HFCL Limited

March 29, 2022

Ratings

Facilities/Instruments	Amount (Rs. crore)	Rating[1]	Rating Action
Long Term Bank Facilities	539.21 (Reduced from 579.77)	CARE A; Stable (Single A; Outlook: Stable)	Revised from CARE A-; Negative (Single A Minus; Outlook: Negative)
Short Term Bank Facilities	1,842.02	CARE A2+ (A Two Plus)	Revised from CARE A2 (A Two)
Total Bank Facilities	**2,381.23 (Rs. Two Thousand Three Hundred Eighty-One Crore and Twenty-Three Lakhs Only)**		
Non Convertible Debentures	11.24	CARE A; Stable (Single A; Outlook: Stable)	Revised from CARE A-; Negative (Single A Minus; Outlook: Negative)
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 upgrade in the ratings assigned to the bank facilities and instruments of HFCL Limited (HFCL) is on account of substantial improvement in the financial risk profile in 9MFY22 (refers to period from April 01 to December 31) characterized by growth in total operating income and profitability and also improvement in the capital structure. The same is on the back of increased revenues from the product segment of the company which also garners higher profitability vis-à-vis the turnkey (services) segment as is also evident from the increased profitability in 9MFY22. The improvement in the capital structure follows the successful completion of QIP of Rs 600 crore which has led to enhanced net worth base of the company. Further, there is continued healthy order book of the company aggregating to ~Rs 5,460 crore as on Dec 31, 2021 which provides medium term revenue visibility. HFCL has also got approval under the product linked incentive (PLI) scheme for IT and telecom products which would benefit the company to also bolster its product revenues in the medium term. HFCL is well placed to benefit from the increasing demand in the 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. The ratings continue to derive strength from experienced promoters and management team, long track record of operations and strategic business relationship with Reliance Jio Infocomm Limited (RJIL).

The rating strengths are, however, tempered by inherently working capital-intensive operations due to elongated collection cycle in turnkey segment, risk associated with large-sized, tender-based orders, project risk emanating from significant investments over the next 2 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.

The company's working capital cycle had got stretched over the last two years amidst COVID induced disruption especially in turnkey business which got accentuated due to the large size of the projects and milestone linked payments; the same had resulted in the continued negative outlook on the credit ratings assigned by CARE. However, the outlook has now been revised to stable as CARE 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 defense projects where the milestone linked payments are expected to be release during the next fiscal (FY23) leading to an expected improvement in the collections.

Rating Sensitivities

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

- Substantial improvement in scale of operations along with improvement in capital structure and coverage indicators, with Total Debt (Including LC's)/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- Factors that could lead to negative rating action/downgrade:

- 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 LC's) to PBILDT exceeding 3x on sustained basis.

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

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 RJIL 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, HFCL has been making constant effort to diversify its revenue base and accordingly 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.

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. 5460 crore giving a medium term revenue visibility. Out of the total order book, orders of Rs. 2381 crore are where BSNL is the implementing agency (almost all of which are funded out of Network for Spectrum (NFS) funds). 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 44% defence projects (DWDM, GOFNMS, MW Radios, IPMPLS, etc.), 18% optical fiber cable, 19% from Reliance Jio, 5% 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.

Improvement in financial profile marked by improving profitability and successful completion of QIP leading to improvement in the capital structure
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%). HFCL posted growth in 9MFY22 with 17% growth y-o-y in sales to Rs 3,544 cr; 43% growth in EBITDA. The significant growth in sales and profitability in 9M FY22 is owing to higher contribution of manufactured products (mainly OFC, OF and Wifi products) which have better margins and shorter collection period. In the past, the turnkey division comprised of more than 70% of revenue and had longer execution period (2-3 years apart from warranty period & O&M). Therefore, the payments get spread over similar time period. However, the company has consciously shifted focus on manufacturing division (average credit period: 90-100 days) which now comprises close to 41% of sales in 9MFY22. The mix has moved from 22% in FY20 to 27% in FY21 and further to 41% in 9MFY22. Management is focused on bringing the product mix to 60-70% by FY24 and the planned capex over the next 2 years is also in line to achieve the same.

