HFCL Limited

July 07, 2021

Ratings

Facilities/Instruments	**Amount (Rs. crore)**	**Ratings**	**Rating Action**
Long Term Bank Facilities	579.77	**CARE A-; Negative (Single A Minus; Outlook: Negative)**	**Reaffirmed**
Short Term Bank Facilities	1,842.02	**CARE A2 (A Two)**	**Reaffirmed**
Total Bank Facilities	**2,421.79 (Rs. Two Thousand Four Hundred Twenty-One Crore and Seventy-Nine Lakhs Only)**		
Non Convertible Debentures	11.24	**CARE A-; Negative (Single A Minus; Outlook: Negative)**	**Reaffirmed**
Total Long Term Instruments	**11.24 (Rs. Eleven Crore and Twenty-Four Lakhs Only)**		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The reaffirmation for the ratings assigned to the bank facilities and instrument of HFCL Limited (HFCL) continues to derive strength from its experienced promoters and management team, long track record of operations and strategic business relationship with Reliance Jio Infocomm Limited (RJIL), comfortable financial profile along with strong order book which provides medium-term revenue visibility for the company.

The ratings, however, remain constrained by significantly high outstanding debtors leading to elongated operating cycle and increased working capital intensity, counter-party risks and its susceptibility to the regulatory oversights governing the telecom sector.

Going forward, the ability of the company to profitably scale-up its operations along with improving its operating cycle by efficient management of its working capital and maintaining its capital structure shall remain the key rating sensitivities.

Key Rating Sensitivity:

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

- Ability of the company to profitability scale up its operations by more than 30% over FY21 total operating income on a sustained basis.
- Improvement in the average collection period to less than 100 days on a sustained basis.

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

- Any sizeable debt funded capex undertaken/ elevated working capital borrowings (including LC acceptances) leading to its debt remaining above Rs.1200 crores on a sustained basis.
- Slower than anticipated realization of the outstanding debtors impacting the liquidity profile of the company.

Outlook: Negative

The outlook continues to remain Negative on account of CARE's belief that the liquidity profile of HFCL may weaken on account of significantly high outstanding debtors as on March 31, 2021 due to slow execution of projects on account of site unavailability and further by slow release of funds by BSNL against their own contracts resulting in higher utilization of fund-based and non-fund based limits. The outlook may be revised back to Stable, in case HFCL is able to timely realize its outstanding debtors along with reduction in its total debt levels (including LC acceptances) and increase in demand for optical fiber cable leading to improved collection period and moderate utilization of working capital limits.

Detailed description of the key rating drivers

Key Rating Strengths

Long and established track record with highly experienced management team and strong association with RJIL

Mr. Mahendra Nahata, the managing director of the company, has a business experience of more than thirty-five years in the telecom sector. He is also on the Board of RJIL since 2010 and is associated with various forums related to the industry. He is assisted by the management team comprising of officials who are highly experienced in their respective domains.

The company also has a strong association with RJIL, with HFCL being responsible for execution of RJIL's network expansion plans for the Northern region. HFCL has been associated with them since the network roll out of RJIL started and has been responsible for network planning, design and implementation of its network for the Northern region. However, the contribution of revenue from RJIL to the total operating income of HFCL is decreasing y-o-y. RJIL contributed ~63% to the total revenue of HFCL in FY18 which decreased to 24% in FY21. The current order book also has around 14% orders of from RJIL.

Strong order book providing revenue visibility and diversifying customer base

HFCL has a strong order book (consolidated) with the company having firm orders to the tune of Rs. 5696.89 crore and orders under release of Rs. 1177.85 crore totalling to Rs.6874 crore as on March 31, 2021 (which is ~1.54x of FY21 TOI). Out of the total order book, orders of Rs. 2851.21 crore are where BSNL is the implementing agency (95% of which are funded out of Network for Spectrum (NFS) funds and 1% from Universal Service Obligation Fund (USOF)). The management has been diversifying its customer base by focusing on PSU contracts which have potential business with 'Digital India' programme of GoI. The order book broadly consists of 51% defence projects (DWDM, GOFNMS, MW Radios, IPMPLS, etc.), 14% optical fiber cable, 15% from Reliance Jio, 6% from BharatNet and balance from miscellaneous segments such as Railway Communications, Smart City etc.

The order book is also well diversified with revenue stream across geographies such as Punjab, J&K, Rajasthan, Uttarakhand, Himachal Pradesh, Uttar Pradesh, Delhi, Chhattisgarh, Madhya Pradesh, Andhra Pradesh, Telangana etc.

