HFCL Limited

July 07, 2023

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Long-term bank facilities	1,044.54 (Enhanced from 539.27)	CARE A; Stable	Reaffirmed
Short-term bank facilities	1,984.13 (Enhanced from 1,841.97)	CARE A1	Revised from CARE A2+
Non-convertible debentures	-	-	Withdrawn

Details of instruments/facilities in Annexure-1.

Rationale and key rating drivers

The ratings assigned to the bank facilities of HFCL Limited (HFCL) continues to derive strength from long and established track record with experienced management team and strong association with Reliance Jio Infocomm Limited (RJIL), healthy order book aggregating to around ₹5,492 crore and orders under release of ₹1,517 crore totalling to ₹7,009 crore as on March 31, 2023 which provides medium-term revenue visibility and its diversified customer base. Furthermore, the rating continues to take into account HFCL's comfortable financial risk profile characterized by healthy total operating income and improved profitability along with comfortable capital structure and revision in the short-term rating has factored in adequate liquidity with shortening of its working capital cycle.

HFCL is well placed to benefit from the increasing demand in the telecom industry driven by capex by major telcos globally towards 5G rollout and by domestic telcos/corporates towards network strengthening in light of increasing level of digitization. These rating strengths are, however, tempered by inherently working capital-intensive operations though reducing with the changing sales mix, risk associated with large-sized/ tender-based orders, project risk emanating from significant investments over the next two years in enhancing optic fibre and cable capacity as well as under PLI scheme, susceptibility to volatile raw material prices and prevalent competition in the industry. Care Ratings limited (CARE Ratings) however believes, that going forward, the operating cycle of the company would rationalize given its conscious strategy to increase the mix of product-based sales in total revenues and the near completion of some of its large sized turnkey projects especially the defence projects where the milestone linked payments are expected to be release during the next fiscal (FY24) leading to an expected improvement in the collections.

Furthermore, CARE Ratings has withdrawn the rating assigned to the NCD issue of HFCL with immediate effect, as the company has repaid the aforementioned NCD in full in September 2021 and there is no amount outstanding under the issue as on date.

Rating sensitivities: Factors likely to lead to rating actions

Positive factors

- Substantial improvement in scale of operations along with improvement in capital structure and coverage indicators, with Total Debt (Including acceptances)/EBITDA in the range of 2- 2.5x on a sustained basis.
- Improvement in the average collection period to less than 100 days on a sustained basis.

Negative factors

- Substantial decline in operating profitability due to global supply–demand mismatch, which could result in operating margin sliding below 12% on sustained basis. Slower than anticipated realization of the outstanding debtors having an impact on the liquidity profile of the company.
- Total debt (including acceptances) to PBILDT exceeding 3x on sustained basis.

Analytical approach: Consolidated. The subsidiaries being consolidated are as under:

Company	Shareholding
HTL Limited	74%
Polixel Security Systems Private Ltd	100%
Radeff Private Limited	90%
Nimpaa Telecommunications Private Limited	50%

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

Company	Shareholding
(Jointly controlled entity)	
HFCL Technologies Private Ltd	100%
BigCat Wireless Pvt. Limited (Jointly Controlled Entity with 50% voting right)	50%
Moneta Finance (P) Ltd	100%
HFCL Advance Systems (P) Ltd	100%
DragonWave HFCL India Private Limited	100%
HFCL B.V. (Wholly owned Subsidiary w.e.f. 07th October 2021) – Netherland	100%
HFCL Inc. (Wholly owned Subsidiary w.e.f. 08th October 2021) – United States of America	100%

Outlook: Stable

Stable outlook assigned to HFCL reflects the likelihood of HFCL to maintain its strong market position which coupled with favourable demand scenario shall enable it to sustain healthy operational and financial performance over the medium term. Furthermore, the continuous conscious strategy of HFCL to increase the mix of product-based sales in total revenues is likely to keep margin profile healthy over the medium term.

Detailed description of the key rating drivers:

Key strengths

Strong order book providing revenue visibility and diverse customer base

HFCL has a strong order book (consolidated) of ₹5,492 crore and orders under release of ₹1,517 crore totalling to 7,009 crore as on March 31, 2023 (which is 1.48x of FY23 TOI), giving a medium-term revenue visibility. HFCL had been awarded many new contracts including State Water & Sanitation Mission (SWSM), UP aggregating to around ₹ 1,770 crore for providing EPC Services, Surat metro, Dhaka metro, Railtel VSS (Video Surveillance System) to name a few. Under the SWSM contract, the company is required to setup infrastructure for supply of water to allocated villages in the division of Varanasi, Uttar Pradesh. The project is expected to be executed by September 2024. Post-completion of the project, the company is also required to provide operations and maintenance (O&M) services for a period of 10 years. The timely execution (reckoning the large size) and timely realisation of the receivables from the project will remain key monitorable.

