Hindustan Aeronautics Limited

January 14, 2020

Ratings

Facilities	Amount (Rs. crore)	Rating[1]	Rating Action
Commercial Paper*	1000.00 (One Thousand crore only)	CARE A1+ (A One Plus)	Assigned

**carved out of overall working capital limit of Rs. 7300 crore*
Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The rating derives strength from the strategic importance of the company to the Indian Defence sector as the core aviation equipment supplier with majority ownership by Government of India (GoI), integrated presence through design, development, manufacturing, maintenance & overhaul of aviation products as well its strong financial risk profile backed by assured margin structure. The rating also takes note of improvement in its operating PBILDT margin (excluding interest income) in FY19 on back of growth in maintenance, repair and overhaul income and stable revenue from sale of products, healthy order- book position which impart revenue visibility in medium term and strong research and development capabilities of the company resulting in continually improving product portfolio. The rating also factors in the change in operating environment involving reduced advance funding by customers and build-up of receivables position translating into increased reliance on working capital debt. Earlier, HAL used to receive significant advance funding and milestone payments resulting in negligible borrowings and robust liquidity. However during FY19, delay in disbursement of sanctioned budget resulted in high receivables position and reduced cash balances. It was expected that post resolution of budget constraints and release of funds, the situation would normalise. Between December 2018 and September 2019, while receivables position has improved, a sizeable amount is left for HAL to fund and hence reliance on bank borrowings is expected to continue. The rating also takes cognizance of the efforts undertaken by HAL to improve operating efficiency including optimising overhead expenditures, inventory rationalisation and indigenisation to compensate the increase in interest expense and loss in interest income. Going forward, sustenance of efforts in improving operating efficiency and pricing the new contracts to sustain higher operating profitability to cover additional interest expense will be a key rating monitorable. The rating also considers the decline in liquidity profile and increased reliance on working capital borrowings.

Rating Sensitivities

Positive Factors:

- Sustenance of PBILDT margins from operations and healthy order book.

Negative Factors:

- Any significant fall in company’s order book and/ or substantial dilution of GoI stake in the company.
- Increased reliance on bank borrowings resulting in deterioration of leverage

Detailed description of the key rating drivers

Key Rating Strengths

HAL’s strategic importance to Indian Defence Sector

HAL is promoted and majorly owned by Government of India (GoI). HAL plays a strategic role in India’s defence programme being the only Indian company having specialization in aircraft manufacturing and providing its Maintenance, Repair and Overhauling services (MRO). Further, HAL has established track record in offering Product Life Cycle support. The company’s competitive position remains strong as it maintains leadership position in Indian Aerospace and Defence Industry, being GoI’s prime defence contractor and supported by defence outlays by GoI.

Improved profitability margins and healthy order book position

Earlier upfront advances from customers which resulted in robust liquidity condition earned significant interest income over the years. The company has been continuously improving its operating efficiency to compensate the

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

decline in interest income as witnessed from improvement in adjusted PBILDT margin (excluding interest income) from 17% to 23% over FY17-19 driven by growth in net sales. This improvement is also on account of growth in Maintenance, repair and overhaul (MRO) services which yield higher margins. The company's order book continues to be healthy at Rs. 58,588 crore (2.95x of Total Operating Income) as on March 31, 2019 (FY18: Rs.61,123 crore, 3.2x of FY18 revenue). The order book stands improved to Rs. 59,540 crores as on September 30th, 2019.

Strong Research and Development capabilities

HAL is present in an industry which demands constant innovation and technological changes and it is critical for HAL to adapt to technological advancements, absorb imported technologies. In order to ensure the same, company has been constantly spending on R&D through its 11 R&D centres. The company's focus on innovation and design is evident from the 70 IPRs were granted during the year, taking the total IPR held by the organization to 178 (as against 108 IPRs held on March'18). Further the company has filed 82 IPR applications, making a total of 1,621 IPRs filed by company.

Fully integrated production capabilities and continually improving product portfolio

Over the years, HAL has developed its capability to operate under entire value chain of the production right from design, development, manufacturing, maintenance, repair and overhaul of aviation products. Company has 20 Production/ Overhaul division and 11 R&D centers co -located with production divisions across the country. Apart from design and manufacturing, HAL takes up maintenance and overhaul services (MRO) to cover the life cycle requirement of all the old and new products, which is also second highest revenue generator for HAL. In FY19, HAL produced 41 aircrafts and Helicopters in addition to production of 102 New Engines and overhaul of 213 platforms of various aircrafts in addition to overhaul of 560 Russian and other origin aero engines.