The PAT margin had moderated to 5.52% in FY21 year end 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 optic fibre plant in Hyderabad the interest cost was getting capitalized. However, as the capex is now complete the same is being charged to P&L. With increased profitability in 9MFY22, the PBILDT & PAT have also registered improvement to 15.02% and 7.27% respectively as against 12.27% and 5.27% in 9M of fiscal 2021.

The overall gearing (including LC's & acceptances) & overall debt protection metrics of HFCL have witnessed moderation in FY21 owing to pandemic with overall gearing increasing to 0.97x as on March 31, 2021 vis-à-vis 0.67x as on March 31, 2020 on account of significant increase in working capital borrowings & LC acceptances (which are part of trade payables) and partly due to term loan due to the ongoing capex. The overall gearing is likely to significantly improve and expected to be less than 0.6x by FY 22 end due to enhancement in the company's networth on the back of the recent QIP issue of Rs 600 crore in December 2021 and expected healthy profitability for FY22. The QIP proceeds have been partly used to reduce debt, creditors and some part of ICD's and company has parked an amount equivalent to Rs 350 crore as fixed deposits to be used for the planned expansions.

Approval under PLI Scheme and expansion in capacities
DoT launched the PLI scheme to boost domestic manufacturing in telecom and networking products by incentivising incremental investments and turnover with expected total outlay of Rs 12,195 crore. The scheme is effective 1 April 2021. The investments made by successful applicants in India from 1 April 2021 onwards and up to FY24-25 are eligible, subject to qualifying incremental annual thresholds. The support under the scheme would be provided for five years from FY21-22 to FY25-26. HFCL has received the approval under the PLI scheme in October 2021.

A wholly owned subsidiary named HFCL Technologies Private Limited (HTPL) was incorporated to undertake the production under PLI scheme. HTPL would be required to set-up in-house facilities for the manufacturing of various telecom products including Wi-Fi, UBR, switches, routers, 5G small cell & 5G macro–Radio Unit (RU), DU (Distributed Unit) aggregation router, CU (centralized unit) aggregation router etc. HTPL's investment will be eligible for various benefits, which include lower income tax (15%) and PLI benefits including incentives based on stipulated turnover. Further, given the huge opportunities owing to 4G network expansions, FTTH rollouts, BharatNet project and evolution of 5G networks, the company intends to expand its optical fibre and optical fibre cable facilities by 10 mn fkm each, through HTPL. The total capex outlay being undertaken by HFCL is in the range of ~Rs 1000 crore over FY22 – FY24. The same will be funded in a judicious debt/equity/ internal accrual mix. Successful completion of all the capex being undertaken by HFCL and the company being able to derive the expected benefits out of these are key rating monitorable going forward.

Favorable 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. Industry outlook remains positive with growth opportunities for all the players including HFCL.

Key Rating Weaknesses

Elongated working capital cycle, however back-to-back arrangement with the creditors

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. Defence projects contributed close to 43% of the topline in FY21 compared to 28% in FY20 & hence there was spike in debtors leading to a stretch in operating cycle. The debtor issue in defence projects was due to milestone-based payments which got impacted due to covid and the large size of these orders accentuated the issue. The delays in the execution leg of the contracts was due to various reasons (site unavailability / lockdown etc).

Thus, while the company had billed for those projects, it had not actually fallen due for payment as per commercial terms of respective contracts. Furthermore, the company recorded significantly high sales in March'21 of Rs. 725 crore against sales of Rs. 263 crores in March'20. However, the trend of debtors has already started showing an improvement in 9M FY 22 with a reduction of Rs.223 crores compared to March 21 end levels. As for the overall debtors, IPMPLS, GOFNMS and DWDM comprise almost 48% of the group's overall debtors as on date. The defense debtors for projects where BSNL is the implementing agency 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. With the major part of these defense projects completed and milestone now being achieved, it is expected that the operating cycle shall get rationalized during next fiscal (FY23).

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 continues to face competition due to presence of many players. Further HFCL is making efforts to expand its product basket and also foray 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 to gain traction in new geographies and value-added services as well as mitigate pricing pressure in relatively commoditized OF/OFC segment. The main raw materials required are optical fibre. The company is partially backward integrated for the same and is also in process to expand its OF capacities. At present the some of the balance 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 still remains susceptible to the volatility in the prices of other raw materials which are procured from 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 Rs 400 – Rs 450 crore and free cash/liquid investments. The current ratio stood at 1.29x as on March 31, 2021. HFCL had free cash & bank balance of Rs.