Out of the total order book, BSNL is the implementing agency for orders of around ₹1700 crore (almost all of which are funded out of Network for Spectrum (NFS) funds). The order book is spread across different verticals – telecom, defence, railways, OFC Turnkey & manufacturing, Smart Cities 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.

Shift towards high margin product segment along with increase in revenue from private sector

HFCL is gradually moving its business towards being a manufacturing focused player as seen from latest 3-year revenue mix. Company has strategically changed its revenue mix by increasing the revenue from products, share of products in FY21 was 27.25% which has increased to 43.48% in FY22 and reaching 55.61% in FY23. Management is focused on further improving the share of product revenue in coming years and the planned capex over the next two years is also in line to achieve the same. Manufactured products (mainly OFC and Wifi products) have better operating margins and shorter collection period when compared to EPC busniess of the company and increased focus toward this segment is likely to enhance its overall profitability going forward. Also, the government/private mix of the company has changed from 49:51 in FY21 to 18:82 in FY23.

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

Mahendra Nahata, the managing director of the company, has a business experience of more than 35 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 RJIL since the start of network roll out of RJIL and has been responsible for their network planning, design and implementation for the Northern region. RJIL contributed around 63% to the total revenue of HFCL in FY18 which decreased to 28% in FY22, this however has increased to 43% in FY23 on account of higher offtake of OF/OFC products by RJIL on account of 5G rollout.

Established relationship with reputed clients

HFCL has established long-standing relationships with reputed corporate houses in both public & private sectors. Apart from telecom projects, HFCL has expanded its business has become a leading material supplier and turnkey contractor for defence and railway communication projects.

Turnkey contract & service business segment normally deals in capex undertaken by different companies and government, resulting in single high value orders from few customers with longer execution period. Also, many of these contracts are tender based contract awarded through bidding process. Therefore, it is normal to get repeat orders from few customers due to strong execution capability and product deliverability of the company. In the product segment, company has been expanding its customer base in domestic as well as international market. Sales contribution from top five customers for the turnkey contract and segment has been constantly decreasing from 53.6% in FY21 to 39.2% in FY23, hence decreasing concentration risk.

Improved operational performance, likely to sustain

HFCL has been able to grow its operating income by approximately 8% CAGR over past five years (FY18 to FY23), from Rs 3,227 crore during FY18 to ₹4,743 crore in FY23. In FY23, growth in manufacturing products segment was 28.4% y-o-y, which has a high margin vis-à-vis turnkey projects segment.

EBIDTA margins stood at 13.39% in FY23 (PY: 13.75%). The margins were impacted on account of high commodity prices in H1FY23 which moderated in H2FY23, along with increased revenue from manufacturing segment. In FY23, share from manufacturing segment was 56% (PY:43%). Over the last 5-years, revenue from manufacturing segment has increased at CAGR of approx. 30%. The gross margins from this segment is around 19% as compared to turnkey segment, which has a margin of 7-9%. Going forward, with higher contribution from manufacturing segment, the margins of HFCL are expected to improve significantly.

Along with the diversification in segment, company has been able to increase share of revenue from exports from 7.68% (₹362.94 Cr) in FY22 to 17.20% (₹815.75 Cr) in FY23, which is an increase of 124.76% on y-o-y basis, thereby reducing geographical & political risk and expanding global footprint.

Comfortable financial risk profile

In order to support the future expansion programs, and R&D initiatives, the company has successfully raised a sum of ₹600 cr by way of Qualified Institutional Placement (QIP) in the month of December 2021. Overall gearing (including acceptances) as on March 31, 2023 was at 0.25 in comparison to 0.28 as on March 31, 2022 (0.50 as at March 31, 2021). Interest Coverage Ratio has improved and comfortable at 4.10x during FY23 (PY: 3.94). However, the overall gearing is expected to moderate by FY24-end, with the outstanding debt increasing because of availment of term loans for the capex being planned by HFCL group. Fresh term loans will be availed for its capex plans of increasing OF & OFC capacities and augment the working capital to fund the increasing scale of operations. Healthy net worth base on the back of improving profitability should however prevent any significant deterioration in the capital structure in the near future.

Key weaknesses

Large working capital requirements

With increase in revenue contribution from product manufacturing segment, the average collection period has reduced to 182 days in FY23 compared to 211 days in FY22 & 195 days in FY21. With increasing contribution from product manufacturing segment, the operating cycle is expected to improve further. However, the total operating cycle continues to remain elongated at 159 days in FY23 (PY: 135 days). The total debtors, in absolute terms, have reduced to Rs. 2309 crore as on March 31, 2023 as against ₹2492 crore as on March 31, 2022.

