HFCL Limited (Revised)

July 07, 2020

Ratings

Facilities	Amount (Rs. crore)	Rating[1]	Rating Action
Long term Bank Facilities	565.94	**CARE A-; Negative (Single A Minus; Outlook: Negative)**	**Reaffirmed**
Short term Bank Facilities	2067.52	**CARE A2 (A Two)**	**Revised from CARE A2+**
Total	**2633.46 (Rupees Two thousand six hundred and thirty three crore and forty six lakhs only)**		
Long Term Instrument - Non Convertible Debentures	22.48	**CARE A-; Negative (Single A Minus; Outlook: Negative)**	**Reaffirmed**

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers
The reaffirmation of the long-term rating 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 HFCL's moderate capital structure along with strong order book which provides medium-term revenue visibility.
The revision in the short-term rating is on account of significantly elevated outstanding debtors leading to elongated operating cycle and increased working capital intensity. The ratings continue to remain constrained by 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.

HFCL has sought moratorium on interest payments from its lenders as part of the COVID-19 - Regulatory Package announced by the RBI on March 27, 2020. CARE has not recognized this instance as a Default, as the same is permitted by the RBI as part of the relief measures announced recently. The company has already received the approval for the same from its lenders. Non-recognition of default in this case is as per the guidance provided by the SEBI circular SEBI/ HO/ MIRSD/ CRADT/ CIR/ P/ 2020/ 53 dated March 30, 2020.

Key Rating Sensitivity:
Positive Sensitivity:
- Ability of the company to profitability scale up its operations by more than 30% of 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 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, 2020 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 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.

[1] *Complete definitions of the ratings assigned are available at www.careratings.com and in other CARE 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 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.
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 47% in FY19 and was 34% in FY20. The current order book also has around 13% orders of from RJIL.

Strong order book providing revenue visibility and diversifying customer base
HFCL has a strong order book with the company having firm orders to the tune of Rs. 7296.45 crore and orders under release having value of Rs. 1112.31 crore totalling to Rs. 8408.76 crore as on March 31, 2020 (which is ~2.10x of FY20 TOI). Out of the total order book, orders of Rs. 5231.84 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 59% defence projects (DWDM, GOFNMS, MW Radios, IPMPLS etc.), 12% optical fiber cable, 13% from Reliance Jio, 9% from BharatNet and 7% 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 marked by improving profitability and comfortable capital structure
The total operating income of HFCL on a consolidated basis witnessed moderation in FY20 to Rs. 3858.13 crore vis-à-vis Rs. 4778.95 crore in FY19 (decline of 19%). TOI decreased in FY20 on account of subdued demand scenario of optical fibre and slow movement/progress in BharatNet projects. Further the revenue in Q4FY20 was impacted due to the outbreak of Covid-19 which disrupted the entire supply chain.
However PBILDT margins improved significantly to 13.34% in FY20 vis-à-vis 9.52% in FY19 on account of better margins from the turnkey projects and decrease in raw material (fibre) price (fibre constitutes about 40% to 50% of the total raw material cost for OFC manufacturing).
The capital structure of HFCL continues to remain strong with overall gearing (including LC acceptances) of 0.51x as on March 31, 2020. As on March 31, 2020, total debt amounted to Rs. 821.76 crore mainly due to increase in working capital borrowings and draw down of term loan for the capex at Hyderabad. Further, the other coverage indicators also marginally deteriorated n FY20 with interest coverage at 4.47x and total debt to GCA at 2.05x.

Moderate Liquidity
The liquidity profile of HFCL stood moderate with current ratio of 1.50x as on March 31, 2020, primarily on account of high debtors, however it also had a free cash & bank balance of Rs. 13.96 crore (total cash & bank of Rs. 222.92 crore) as on March 31, 2020. Against which, the total debt repayment due in FY21 is of Rs. 43.10 crore which includes term loan repayment of Rs. 31.86 crore and NCD of Rs. 11.24 crore.
Further, the average working capital utilization stood at 80.97% during 12 month period ending May 2020, while maximum utilization on an average remained around 94%.

