HFCL Limited

January 29, 2020

Ratings

Facilities	**Amount (Rs. crore)**	**Rating[1]**	**Rating Action**
Long term Bank Facilities	565.94 (enhanced from Rs. 515.94 crore)	**CARE A-; Negative (Single A Minus; Outlook: Negative)**	**Rating reaffirmed; Outlook changed to Negative from Stable**
Short term Bank Facilities	2125.88 (enhanced from Rs. 1398.36 crore)	**CARE A2+ (A Two Plus)**	**Reaffirmed**
Total	**2691.82 (Rupees two thousand six hundred and ninety one crore and eighty two lakhs only)**		
Long Term Instrument - Non Convertible Debentures	33.73	**CARE A-; Negative (Single A Minus; Outlook: Negative)**	**Rating reaffirmed; Outlook changed to Negative from Stable**

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The reaffirmation of the ratings assigned to the bank facilities and instrument of HFCL Limited (HFCL) continue 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). The ratings also take into account the comfortable financial profile of HFCL, moderate capital structure along with strong order book which provides medium-term revenue visibility.

The ratings, however, remain constrained by its high collection period with significantly increasing outstanding debtors from Bharat Sanchar Nigam Limited (BSNL) leading to elongated operating cycle and increased utilization of working capital limits, 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:

- Ability of the company to profitability scale up its operations by more than 30% over FY19 total operating income on a sustained basis.
- Improvement in the average collection period to less than 100 days on a sustained basis.

Negative Sensitivity:

- Any sizeable capex undertaken by the company impacting its capital structure with overall gearing of more than 1.0x on a sustained basis
- Slower than anticipated realization of the outstanding debtors and slower than anticipated release of funds from BSNL impacting the liquidity profile of the company.

Outlook: Negative

The revision in the outlook from Stable to Negative is on account of CARE's belief that the liquidity profile of HFCL may weaken on account of significantly high outstanding debtors as on December 31, 2019 due to slow release of funds from BSNL 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 timely release of funds from BSNL 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 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 chairman of the board, Mr. MP Shukla, has over five decades of experience in the telecom industry and had worked at senior positions in various undertakings owned by the Government of India.

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

The company also has a strong association with RJIL (rated CARE AAA; Stable/ CARE A1+), 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.

Strong order book providing revenue visibility and diversifying customer base

HFCL has a strong order book with orders of Rs. 8621 crore as on December 31, 2019 which is ~1.80x of FY19 total revenue. Out of the total order book, orders of Rs. 5154 crore are in which BSNL is the implementing agency (95% of which are funded out of Network for Spectrum (NFS) funds and 2% 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 58% defence projects (DWDM, GOFNMS, MW Radios, IPMPLS etc.), 9% optical fiber cable, 16% private sector turnkey projects mainly from Reliance Jio, 10% from BharatNet and 7% from miscellaneous segments such as Railway Telecommunications, 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 marked by significant growth in total operating income and comfortable capital structure

The total operating income of HFCL on a consolidated basis reported growth of 47% in FY19 to Rs. 4778.96 crore vis-à-vis Rs. 3245.59 crore in FY18. The growth was primarily driven by factors like high value of executed orders and significant improvement in the HTLs performance on account of increased production capacities (from 3.5 Mn fkm to 7 Mn fkm). The PBILDT margins improved marginally at 9.52% in FY19, however the PAT margins moderated to 4.86% in FY19.

Further, the capital structure of HFCL continues to remain strong with overall gearing of 0.52x as on March 31, 2019. The total debt as on March 31, 2019 increased to Rs. 590.31 crore mainly due to increase in Intercorporate deposits (ICD) and working capital borrowing to Rs. 418.74 crore. Further, outstanding CRPS of Rs. 60.38 crore have been fully redeemed as on March 31, 2019. The other coverage indicators improved in FY19 with interest coverage at 4.95x (PY: 4.74x) and total debt to GCA at 1.96x (PY: 2.27x).