As for the overall debtors, IPMPLS, GOFNMS and BSNL comprise almost 28% of the group's overall debtors as on date. The debtors for defense projects, where BSNL is the implementing agency are funded by DOT and paid directly through a dedicated escrow account created by DOT for all NFS projects. Furthermore, 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 in the past. With major part of these defense projects completed and milestone now being achieved, it is expected that the operating cycle shall get further rationalized during current fiscal (FY24). Besides, the average utilisation of the fund-based working capital limits stood at a satisfactory level of around 76% for the 12-month period ending April 2023. The company has high reliance on the non-fund-based working capital limits for the procurement of materials and bank guarantee requirements in the EPC segment.

Project Risk

Group is planning backward and horizontal integration of its OFC and OF facilities in addition to setting up of new facility for the manufacture of Telecom and Networking Products of around Rs. 1000 crore in next 3 years from FY24-FY26 (proposed to be funded by 70% debt and balance through internal accruals / equity). HFCL has been deploying funds towards capacity expansion

to meet the rising demand in OF and OFC segment after reaching 100% utilization of its current OF production capacity. It has the advantage of having backward integration, as it manufactures around 40% of Optical Fibre requirement inhouse. It is planning to enhance its OF capacity from 10 mn fkm to 33.9 mn fkm, which will reduce dependence on external parties in terms of availability, cost and quality. This planned expansion is expected to generate additional profitability. This will insulate the company from the volatility in Optical Fibre prices and help improve margins. Apart from this, the group is also evaluating other capex opportunities to augment is capacities to meet the increasing demand.
Successful completion of all the capex being undertaken by the Group with no cost and time overrun, and the company being able to derive the expected benefits out of these, are key rating monitorable going forward.

Intense competition in the industry & susceptibility to volatility in raw material prices
The demand in cable business is majorly dependent on the operational/capital expenditure from telecom companies. Any delay or deferral of such expenditure would impact revenue visibility of companies catering to this business. Also, EPC business co ntinues to face competition due to presence of many players. Further, HFCL is making efforts to expand its product basket. It is also foraying into exports where large-sized global players have established presence, and the stiff competition in that segment may limit its pricing flexibility. The company is, however, focused on gaining traction in new geographies and value-added services to mitigate pricing pressure in relatively commoditized OF/OFC segment. The main raw materials required is optical fibre. The company is partially backward integrated for the same and is also in process to expand its OF capacities. At present, some of the OF requirement is met from outside vendors. The company is insulated against the volatility in optical fibre prices partially due to the backward integration but remains susceptible to the volatility in the prices of other raw materials which are procured fr om external sources and time lag in pass through of escalated costs.

Liquidity: Adequate

The liquidity position of HFCL is adequate marked by steady cash accrual generation in the range of ₹ 400 – ₹ 450 crore and free cash/liquid investments. The current ratio stood at 1.78x as on March 31, 2023 which improved from 1.62x as on March 31, 2022. The company's liquidity profile continues to be adequate, aided by cash and liquid investments (unencumbered) of around ₹75.30 crore as on March 31, 2023. The company has consolidated bank debt repayments (estimated) of ₹58.7 crore in FY24 and ₹145 crore in FY25 against which this CARE Ratings estimates HFCL to have accruals in the range of ₹430-530 crore in FY24 & FY25. The consolidated repayments also include repayments of its subsidiary HTL ltd where HFCL has given irrevocable and unconditional corporate guarantee to its bank facilities. HFCL intends to pay the ICD's amounting to ₹ 50- 60 crore over the next two years. Furthermore, owing to the working capital-intensive nature of operations, the average and maximum working capital utilization for the past 12 months ended April'23 stood at around 76% and around 92% respectively.

Assumptions/Covenants: NA

Environment, social, and governance (ESG) risks

HFCL recognises the importance of environmental sustainability and continues to invest in minimising its environmental impact. For a greener tomorrow, the company undertakes several initiatives under the areas of energy, water and waste management.
Environmental: Save between 88-126 kWh energy per month per site. Replacement of conventional lighting by LED across facilities and offices Sustainable manufacturing through initiatives such as installation of high-efficiency compressed air suction devices reducing noise and usage of compressed air. Continuous water recycling in both Goa and Hyderabad manufacturing facilities through an efficient recycling process, reducing freshwater consumption. 15 KL/day and 30 KL/day Sewage Treatment Plants (STP) for recycling wastewater for gardening purposes both at Hyderabad and Goa Plant respectively.

Social: Company has undertaken several healthcare aid, education initiatives, old age care & societal welfare programs.

Governance: HFCL's well-articulated governance framework provides direction for responsible and credible conduct across its operations. The Board has five committees (Audit, Nomination, Remuneration and Compensation, Stakeholders relationship, CSR & Risk management) that support the Board's decision-making processes. Each committee has its own terms of reference and operates under a clearly defined charter. All Board proceedings are logically segregated, and specific matters are delegated to the committees. The Board committee consists of one executive director, two non-executive director and four independent directors.