Comfortable financial profile

The total operating income on a consolidated basis witnessed a growth of 15.57% in FY21 to reach Rs. 4459.09 crore as against Rs. 3858.13 crore in FY20. HFCL on a consolidated basis registered healthy traction on its key defence projects during FY21. The profitability margin however remained stable with PBILDT margin at 13.14% in FY21 (PY: 13.30%). The PAT margin has however moderated to 5.52% in FY21 the same is primarily on account of increase in interest and depreciation cost during the year. This increase in interest cost is on account of LC rollover in FY21 from 30 to 90 days resulting in additional interest. Further, for the capex of the fibre plant in Hyderabad the interest cost was getting capitalized. However, as the capex is now completed the same is charged to P&L.

The overall gearing (including acceptances) of HFCL witnessed an increase to 0.75x as on March 31, 2021 vis-à-vis 0.52x as on March 31, 2020. The same was on account of significant increase in LC acceptances (which are part of trade payables) which stood outstanding at Rs. 465 crore as on March 31, 2021 along with significant increase in working capital borrowings. Further, the term loan also increased marginally due to the capex of Rs. 58 crs during FY21 towards setting up of its FTTH facilities and Phase IV expansion under HTL i.e., expansion in OFC capacity from 7 Mn fibre km to 10.5 Mn fibre km.

The total debt increased during the year and stood at Rs. 1406.88 crore as on March 31, 2021 as against Rs. 843.70 crore as on March 31, 2020. Further, the other coverage indicators also marginally deteriorated in FY21 with interest coverage at 3.33x (PY: 4.47x) and total debt to GCA at 4.41x (PY: 2.43x).

Moderate Liquidity

HFCL had free cash & bank balance of Rs. 18.50 crore as on March 31, 2021 (total cash & bank of ~Rs. 316 crore, balance is margin money against NFB limits) and liquid investments of Rs. 5.79 crore as on March 31, 2021. The company has consolidated bank debt repayments of Rs. 70 crore due in FY22 and Rs. 11.24 crore towards repayment of NCDs. Along with this, the outstanding LCs of ~Rs. 465 crores as on March 31, 2021 are to be crystalized month on month till September 2021. The average and maximum working capital utilization for the past 12 months ended April 2021 stood at 80.92% and 90.72% respectively.

Industry scenario and potential demand

The global fiber optic cable market was valued at USD 9.24 billion in 2020, and it is expected to reach USD 20.83 billion by 2026 at a CAGR of 14.5%. Submarine cables act as the backbone of the internet. There are about 350 submarine cables spanning 1.2 million kilometres connecting around 100 countries with USD 8 billion investments for 2019-21. Optical fiber cable (OFC) is a significant building block in the telecommunication infrastructure and is chosen by telecoms and consumers due to its high data volume capacity and lightweight nature which is associated with low susceptibility to noise and intrusion. In the Asia Pacific region, China dominates not only the regional market but also the global fiber optic cable market. The country has a high density of optical fiber network and is aggressively investing in new optical fiber infrastructure.

In the past decade, India has emerged as one of the fastest growing digital economies and the largest consumers of data globally. Efforts have been made to improve broadband connectivity in rural areas with projects such as BharatNet offering broadband connectivity to all 2.5 lakh Gram Panchayats in India. The rise of cloud adoption across industries and the growth potential with respect to increasing demand for OFC from the IT & telecom sector, rising number of mobile devices, increasing adoption of FTTH (Fiber to the Home) connectivity, and surging number of data centers is further anticipated to fuel fiber optic cables market in India over the coming years. Moreover, owing to their security, scalability, and the unlimited bandwidth potential to handle the vast amount of traffic being generated, fiber optic cables are also being chosen to support the bandwidth levels catering to advanced technologies like 5G, Big Data, and IoT that rely heavily on real-time data collection and transfer. The pandemic accelerated the adoption of new digital technologies and created a hybrid work model in many companies. The expectations of 5G rollout in the near future is expected to present the need for equipment upgrades such as focus on new business models hinged on fiber, small cells, data centers, Wi-Fi, smart cities and beyond.

Increasing demand in FTTX and telecommunications industry and technological advancements are primarily responsible for the increased growth of the market. As telecom operators are looking for high fiber count cables in reduced diameters, optical fiber and cable manufacturers are investing in research and development to realize smaller fibers and cables. Global technology spends are expected to continue being upbeat in FY22 with robotics, artificial intelligence, cybersecurity, IoT the key technology focus areas in FY22.