Industry scenario and potential demand
The telecom industry has seen sound growth in past years under the new government due to the announcement of large projects (including Defence sector) like NOFN (National Optical Fibre Network) and NFS (Network for Spectrum).
OFC continues to be the backbone of the increasingly digital world. Government and Private Operators are investing substantial capital in upgrading telecom infrastructure. National Digital Communication Policy, 2018 sets aggressive 2022 targets with broadband for all. Only 25% of sites in India are fiberised, a number that needs to go up to 80-85% to support 5G and its enabling technologies IoT, M2M. Even 4G needs fiberisation upto 60-65% of sites and this shift from wireless to Optical Fibre is taking place in a gradual manner. Fibre spread and its densification shall ensure fibre reaches the doorstep of consumers. With 4G on rise and 5G on the anvil, microwave-based backhaul will become less effective. Nearly 70% of the India's towers will need to be fiberized by 2022 from the current levels of sub-25% requiring an estimated 600,000 fKm, at an investment of $8 billion

Also, there is a significant untapped potential still left in the rural space and with government's renewed focus on developing rural telecom infrastructure to use telecom services to effectively reach out to the real beneficiaries of its various welfare schemes. Furthermore, with Smart Cities Mission and Digital India Initiative, the requirement of network infrastructure at integration as well as end-user points is expected to rise. One of the projects under the 'Digital India' initiative is 'BharatNet', launched to deploy high-speed optical fiber cables to connect 2.58 lakh Gram Panchayat across the country by end of 2019. This project would also help in increasing the fiberized sites in India which currently stands at less than 25% as compared to other developed countries. Also, 'Smart Cities', 5G deployment, Machine to Machine (M2M), Internet of Things (IoT)' require advanced information technology and connectivity landscape. Further, next generation technologies such as LTE and FTTx, which require last mile connectivity, would also propel the demand for optical fiber cables.

Key weaknesses

Elongated operating cycle, however back-to-back arrangement with the creditors

HFCL's operating cycle has increased from 71 days in FY19 to 90 days in FY20 primarily on account of increase in collection period which increased from 104 days in FY19 to 154 days in FY20. Due to the subdued demand scenario of optical fiber cable, the revenue contribution from the same to the total operating income of FY20 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. Also, there have been some delays in the execution leg of the contracts due to various reasons such as site unavailability resulting in the material invoice value to be stuck. Thus, while the company has billed for those projects, it has not actually fallen due for payment as per commercial terms of respective contracts.

As on March 31, 2020, total debtors stood at Rs. 1665.58 crore on a standalone basis out of which debtors outstanding for more than 150 days stood at Rs. 816.85 crore (~49%). Further out of the total debtors of Rs. 1665.58 crore as on March 31, 2020, debtors to the tune of Rs. 638.70 crore were not due for payment on March 31, 2020. Out of the total debtors, debtors of Rs. 130 crores (7.5% of total debtors), pertain to direct contracts of BSNL. 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/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. This resulted in increasing collection and creditor period. The creditor days have also increased from 55 days in FY19 to 90 days in FY20.

Counterparty Credit Risk

Going forward, 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 Bharat Sanchar Nigam Limited (BSNL) and Bharat Broadband Network Limited (BBNL) 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]

[Short Term Instruments]

[Rating Methodology-Manufacturing Companies]

[Financial ratios – Non-Financial Sector]

[Rating Methodology: Consolidation and Factoring Linkages in Ratings]

About the Company

HFCL (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 (78% in FY20). 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)	FY19 (A)	FY20 (A)
Total operating income	4778.95	3858.13
PBILDT	455.00	513.32
PAT	232.26	237.34
Overall gearing (times)	0.51	0.51
Interest coverage (times)	4.95	4.47

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	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		-	-	July 31, 2027	190.94	CARE A-; Negative
Fund-based - LT-Cash Credit		-	-	-	375.00	CARE A-; Negative
Non-fund-based - ST-BG/LC		-	-	-	2067.52	CARE A2
Debentures-Non Convertible Debentures	-	March 28, 2017	10.30	30 Sep 2021	22.48	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 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018
1.	Fund-based - LT-Term Loan	LT	190.94	CARE A-; Negative	-	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-	1)CARE BBB+; Negative (26-Jul-17)

							18)	
2.	Fund-based - LT-Cash Credit	LT	375.00	CARE A-; Negative	-	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)	1)CARE BBB+; Negative (26-Jul-17)
3.	Non-fund-based - ST-BG/LC	ST	2067.52	CARE A2	-	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)	1)CARE A2+ (26-Jul-17)
4.	Debentures-Non Convertible Debentures	LT	22.48	CARE A-; Negative	-	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)	-

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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