Applicable criteria

Policy on default recognition

[Consolidation](#)
[Financial Ratios – Non financial Sector](#)
[Liquidity Analysis of Non-financial sector entities](#)
[Rating Outlook and Credit Watch](#)
[Short Term Instruments](#)
[Manufacturing Companies](#)
[Policy on Withdrawal of Ratings](#)

About the company and industry

Industry classification

Macro-Economic Indicator	Sector	Industry	Basic Industry
Telecommunication	Telecommunication	Telecom - Equipment & Accessories	Telecom - Equipment & Accessories

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. The company is an established leader in offering fully integrated communication network solutions. It manufactures Optical Fibre (OF), Optical Fiber Cables (OFC), Cable Accessories and High - End Telecom Transmission and Access Equipment and specializes in providing turnkey solution to telecom service providers, railways, defence, smart city & surveillance projects. Current HFCL has OF & OFC capacity of 10mn fkm & 25.08 mn fkm respectively.

Brief Consolidated Financials (₹ crore)	March 31, 2021 (A)	March 31, 2022 (A)	March 31, 2023 (A)
Total operating income	4438.72	4727.11	4762.45
PBILDT	565.34	650.07	637.82
PAT	246.24	325.86	317.71
Overall gearing (times)^	0.75	0.38	0.42
Interest coverage (times)	3.24	3.91	4.19

A: Audited UA: Unaudited; Note: 'the above results are latest financial results available'
^Including LC Acceptances

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: Annexure-4

Lender details: Annexure-5

Annexure-1: Details of instruments/facilities

Name of the Instrument	ISIN	Date of Issuance (DD-MM-YYYY)	Coupon Rate (%)	Maturity Date (DD-MM-YYYY)	Size of the Issue (₹ crore)	Rating Assigned along with Rating Outlook
Debentures-Non Convertible Debentures		28-Mar-2017	10.30	30 Sep 2021	0.00	Withdrawn
Fund-based - LT-Cash Credit		-	-	-	450.00	CARE A; Stable
Fund-based - LT-Term Loan		-	-	31/01/2031	594.54	CARE A; Stable
Non-fund-based - ST-BG/LC		-	-	-	1984.13	CARE A1

Annexure-2: Rating history for the last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating History			
		Type	Amount Outstanding (₹ crore)	Rating	Date(s) and Rating(s) assigned in 2023-2024	Date(s) and Rating(s) assigned in 2022-2023	Date(s) and Rating(s) assigned in 2021-2022	Date(s) and Rating(s) assigned in 2020-2021
1	Fund-based - LT-Term Loan	LT	594.54	CARE A; Stable	-	1)CARE A; Stable (06-Jul-22)	1)CARE A; Stable (29-Mar-22) 2)CARE A-; Negative (07-Jul-21)	1)CARE A-; Negative (07-Dec-20) 2)CARE A-; Negative (07-Jul-20)
2	Fund-based - LT-Cash Credit	LT	450.00	CARE A; Stable	-	1)CARE A; Stable (06-Jul-22)	1)CARE A; Stable (29-Mar-22) 2)CARE A-; Negative (07-Jul-21)	1)CARE A-; Negative (07-Dec-20) 2)CARE A-; Negative (07-Jul-20)
3	Non-fund-based - ST-BG/LC	ST	1984.13	CARE A1	-	1)CARE A2+ (06-Jul-22)	1)CARE A2+ (29-Mar-22) 2)CARE A2	1)CARE A2 (07-Dec-20) 2)CARE A2

							(07-Jul-21)	(07-Jul-20)
4	Debentures-Non Convertible Debentures	LT	-	-	-	1)CARE A; Stable (06-Jul-22)	1)CARE A; Stable (29-Mar-22) 2)CARE A-; Negative (07-Jul-21)	1)CARE A-; Negative (07-Dec-20) 2)CARE A-; Negative (07-Jul-20)

*Long term/Short term.

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

Annexure-4: Complexity level of the various instruments rated

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

Annexure-5: Lender details

To view the lender wise details of bank facilities please click here

Note on the complexity levels of the rated instruments: 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@careedge.in for any clarifications.

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About us:

Established in 1993, CARE Ratings is one of the leading credit rating agencies in India. Registered under the Securities and Exchange Board of India, it has been acknowledged as an External Credit Assessment Institution by the RBI. With an equitable position in the Indian capital market, CARE Ratings provides a wide array of credit rating services that help corporates raise capital and enable investors to make informed decisions. With an established track record of rating companies over almost three decades, CARE Ratings follows a robust and transparent rating process that leverages its domain and analytical expertise, backed by the methodologies congruent with the international best practices. CARE Ratings has played a pivotal role in developing bank debt and capital market instruments, including commercial papers, corporate bonds and debentures, and structured credit.

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