Hindustan Aeronautics Limited

September 20, 2021

Ratings

Facilities/Instruments	**Amount (Rs. crore)**	**Rating[1]**	**Rating Action**
Long-term / Short-term (LT/ST) Bank Facilities	12,050.00	**CARE AAA; Stable/CARE A1+ (Triple A; Outlook: Stable/ A One Plus)**	Revised from CARE AA+; Stable/CARE A1+ (Double A Plus; Outlook: Stable/A One Plus)
Total Bank Facilities	**12,050.00 (Rs. Twelve thousand fifty crore only)**		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The revision in the long-term rating assigned to the bank facilities of Hindustan Aeronautics Limited (HAL) is on account of the significant improvement in its operating and financial performance along with strong growth in its order book. The order book of the company grew to Rs.80,639 crore as on March 31, 2021, as compared with Rs.52,965 crore as on March 31, 2020, on the back of new orders for 83 Light Combat Aircrafts (LCA) of about Rs.37,000 crore which provides long-term revenue visibility and reinforces the strategic importance of HAL to the Government of India (GoI) as its core defence aviation equipment supplier. The GoI remains HAL's majority shareholder despite divestment of part of its stake in August 2020. HAL has an integrated presence through design, development, manufacturing, maintenance and overhaul of aviation products and is the dominant supplier of aircrafts, helicopters, engines, accessories, etc, to the Indian defence forces. The relatively stable repair and over-hauling (ROH) order book where the gross margins are relatively higher continues to provide stability to its revenue.
The receivables level of HAL from the Indian Air Force (IAF) had witnessed substantial increase during FY19 (refers to the period April 1 to March 31) and FY20 due to which HAL's reliance on debt to fund its working capital had increased significantly and the surplus liquidity maintained by the company in the past had also got depleted. However, with release of significant amount of dues from its defence sector customers in FY21, its outstanding receivables reduced to Rs.5,639 crore as on March 31, 2021, as compared with Rs.11,235 crore as on March 31, 2020. With the increase in cash generated from operations, the debt level reduced to a negligible level as on March 31, 2021, and the company had surplus liquidity in the form of cash and cash equivalents of Rs.7,164 crore as on March 31, 2021. Going ahead, as strongly articulated by the company, HAL's collection period is expected to remain under control which would result in continued low reliance on debt and maintenance of significant surplus liquidity.
The ratings also take comfort from the high-entry barrier in the business considering the capital intensity and long gestation period required for developing the manufacturing and servicing facilities. HAL continues to invest in research and development resulting in continually improving product portfolio in a technology-intensive industry. The government's initiatives for promoting domestic manufacturing and HAL's established relationship with its customers is expected to continue to benefit HAL in the long run, though there might be increase in the competition from the private sector.
The ratings also take note of HAL's high dependence on the Ministry of Defence, GoI, for the contracts and the annual budget allocation towards strengthening the defence infrastructure.

Rating Sensitivities

Positive Factors – *Factors that could lead to positive rating action/upgrade:* Not applicable

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

- Any significant fall in the company's order book and/or substantial dilution of GoI stake in the company.
- Substantial increase in bank borrowings on a sustained basis resulting in significant deterioration of its leverage.
- Significant decline in its surplus liquidity in the form of cash and cash equivalents maintained by the company.

Detailed description of the key rating drivers

Key Rating Strengths

HAL's strategic importance to the Indian defence sector and GoI's majority ownership

HAL is a *Navratna* Central PSU promoted and majorly owned by GoI. HAL plays a strategic role in India's defence programme being the major Indian company having specialization in aircraft manufacturing and providing its ROH services. Furthermore,

[1]*Complete definitions of the ratings assigned are available at www.careratings.com and in other CARE publications.*

HAL has an established track record in offering product life cycle support. The company's competitive position remains strong as it maintains leadership position in the Indian Aerospace and Defence industry, being GoI's prime defence contractor and supported by defence outlays of the GoI.