Key weaknesses

Significant elongation in the operating cycle resulting in moderation of liquidity position

HFCL's operating cycle has been increasing y-o-y from 67 days in FY19 to 112 days in FY21 primarily on account of increase in collection period which increased from 106 days in FY19 to 195 days in FY21. The total debtors in absolute terms increased to Rs. 3055.82 crore as on March 31, 2021 as against Rs. 1729.69 crore as on March 31, 2020. The same in on account of delays in the execution of certain contracts due to site unavailability and outbreak of Covid-19 resulting in the material invoice value to be stuck. Furthermore, the company recorded significantly high sales in March'21 of Rs. 725 crore against sales of Rs. 263 crs in March'20. Thus, while the company has billed for those projects, it has not actually fallen due for payment as per commercial terms of respective contracts subject to completion of acceptance test and actual installation and commissioning of material on site.

As for the overall debtors, IPMPLS, GOFNMS and DWDM comprise almost 58% of the group's overall debtors as on date. Out of total billing of Rs. 4100 crs till date against these projects, a sum of Rs 2352 crs have been received till Mar 21. While the total outstanding debtors against the projects stand at Rs 1748 crs in value terms, Rs. 1670 crs has not become due for payment as per contractual terms. The company expects part amount to fall due on completion of Regional AT (Acceptance Test), and balance after 90 days.

Further, ~43% of the group's overall debtors as on Mar 21 amounting to Rs. 1767 crs have not fallen due for payment as per commercial terms of contract. Also, out of the total debtors as on March 31, 2021 debtors to the tune of Rs. 62.38 crores (~2% of total debtors), pertain to direct contracts of BSNL which got stuck due to liquidity issues at BSNL's end. During FY21, company has received a sum of Rs 68 crore out of Rs. 130.33 crores outstanding as on March 31, 2020 against these BSNL projects. The other BSNL debtors are for projects which are funded by DOT for which there is a dedicated escrow account created by DOT against NFS projects in which all NFS project related proceeds are credited by DOT.

Further, HFCL enters into back-to-back arrangements with its suppliers/OEM partners in line with payment terms from authorities and hence, against a corresponding increase in the receivable levels, there has been an increase in the payable levels as well. However, the increase in creditor period is not proportionate to increase in collection period thus resulting in elongation of operating cycle and stretch in the liquidity position of the company.

Ongoing capex plans

During FY21, the group commenced setting up manufacturing facility of FTTH cables, Micro-module OFC, CATV OFC, Multi-Tube OFC & IBR OFC (Intermittently Bonded Ribbon) at its existing Fiber manufacturing facility at Hyderabad, Telangana in a phased manner. While it achieved COD under Phase I of its FTTH division in Nov 20, the remaining product lines are expected to operationalize gradually between FY21-FY24. Further, the group on a consolidated basis is projecting a capex of ~Rs. 400 crore (including Rs. 125 crore for R&D) over a span of next two years, which is to be funded with debt of Rs 160 crore and balance through internal accruals.

Counterparty Credit Risk

Presently majority of HFCLs orders are funded mainly by the Central Government of India. These orders typically have tenure of 18-24 months and the payment terms vary from order to order. This may result in cash flow fluctuations as well as increase in the working capital requirements to support the operations. The company also has large orders from state run companies Jharkhand Communications Network Limited (JCNL) for the government's mega project BharatNet. With the prevailing weakness in the telecom sector, these companies are currently facing financial stress which has adversely impacted the company's business profile. However, with the revival package announced for BSNL as well as Government's intent to bring the BharatNet project back on track, the financial stress in these companies is expected to reduce which in turn will improve demand for HFCL.

Analytical approach: Consolidated.

Companies considered in consolidated financials:

Name of Subsidiary Company	% of share Holding
HTL Limited	74%
Polixel Security Systems Private Ltd	100%
Moneta Finance (P) Ltd	100%
HFCL Advance Systems (P) Ltd	100%
DragonWave HFCL India Private Limited	100%
Radeff Private Limited	90%

Applicable Criteria

Criteria on assigning 'outlook' and 'credit watch' to Credit Ratings

[CARE's Policy on Default Recognition](#)
[Financial ratios – Non-Financial Sector](#)
[Criteria for Short Term Instruments](#)
[Rating Methodology - Manufacturing Companies](#)
[Rating Methodology – Construction Sector](#)
[Rating Methodology: Consolidation](#)
[Liquidity Analysis of Non-Financial Sector Entities](#)

