Hindustan Aeronautics Limited

July 03, 2020

Ratings

Facilities	Amount (Rs. crore)	Rating1	Rating Action
Long term / Short Term Bank Facilities	12,050 (enhanced from 7300.00)	**CARE AA+; Stable/CARE A1+ (Double A Plus; Outlook: Stable/ A One Plus)**	**Re-affirmed**
Total Facilities	**12,050 (Rs. Twelve thousand fifty crore only)**		
Commercial Paper Issue @	**2,500 (Rupees Two Thousand Five Hundred crore only)**	**CARE A1+ (A One Plus)**	**Re-affirmed**

Details of instruments/facilities in Annexure-1| @Carved out of WC limits

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of Hindustan Aeronautics Limited (HAL) continue to derive strength from its strategic importance 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 stable profitability margin. HAL continues to invest in research and development resulting in continually improving product portfolio. The rating also takes note of satisfactory order book position though manufacturing order book is declining in absence of placement of large new orders with HAL though significant amount of new manufacturing order is expected to get added in FY21. While the fresh nominated manufacturing orders are expected to yield comparatively lower margins for the company, the same is likely to be compensated with advance funding along with compensation for delay in receipt of receivables. Besides, increasing ROH (repair and over-hauling) order book where the gross margins are relatively higher and cost cutting efforts is expected to help sustain its profitability.

Company's receivable realization from it's customers has improved during FY20, however, receivables position continues to remain at elevated level. Incremental receivables are primarily being funded out of WC borrowing and is expected to be so in view of reduced advance funding by customers. 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. Further, the company has also diversified its resource profile in terms of raising borrowing by way of Commercial Paper issue. 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.

Rating Sensitivities

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

- Improvement in receivable cycle to below 150 days on sustained basis.
- Net debt (Gross debt-Free cash balance)/ Net cash accruals (GCA- dividend payment) less than 0.5x.

Negative Factors- Factors that could lead to negative rating action/downgrade:

- 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 and Government of India ownership

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 (ROH). 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.

Continuing healthy order book position

HAL follows assured cost plus margin structure and milestone payments in addition to advance funding by customer. HAL enters into long term variable price contract with its customers viz. Indian Airforce, Indian Army and Indian Navy for period of

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

15-20 years which ensures order book visibility with assured margins. The company's order book continues to be healthy at Rs. 52,965 crore as on March 31, 2020 (Mar'19: Rs.58,588 crore). Manufacturing order book of the company is on declining trend (from 86% of order book as on March 31, 2018 to 70% as on March 31, 2020) due to non-placement of large orders by Indian defence forces with HAL. Nevertheless, ROH order book for the company is increasing (from 11% as on March 31, 2018 to 27% as on March 31, 2020) and is expected to remain robust in near to medium term.

Going forward, HAL is estimating orders for 12 Sukhoi-30, 83 LCA (Low Combat Aircraft) and 15 LCH (Low Combat Helicopter) which is expected to improve manufacturing order book position. Order book of the company continues to remain skewed towards Indian Defense services which forms 97% of order book.

Strong financial risk profile marked by stable profitability and cash accruals

HAL registered growth of 7.5% in turnover during FY20 with PBDIT margin of 24.35% in FY20 (PY:24.91%). Adjusted for interest income earned, PBDIT margin improved from 23.61% in FY19 to 24.05% despite increase in employee expenses from 21.6% of TOI in FY19 to 22.4% of TOI in FY20. Improvement was largely on account of higher share of ROH income in which margins are relatively higher. Company's GCA for FY20 was Rs. 3886 crore as against Rs. 3620 crore in FY19.

With conclusion of major deals pertaining to Sukhoi 30, LCA and LCH, the company expects significant improvement in customer advances. It may be noted that new nominated orders may fetch lower margins than that of current orders. However, in new contracts, penal interest clause with regards to delayed receipt of payments is expected to be incorporated. Further, company is also working upon to improve operational efficiencies through inventory rationalization and optimizing overhead expenditure. This along with increasing share of income from ROH is expected to keep the margins stable.

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 to cover the life cycle requirement of all the old and new products, which is also second highest revenue generator for HAL.