Significant improvement in order book providing healthy revenue visibility
HAL's order book improved to Rs.80,640 crore as on March 31, 2021 (March 21, 2020: Rs.52,966 crore) with significant increase in manufacturing order book on the back of orders received from GoI for 83 LCA valued at about Rs.37,000 crore to be supplied over the next eight years. The ROH order book remained healthy at Rs.13,313 crore and is expected to remain robust in near to medium term as HAL undertakes the repair and maintenance work of aircraft manufactured by it for its entire life as well as for aircrafts manufactured by others for which it has built infrastructure across the country. Furthermore, there remains visibility of future orders with new orders anticipated for various aircrafts in the near to medium term.
Given the significantly long tenure of its contracts, HAL enters into variable price contracts with its customers, viz., Indian Airforce, Indian Army and Indian Navy, which have escalation clauses for increase in cost including forex fluctuation on procurement and y-o-y escalation built-in the pricing of its long-term contracts. This protects its margins from forex and raw material price escalation to a large extent.

Strong financial risk profile marked by stable profitability and cash accruals
HAL continues to have a sizeable scale of operations and the total operating income grew y-o-y by 5% from Rs.21,325 crore in FY20 to Rs.22,500 crore in FY21 majorly on the back of increase in revenue from repairs and maintenance of aircrafts. The PBILDT margin stood healthy at 23.42% in FY21 as against 22.90% in FY20. The company earned Gross Cash Accruals (GCA) of Rs.4,904 crore in FY21 as against Rs.3,777 crore in FY20. Its debt coverage indicators remain strong.

Improvement in the operating cycle and significant reduction in debt level
The receivables of HAL reduced to Rs.5,639 crore as on March 31, 2021, as against Rs.11,235 crore as on March 31, 2020. The outstanding receivables were from GoI (primarily relating to supplies to the IAF). The government released substantial payment to HAL in February 2021 resulting in noteworthy improvement in its receivable days to 136 days in FY21 as against 201 days in FY20.
HAL also receives advance from its customers against the contracts which constitutes a stable source of funding its working capital requirement. The advances increased to Rs.13,345 crore as on March 31, 2021, as against Rs.7,013 crore as on March 31, 2020.
The release of receivables along with increase in advances resulted in HAL significantly reducing its working capital debt to Rs.9 crore as on March 31, 2021, as against Rs.5,887 crore as on March 31, 2020. The same resulted in improvement in its overall gearing ratio to almost nil as on March 31, 2021, as against 0.49x as on March 31, 2020. The company has strongly articulated that going forward HAL's debt level is expected to remain low on the back of sustaining its improved collection period.

Fully-integrated production capabilities and continually improving product portfolio
Over the years, HAL has developed its capability to operate under the entire value chain of the aviation production right from design, development, manufacturing, maintenance, repair and overhaul. The company has twenty production/ overhaul divisions and eleven R&D centers co-located with production divisions across the country. Apart from design and manufacturing, HAL takes up maintenance and overhaul services to cover the life cycle requirement of all the old and new products, which is also a very important revenue generator for HAL. The company is also setting up a new facility in Karnataka to expand its manufacturing capacity for defence helicopters and other products. The total cost of the capex is estimated to be around Rs.5,000 crore spread over a period of five years out of which the company has already incurred Rs.600 crore as on March 31, 2021. The project is proposed to be entirely funded out of internal cash generation.

Strong research and development capabilities
HAL is present in an industry which demands constant innovation and technological advances. Consequently, it is critical for HAL to adapt to technological advancements and absorb imported technologies. In order to ensure the same, the company has been regularly spending on R&D through its eleven R&D centres. The company has been making dedicated contribution towards R&D costs over the years.

Liquidity: Strong
HAL has witnessed significant improvement in its liquidity position with reduction in receivables and increase in advances from customers. Its free liquidity improved significantly from Rs.298 crore as on March 31, 2020 to Rs.7,164 crore as on March 31, 2021, which further increased to about Rs.8,650 crore as on July 31, 2021. Its free liquidity is expected to be sustained at similar healthy levels going forward in the medium-term as strongly articulated by the company management. Furthermore, there has been negligible utilisation of its sanctioned fund-based working capital limits of Rs.10,000 crore since March 2021. The cash accruals remain healthy and are expected to comfortably meet its working capital and the planned capex requirement for its

new plant being set up in Karnataka over a period of next 5 years. The company does not have any term debt repayment obligations.
Furthermore, the company derives significant financial flexibility by virtue of it being majorly held by GOI and its strategic importance to the defence sector.

Key Rating Weaknesses
Prospects of the company depend on Indian Defence sector with limited exports
HAL derives majority of its revenues from the Indian defence sector. Accordingly, continuous flow of orders from defence segment which in turn is dependent upon defence budget is critical for the company's prospects. Apart from licensed production, HAL has focused on development of indigenous aircrafts and helicopters which can be translated into production orders and shall give revenue visibility for the next 5-10 years. Moreover, the company has been making efforts towards improving exports and aims to secure export orders arising out of bilateral Defence Cooperation agreements signed between the Government of India and the respective countries. However, the level of export continues to remain low.