9MFY20 Performance: Total operating income moderated by 9.65% in 9MFY20 vis-à-vis 9MFY19 on account of subdued demand scenario of optical fibre and slow progress in BharatNet projects. However PBILDT margins improved significantly to 13.75% in 9MFY20 vis-à-vis 9.11% in 9MFY19 on account of better margins from the turnkey projects, decrease in raw material (fibre) price and cost rationalization measures. The overall gearing (including LC Acceptances) stood at 0.50x as on December 31, 2019.

Key weaknesses

Elongated operating cycle

Due to the subdued demand scenario of optical fiber cable, the revenue contribution from the same to the total operating income of 9MFY20 decreased whereas contribution from the turnkey/EPC business increased thereby leading to higher collection period as turnkey projects have milestone based billing and payment cycle. However, HFCL enters into back to back arrangements with its suppliers/subcontractors in line with payment terms from authorities and hence, against a corresponding increase in the receivable levels, there has been a proportionate increase in the payable levels. However this has still resulted in higher utilization of working capital limits as its collection period has increased from 106 days in FY19 to 144 days in 9MFY20. The total outstanding debtors as on March 31, 2019 stood at Rs. 1525.63 crore which included BSNL project related debtors of Rs. 833.96 crore (55% of total debtors). However the same increased to Rs. 1891.63 crore as on December 31, 2019 which included BSNL related debtors of Rs. 1136.51 crore (60% of total debtors). Further, 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 47% in FY19 and is projected to be ~25-30% in FY20. The collection period from RJIL was ~30-60 days however as the percentage share of RJIL to the total operating income of HFCL is decreasing it is also resulting in increased collection period for the company.

Adequate Liquidity

Due to the increased collection period, the maximum utilization of working capital facilities and non-fund based facilities increased in the last 12 months ended December 2019 to 94.83% and 80.39% respectively vis-à-vis 85.93% and 81.10% for the 12 month ended May 2019. The company also had cash and cash equivalents of Rs. 245.61 crore (unencumbered balance: Rs. 38.86 crore) as on December 31, 2019. The company will also avail project specific limits which will be available for the complete duration of the project.

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]
[Short Term Instruments]
[Financial ratios – Non-Financial Sector]
[Rating Methodology: Consolidation and Factoring Linkages in Ratings]

About the Company
HFCL 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 (71% in FY19). Under sale of telecom equipment's, HFCL manufactures and sells telecom equipment in Optical, Wireless, and Wireline technologies (like 2G and 3G Repeaters, Broadband, etc.). Further, CARE notes that HFCL has commissioned its backward integrated optical fiber plant in January 2020.

Brief Financials (Rs. crore)	FY18 (A)	FY19 (A)
Total operating income	3245.59	4778.95
PBILDT	301.36	455.00
PAT	171.70	232.26
Overall gearing (times)	0.49	0.52
Interest coverage (times)	4.74	4.95

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	-	-	July 31, 2027	215.94	CARE A-; Negative
Fund-based - LT-Cash Credit	-	-	-	300.00	CARE A-; Negative
Non-fund-based - ST-BG/LC	-	-	-	1398.36	CARE A2+
Debentures-Non Convertible Debentures	March 28, 2017	10.30%	Sep 30, 2021	29.50	CARE A-; Negative
Debentures-Non Convertible Debentures	June 2, 2017	10.30%	Sep 30, 2021	4.23	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 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017
1.	Fund-based - LT-Term Loan	LT	190.94	CARE A-; Negative	1)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)	1)CARE BBB+; Negative (26-Jul-17)	1)CARE BBB+ (06-Sep-16)
2.	Fund-based - LT-Cash Credit	LT	375.00	CARE A-; Negative	1)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)	1)CARE BBB+; Negative (26-Jul-17)	1)CARE BBB+ (06-Sep-16)
3.	Non-fund-based - ST-BG/LC	ST	2125.88	CARE A2+	1)CARE A2+ (03-Jul-19)	1)CARE A2+ (23-Jan-19) 2)CARE A2+ (03-Jul-18) 3)CARE A2+ (25-Jun-18)	1)CARE A2+ (26-Jul-17)	1)CARE A2+ (06-Sep-16)
4.	Debentures-Non Convertible Debentures	LT	33.73	CARE A-; Negative	1)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)	-	-

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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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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