations. Going forward, the company management has decided to focus on relatively small sized ground mounted and rooftop solar projects. In order to curtail the losses, company has relieved many ground-mounted specialized manpower as HEIL is currently focusing on smaller size projects. As on March 31, 2021, HEIL had Rs.38.85 crore of debtors outstanding for more than three years related to solar EPC business whereby there is lack of clarity about the quantum and timelines for its actual collection.

Competitive and fragmented solar power EPC business with low entry barriers

As EPC business does not require any significant investment or gestation period, unlike manufacturing facilities, it entails high competition in relatively lower expertise EPC business such as solar power EPC. These low entry barriers have resulted in large number of organized and unorganized players entering the industry which has led to increased competition and pressure on profitability. However, HEIL has now decided to restrict itself to smaller size ground mounted projects with capacity up to 4-5 MW and solar rooftop projects which could result in non-recurrence of losses it had incurred in past.

Inherent cyclicality in its operations due to significant linkages of its prospects with that of the automobile industry

HEIL's bearing cages have major application in the bearings manufactured for the automobile sector and hence its fortunes are susceptible to slowdown in the demand of automobile industry which is inherently cyclical in nature. However, over the years, HEIL has gradually increased its exposure to industrial bearing and segments other than automobile in its sales mix to around 50% which is expected to mitigate this risk to some extent.

Weak performance of its European operations

During FY21, the performance of its European operations stood stable, marked by largely steady TOI of Rs.207 crore (PY: Rs.217 crore) along with PBILDT margin of 6.43% (P.Y. 7.72%). However, on the back of lower demand for bearing cages from windmill segment and increased power & fuel cost, the performance of its European operations weakened marked by TOI of Rs.129 crore with PBILDT level losses in H1FY22.

Inherent risk associated with foreign exchange rate fluctuations

On a standalone basis, HEIL's export sales constitute around 50% of its total sales. Although HEIL hedges its foreign exchange exposure through currency options, forward cover, use of packing credit in foreign currency and in-built clause in some of the contracts entered with its customers, it continues to remain susceptible to inherent foreign exchange fluctuation risk.

Risk associated with volatile raw material prices

The main raw materials used in the bearing cage manufacturing process are cold rolled and cold annealed steel strips and brass tubes, castings and strips. All these raw materials are mostly procured from domestic sources. High degree of volatility is associated with the price of its key raw materials which results in susceptibility of its profitability to the risk of volatility in commodity prices. However, HEIL has price escalation clause in some of its sales contracts, mitigating the risk of increase in price of raw material to some extent; albeit it takes effect with some time lag.

Analytical Approach: Consolidated, as HEIL has extended stand-by letter of credit for the bank facilities raised in its overseas subsidiaries which are also engaged in the similar line of business. The companies considered in HEIL's consolidation are given in ***Annexure 3***.

Applicable Criteria

Criteria on assigning 'outlook' and 'credit watch' to Credit Ratings
CARE's Policy on Default Recognition
Rating Methodology: Consolidation
Criteria for Short Term Instruments
Liquidity Analysis of Non-financial sector
Rating Methodology-Manufacturing Companies
Rating Methodology -Auto Ancillary Companies
Financial ratios – Non-Financial Sector

About the Company

Harsha Engineers International Limited (HEIL), formerly known as Harsha Abakus Solar Private Limited (HASPL) was initially incorporated in December 2010 to undertake solar EPC business by way of a joint venture (JV) between Harsha Engineers

Limited (HEL; which housed the bearing cage manufacturing business since 1972) and Abakus Solar AG (of Germany) with initial equity participation in the ratio of 76% and 24% respectively. Post that HEL had gradually increased its stake in HASPL to 96.87% which it later divested to the promoters of HEL (Rajendra Shah and Harish Rangwala families) who increased their equity stake in HASPL to 99.99% by March 31, 2017. Now, post the scheme of corporate restructuring with an appointed date of April 01, 2020, the group has merged HEL (bearing cage manufacturing business) in to HASPL and subsequently renamed HASPL as HEIL. Consequently, HEIL houses both businesses i.e. manufacturing of bearing cages and solar EPC business.