About the Company
HFCL Ltd (Erstwhile Himachal Futuristic Communications Limited) was incorporated in the year 1987 to set up a plant in Solan (Himachal Pradesh) for assembling of telecom equipment. Subsequently, the company has ventured into various segments viz. Optical Fibre Cable (OFC) manufacturing in 1997 by setting up a plant at Goa and commenced rendering turnkey services in 1998. Under the turnkey services, the company provides and implements projects for complete site infrastructure for mobile operators, satellite & radio communication, optical transport networks and spectrum management solution and has worked for various private and government operators including major GSM vendors. HFCL earns majority of income from turnkey services (73% in FY21). Under sale of telecom equipment's, HFCL manufactures and sells telecom equipment in Optical, Wireless, and Wireline technologies (like 3G and 4G Repeaters, Broadband, etc.).

Covenants of rated instrument / facility: *Detailed explanation of covenants of the rated instruments/facilities is given in Annexure-3*

Brief Financials (Rs. crore)	FY20 (A)	FY21 (A)
Total operating income	3858.13	4455.88
PBILDT	513.32	582.50
PAT	237.34	246.24
Overall gearing (times)	0.52	0.75
Interest coverage (times)	4.47	3.31

A: Audited

Status of non-cooperation with previous CRA: Not Applicable
Any other information: Not Applicable
Rating History for last three years: Please refer Annexure-2

Annexure-1: Details of Instruments/Facilities

Name of the Instrument	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Fund-based - LT-Term Loan	-	-	2027	204.77	CARE A-; Negative
Fund-based - LT-Cash Credit	-	-	-	375.00	CARE A-; Negative
Non-fund-based - ST-BG/LC	-	-	-	1842.02	CARE A2
Debentures-Non Convertible Debentures	March 28, 2017	10.30	30 Sep 2021	11.24	CARE A-; Negative

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.	Fund-based - LT-Term Loan	LT	204.77	CARE A-; Negative	-	1)CARE A-; Negative (07-Dec-20) 2)CARE A-; Negative (07-Jul-20)	1)CARE A-; Negative (29-Jan-20) 2)CARE A-; Stable (03-Jul-19)	1)CARE A-; Stable (23-Jan-19) 2)CARE A-; Stable (03-Jul-18) 3)CARE A-; Stable (25-Jun-18)
2.	Fund-based - LT-Cash Credit	LT	375.00	CARE A-; Negative	-	1)CARE A-; Negative (07-Dec-20) 2)CARE A-; Negative (07-Jul-20)	1)CARE A-; Negative (29-Jan-20) 2)CARE A-; Stable (03-Jul-19)	1)CARE A-; Stable (23-Jan-19) 2)CARE A-; Stable (03-Jul-18) 3)CARE A-; Stable (25-Jun-18)
3.	Non-fund-based - ST-BG/LC	ST	1842.02	CARE A2	-	1)CARE A2 (07-Dec-20) 2)CARE A2 (07-Jul-20)	1)CARE A2+ (29-Jan-20) 2)CARE A2+ (03-Jul-19)	1)CARE A2+ (23-Jan-19) 2)CARE A2+ (03-Jul-18) 3)CARE A2+ (25-Jun-18)
4.	Debentures-Non Convertible Debentures	LT	11.24	CARE A-; Negative	-	1)CARE A-; Negative (07-Dec-20) 2)CARE A-; Negative (07-Jul-20)	1)CARE A-; Negative (29-Jan-20) 2)CARE A-; Stable (03-Jul-19)	1)CARE A-; Stable (23-Jan-19) 2)CARE A-; Stable (25-Jun-18)
5.	Preference Shares-Cumulative Redeemable Preference Shares	LT	-	-	-	-	1)Withdrawn (03-Jul-19)	1)CARE BBB+ (RPS); Stable (03-Jul-18)

Annexure-3: Detailed explanation of covenants of the rated instrument / facilities: NA

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

Sr. No.	Name of the Instrument	Complexity Level
1.	Debentures-Non Convertible Debentures	Simple
2.	Fund-based - LT-Cash Credit	Simple
3.	Fund-based - LT-Term Loan	Simple
4.	Non-fund-based - ST-BG/LC	Simple

Note on complexity levels of the rated instrument: *CARE has classified instruments rated by it on the basis of complexity. This classification is available at www.careratings.com. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

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