Key Rating Weaknesses

Reliance on working capital borrowings and build-up of receivables to continue

Earlier significant advance funding from Armed forces had resulted in negligible borrowings and robust liquidity which enabled the company in executing its projects and funding its R&D expenditure without relying on debt. However, the company's liquidity profile witnessed deterioration with continuous decline in customer advances due to delayed allocation of budgeted amount. The shortfall is met out of enhanced working capital borrowings and utilization of cash and bank balances (which stand declined from Rs. 5250 crore as on March 31, 2018 to Rs. 45 crore as on March 31, 2019). Although payments from IAF has eased with conclusion of majority payments (around 75-80%) resulting in improvement in receivables position to Rs. 10,572 crore as on Sept'2019, they are likely to remain high in the range of Rs. 11,000-12,000 crore going forward. Accordingly, reliance on bank borrowings is expected to continue albeit the present bank lines are considered adequate to meet the working capital requirements and HAL envisages no further enhancement. Notwithstanding the above, HAL estimates improvement in customer advances with conclusion of major deal with IAF towards supply of LCA Tejus and HTT-40.

Prospects of company depend on Indian Defence sector

HAL's derives revenue of majority revenues from Indian Defence sector. Accordingly, continuous flow of orders from defence segment which in turn is dependent upon defence budget is critical for company's prospects. Share of Defence Budget in GDP stands at 1.45% of GDP based on 2019-20 (BE) which has further come down against 1.48% in previous year. However, the allocation for modernization of the three forces under the Aircraft and Aero-engines category saw an increase of 4% per cent over the previous year (BE).

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 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.

Increasing private sector participation

Due to relaxation in 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 the private participation in defence production may result in competition in the sector but given the huge investments required, competition is expected to be muted for the medium term.

Liquidity : Adequate
With realization of receivables to some extent in current financial year, the dependence on short term bank borrowings has reduced and average utilization of fund based limits stands at 54% for 12 months ended September 30th 2019. The company has un-utilized limits of Rs. 4164 crore against fund based limits of Rs. 5250 crore as on September 30, 2019.

Analytical approach: Standalone along with strategic importance to GOI

Applicable Criteria
CARE's methodology for manufacturing companies
CARE's methodology for Short-term Instruments
Criteria on assigning Outlook to Credit Ratings
Factoring linkages in ratings
CARE's policy on Default Recognition
Financial Ratios-Non Financial Sector

About the Company
Hindustan Aeronautics Limited (HAL), was incorporated in 1964 by amalgamation of Hindustan Aircraft Limited and Aeronautics India Limited, is a Navratana Company. Government of India (GoI) holds majority stake of 89.97% following listing of shares on March 28, 2018. 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).

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

Brief Financials (Rs. crore)	FY18 (A)	FY19 (A)
Total operating income	19010	20058
PBILDT	4083	4889
PAT	2070	2282
Overall gearing (times) (Including Acceptances / Creditors on LC)	0.2	0.5
Interest coverage (times)	363	45

A: Audited

Status of non-cooperation with previous CRA: CRISIL has revised the rating to AA-/Negative (INC); from 'CRISIL AAA/Stable (INC; rating withdrawn) and CRISIL A1+ (INC; rating withdrawn) dated July 16 2019 due to lack of co-operation from the company.

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
LT/ST Fund-based/Non-fund-based-CC / OD / BG/LC	-	-	-	7300.00	CARE AA+; 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 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.	LT/ST Fund-based/Non-fund-based-EPC / PCFC / FBP / FBD / WCDL / OD / BG / SBLC	LT/ST	7300.00	CARE AA+; Stable / CARE A1+	-	1)CARE AAA; Stable / CARE A1+ (07-Jan-19)	1)CARE AAA; Stable / CARE A1+ (03-Jan-18)	1)CARE AAA; Stable / CARE A1+ (06-Jan-17) 2)CARE AAA / CARE A1+ (04-May-16)

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

Name of the Instrument	Detailed explanation
A. Financial covenants	
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B. Non financial covenants	
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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:
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