(Rs. Crore)

Brief Financials - HEIL Consolidated	FY20 (A; Restated)	FY21 (A)	H1Y22 (A)
Total operating income	898.97	880.14	637.60
PBILDT	103.06	124.27	88.60
PAT	21.91	45.43	43.70
Overall gearing (times)	1.41	1.01	0.92
Interest coverage (times)	3.14	4.14	7.15

A: Audited;

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating History (Last three years): Please refer Annexure-2

Covenants of rated instrument / facility: Not Applicable

Complexity Level of various instruments rated for this company: Please refer Annexure-4

Annexure-1: Details of Instruments / Facilities

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Non-fund-based - LT/ ST-BG/LC		-	-	-	99.87	CARE A+; Stable / CARE A1+
Fund-based - LT-Term Loan		-	-	December 2025	127.19	CARE A+; Stable
Fund-based - LT/ ST-Cash Credit		-	-	-	270.00	CARE A+; Stable / CARE A1+

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/ Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2021-2022	Date(s) & Rating(s) assigned in 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019
1	Non-fund-based - LT/ ST-BG/LC	LT/ST*	99.87	CARE A+; Stable / CARE A1+	-	1)CARE BB / CARE A4 (CWP) (26-Mar-21) 2)CARE BB; Stable / CARE A4 (08-Sep-20)	1)CARE BB+; Stable / CARE A4+; ISSUER NOT COOPERATING* (31-Mar-20)	1)CARE BBB-; Stable / CARE A3 (25-Mar-19)
2	LT/ST Fund-based/Non-fund-based-EPC / PCFC / FBP / FBD / WCDL / OD / BG / SBLC	LT/ST*	-	-	-	1)Withdrawn (08-Sep-20)	1)CARE BB+; Stable / CARE A4+; ISSUER NOT COOPERATING* (31-Mar-20)	1)CARE BBB-; Stable / CARE A3 (25-Mar-19)
3	Fund-based/Non-fund-based-LT/ST	LT/ST*	-	-	-	1)Withdrawn (08-Sep-20)	1)CARE BB+; Stable / CARE A4+; ISSUER NOT COOPERATING* (31-Mar-20)	1)CARE BBB-; Stable / CARE A3 (25-Mar-19)
4	Non-fund-based - LT-Bank Guarantee	LT	-	-	-	1)Withdrawn (08-Sep-20)	1)CARE BB+; Stable; ISSUER NOT COOPERATING* (31-Mar-20)	1)CARE BBB-; Stable (25-Mar-19)
5	Fund-based - LT-Term Loan	LT	-	-	-	1)Withdrawn (26-Mar-21) 2)CARE BB; Stable (08-Sep-20)	1)CARE BB+; Stable; ISSUER NOT COOPERATING* (31-Mar-20)	1)CARE BBB-; Stable (25-Mar-19)
6	Fund-based - LT-Term Loan	LT	127.19	CARE A+; Stable	-	1)CARE BB (CWP) (26-Mar-21)	-	-
7	Fund-based - LT/ ST-Cash Credit	LT/ST*	270.00	CARE A+; Stable / CARE A1+				

* Long Term / Short Term

Note: Part of the above bank facilities of HEIL were last rated at *'CARE A+ / CARE A1+; under Credit watch with developing implications'* in Harsha Engineers Limited (HEL) before it was withdrawn following the merger of HEL with HEIL and consequent transfer of these facilities to HEIL.

Annexure 3: List of entities consolidated

Name of the company	Relationship	% Holding of HEIL
Harsha Precision Bearings Components China Company Limited (HPBCCL)	Subsidiary	100.00%
Harsha Engineers B.V (HEBV)	Subsidiary	100.00%
HASPL Americas Corporation (HAC)	Subsidiary	100.00%
Harsha Engineers Europe SRL (HESSRL)	Step down Subsidiary	99.99%
Cleanmax Harsha Solar LLP	Joint Venture	50.00%

Annexure 4: Complexity level of various instruments rated for this company

Sr. No	Name of instrument	Complexity level
1	Fund-based - LT-Term Loan	Simple
2	Fund-based - LT/ ST-Cash Credit	Simple
3	Non-fund-based - LT/ ST-BG/LC	Simple

Annexure 5: Bank Lender Details for this Company
To view the lender wise details of bank facilities please click here

Note on complexity levels of the rated instrument: CARE Ratings Ltd. has classified instruments rated by it on the basis of complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careedge.in for any clarifications.

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