350 crore as on December 31, 2021 (total cash & bank of ~Rs. 650 crore, balance is margin money against NFB limits). These balances will be utilized partly towards the planned capacity expansions over next two years. The company has consolidated bank debt repayments of Rs. 82 crore due in FY22 and Rs. 46 crore in FY23. HFCL even intends to pay the ICD's amounting to Rs 50-60 crore p.a in next two years. The repayments include the repayments of its subsidiary HTL ltd where HFCL has guaranteed the bank facilities by giving irrevocable and unconditional corporate guarantee. Further, owing to the working capital intensive nature of operations, the average and maximum working capital utilization for the past 12 months ended Jan 2022 stood at 83% and 93% respectively.

Analytical approach: Consolidated.
Companies considered in consolidated financials:

Company	Shareholding
HTL Limited	74%
Polixel Security Systems Private Ltd	100%
Radeff Private Limited	90%
Nimpaa Telecommunications Private Limited (Jointly controlled entity)	50%
HFCL Technologies Private Ltd	100%
BigCat Wireless Pvt. Limited (Jointly Controlled Entity with 50% voting right)	25%
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%

Applicable Criteria
Policy on default recognition
Consolidation
Financial Ratios – Non financial Sector
Liquidity Analysis of Non-financial sector entities
Rating Outlook and Credit Watch
Manufacturing Companies
Construction

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. 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.).

Brief Financials (Rs. crore)	31-03-2020 (A)	31-03-2021 (A)	9MFY22 (UA)
Total operating income	3,858.13	4,455.88	3,544.13
PBILDT	513.32	582.5	532.30
PAT	237.34	246.24	257.73
Overall gearing (times)^	0.67	0.97	NA
Interest coverage (times)	4.47	3.31	4.14

A: Audited, UA: Unaudited, NA: Not available
^Including acceptances and LCs

Status of non-cooperation with previous CRA:
Not applicable

Any other information:
Not applicable

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

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
Fund-based - LT-Term Loan		-	-	Dec, 2027	164.21	CARE A; Stable
Fund-based - LT-Cash Credit		-	-	-	375.00	CARE A; Stable
Non-fund-based - ST-BG/LC		-	-	-	1842.02	CARE A2+
Debentures-Non Convertible Debentures		March 28, 2017	10.30	Sep, 2021	11.24	CARE A; Stable

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	164.21	CARE A; Stable	1)CARE A-; Negative (07-Jul-21)	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; Stable	1)CARE A-; Negative (07-Jul-21)	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-Jul-21)	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; Stable	1)CARE A-; Negative (07-Jul-21)	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	LT	-	-	-	-	1)Withdrawn (03-Jul-19)	1)CARE BBB+

	Redeemable Preference Shares							(RPS); Stable (03-Jul-18)

* Long Term / Short Term

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

Name of the Instrument	Detailed explanation
A. Financial covenants	
I Changes in capital structure	Effect any change in the borrower's capital structure where the shareholding of the existing promoters gets diluted below current level or 51% of the controlling stake (whichever is lower), without permission of the Bank – for which 60 days' prior notice shall be required.
II Selling of assets	The borrower shall not sell, assign, mortgage or otherwise dispose of any of the fixed assets charged to the Bank. However, fixed assets to the extent of 5% of gross block may be sold in any financial year provided such sale doesn't dilute FACR below minimum stipulated level.
B. Non financial covenants	
I Guarantee / Letter of Comfort	The borrower shall not undertake any guarantee or Letter of Comfort in the nature of guarantee on behalf of any other company (including group companies).
II Directors' remuneration	The borrower shall not change the practice with regards to remuneration of Directors by means of ordinary, remuneration or commission, scale of sitting fees, etc. except where mandated by any legal or regulatory provisions.

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

Sr. No	Name of 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: 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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About CARE Ratings Limited:
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With an established track record of rating companies over almost three decades, we follow a robust and transparent rating process that leverages our domain and analytical expertise backed by the methodologies congruent with the international best practices. CARE Ratings Limited has had a pivotal role to play in developing bank debt and capital market instruments including CPs, corporate bonds and debentures, and structured credit.

****For detailed Rationale Report and subscription information, please contact us at www.careedge.in**