Increasing private sector participation
Due to relaxation in foreign direct investment (FDI) guidelines to ease entry of foreign companies in India, there has been increase in alliance and collaboration between Foreign OEMs and Indian private companies coupled with government thrust on private participation in defence production. This may result in competition in the sector but given the huge investments required and HAL's established position in the sector along with its strategic relationship with its customers, competition is not expected to significantly impact the company in the medium term.

Analytical approach: Standalone along with strategic importance to GoI. Investments in the defence sector are critical to the government as seen from sustained annual budget allocation to the sector.
Applicable Criteria
Criteria on Rating Outlook and Credit Watch
CARE's Policy on Default Recognition
CARE's methodology for Short-term Instruments
Rating Methodology – Manufacturing Companies
Financial ratios – Non-Financial Sector
Rating Methodology: Notching by factoring linkages with Government
Liquidity Analysis- Non-Financial Sector

About the Company
HAL was incorporated in 1964 by the amalgamation of Hindustan Aircraft Limited and Aeronautics India Limited and is a 'Navratna' company. GoI held majority stake of 75.15% in the company as on March 31, 2021, while 14.47% was held by the Life Insurance Corporation of India. HAL is into carrying out design, development, manufacture, repair and overhaul of aircraft, helicopter, engines and related systems like avionics, instruments and accessories primarily serving Indian defence programme. It also manufactures the structural parts of various Satellite Launch Vehicles of the Indian Space Research Organization (ISRO).

Brief Financials (Rs. crore)	FY20 (A)	FY21 (A)
Total operating income	21325	22500
PBILDT	4883	5269
PAT	2842	3233
Overall gearing (times)	0.49	0.00
Interest coverage (times)	16.43	24.85

A: Audited
In Q1FY22, HAL reported PAT of Rs.199 crore on TOI of Rs.1,616 crore.
Status of non-cooperation with previous CRA: NA

Any other information: NA

Rating History for last three years: Please refer Annexure-2

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

Complexity level of various instruments rated for this company: Annexure 4
Bank lender details: Annexure 5

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
LT/ST Fund-based/Non-fund-based-EPC / PCFC / FBP / FBD / WCDL / OD / BG / SBLC	-	-	-	12050.00	CARE AAA; 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.	LT/ST Fund-based/Non-fund-based-EPC / PCFC / FBP / FBD / WCDL / OD / BG / SBLC	LT/ST*	12050.00	CARE AAA; Stable / CARE A1+	-	1)CARE AA+; Stable / CARE A1+ (03-Jul-20)	1)CARE AA+; Stable / CARE A1+ (26-Dec-19)	1)CARE AAA; Stable / CARE A1+ (07-Jan-19)
2.	Commercial Paper-Commercial Paper (Carved out)	ST	-	-	1)Withdrawn (28-Jun-21)	1)CARE A1+ (03-Jul-20)	1)CARE A1+ (14-Jan-20)	-
3.	Commercial Paper-Commercial Paper (Carved out)	ST	-	-	1)Withdrawn (28-Jun-21)	1)CARE A1+ (03-Jul-20)	1)CARE A1+ (09-Mar-20)	-

*Long Term / Short Term

Annexure-3: Detailed explanation of covenants of the rated instrument / facilities: Not applicable

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

Sr. No.	Name of the Instrument	Complexity Level
1.	LT/ST Fund-based/Non-fund-based-EPC / PCFC / FBP / FBD / WCDL / OD / BG / SBLC	Simple

Annexure 5: Bank Lender Details

Click here to view Bank Lender Details

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

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About CARE Ratings:
CARE Ratings commenced operations in April 1993 and over two decades, it has established itself as one of the leading credit rating agencies in India. CARE is registered with the Securities and Exchange Board of India (SEBI) and also recognized as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI). CARE Ratings is proud of its rightful place in the Indian capital market built around investor confidence. CARE Ratings provides the entire spectrum of credit rating that helps the corporates to raise capital for their various requirements and assists the investors to form an informed investment decision based on the credit risk and their own risk-return expectations. Our rating and grading service offerings leverage our domain and analytical expertise backed by the methodologies congruent with the international best practices.

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