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. HAL has also established 12 commercial Joint Venture companies in collaboration with leading international aviation and Indian organizations like BAe Systems (UK), Safran Aircraft engines (France), Elbit Systems (Israel), Rolls Royace (UK) etc. for supply of aircraft engines, components (like compressor rings, turbine blades) etc.

Key Rating Weaknesses

Increasing reliance on WC borrowings while build up of receivables continue

Over the past two years, company has witnessed change in operating environment involving reduced advance funding by customers and build-up of receivables position translating into increased reliance on working capital debt. There has been build-up of receivables from Rs. 7,742 crore as on March 31, 2018 to Rs. 14,029 crore as on March 31, 2019 and further to Rs. 15,238 crore as on March 31, 2020. Though receivables are high, comfort is drawn from the fact that more than 90% of total receivables outstanding are from IAF. For FY19, company received Rs. 13,770 crore from it's customers which improved to Rs. 18,107 crore in FY20. Receivables are expected to remain elevated during FY21.

Decline in customer advances and delayed payments from customers resulted in shortfall which was met out of enhanced working capital borrowings, utilization of cash and bank balances and internal accruals in FY19 & FY20. Cash balance as a result had declined from Rs. 5856 crore as on Mar'18 to Rs. 298 crore as on Mar'20. Interest expenses increased from Rs. 28 crore in FY18 to Rs. 170 crore in FY19 and further to Rs. 347 crore in FY20 (of which Rs. 268 crore pertaining to interest on borrowings and balance towards other provisions).

Inventory levels of the company remained stable at Rs. 19,460 crore (345 days) as on Mar'20 as against Rs. 19,765 crore (389 days) as on Mar'19. Typically, 55% of inventory is towards manufacturing division, 35% for ROH division and balance towards 10% spares/exports.

Company's working capital needs are adequately covered with bank lines. Company has sanctioned WC limits of Rs. 12,050 crore, enhanced from its earlier Rs. 7300 crore which include CC limit of Rs. 10,000 crore and LC/BG limit of Rs. 2,050 crore (fully interchangeable with each other). Since Feb'20, company has started to raise funds through CP which comes at finer rates.

Prospects of company depend on Indian Defence sector with limited exports
HAL's derives majority of its 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.
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
Company's financial flexibility is largely derived from it being majorly held by GOI and it's strategic importance. Further, with entire receivables from GOI, banks have been comfortable in lending additional facilities to HAL. The HAL has sanctioned working capital limits of Rs. 12,050 crore from bank consortium. Average utilization stands at 59% for 12 months period ended May 31, 2020. The company has un-utilized limits of Rs. 5,258 crore against fund based limits of Rs. 10,000 crore as on May 31, 2020. HAL has not availed moratorium under RBI's Covid-19 regulatory package.

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% as on March 31, 2020. 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: *No specific covenants are stipulated*

Brief Financials (Rs. crore)	FY19 (A)	FY20 (Abridged)
Total operating income	20058	21815
PBILDT	4889	5219
PAT	2282	2857
Overall gearing (times)(Including Acceptances / Creditors on LC)	0.5	0.5
Interest coverage (times)	45	15

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
LT/ST Fund-based/Non-fund-based-EPC / PCFC / FBP / FBD / WCDL / OD / BG / SBLC	-	-	-	-	12050.00	CARE AA+; Stable / CARE A1+
Commercial Paper	-	-	-	7-365 days	1000.00	CARE A1+
Commercial Paper	-	-	-	7-365 days	1500.00	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 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.	LT/ST Fund-based/Non-fund-based-EPC / PCFC / FBP / FBD / WCDL / OD / BG / SBLC	LT/ST	12050.00	CARE AA+; Stable / CARE A1+	-	1)CARE AA+; Stable / CARE A1+ (26-Dec-19)	1)CARE AAA; Stable / CARE A1+ (07-Jan-19)	1)CARE AAA; Stable / CARE A1+ (03-Jan-18)
2.	Commercial Paper	ST	1000.00	CARE A1+	-	1)CARE A1+ (14-Jan-20)	-	-
3.	Commercial Paper	ST	1500.00	CARE A1+	-	1)CARE A1+ (09-Mar-20)	-	-

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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