

January 29, 2021

Tata Hitachi Construction Machinery Company Private Limited: Ratings reaffirmed and outlook on long-term rating revised to Stable from Negative

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund based/ non-fund based (interchangeable) facilities	900.0	900.0	[ICRA]AA/[ICRA]A1+ Reaffirmed; outlook on long-term rating revised to Stable from Negative
Total	900.0	900.0	

*Instrument details are provided in Annexure-1

Rationale

The revision in outlook on the long-term rating factors in the revival in the domestic Mining and Construction Equipment (MCE) industry over the last few months leading to robust volume ramp up for Tata Hitachi Construction Machinery Company Private Limited (THCM / the company). While industry volumes were adversely impacted in Q1 FY2021 following the lockdown, the same has witnessed revival from July 2020 supported by pickup in demand across segments such as highways, rural roads and infrastructure, agriculture etc. Strong project awarding, faster land acquisition, healthy road construction rates, and regular release of payments from the Government have been supporting industry volumes.

While the company witnessed 65% volume de-growth in Q1 FY2021 and flattish volumes in Q2 FY2021, with pickup in demand over the last few months, the company posted 29% volume growth in Q3 FY2021. Overall, the volume de-growth for the company in 9m FY2021 stands at 11% despite April and May 2020 being a complete washout. With revival in demand, the company has been able to liquidate inventory at a much faster pace resulting in a steep decline in working capital debt (to fund inventory) over the last few months. As against total debt (including lease liabilities) of Rs. 866.5 crore as on March 31, 2020, the company's debt levels stood at Rs. 644.2 crore as on September 30, 2020 and Rs. ~Rs. 500 crore as on December 31, 2020 resulting in a marked improvement in the liquidity position of the company.

The ratings continue to take into account THCM's established position in the domestic MCE industry with healthy market share of 35-40% in the excavator segment supported by its strong product quality and widespread service network and capabilities. The company enjoys strong technology support from its parent, Hitachi Construction Machinery Company Limited (HCMC). HCMC is the world's third largest construction equipment manufacturer and the largest manufacturer of hydraulic excavators in the world.

The company also remains exposed to intense competition (in both excavator and backhoe loader segments) and foreign exchange fluctuations (imports account for ~47-48% of its raw material costs). Further, ICRA also notes the high product concentration risk with excavators contributing to more than 80% of the company's revenues in H1 FY2021. However, with backhoe loaders witnessing healthy demand, the company's revenue contribution from the same has increased to 17% in Q2 FY2021 from 12% in FY2020. ICRA also notes that the increase in pricing on account of the increasing commodity prices and the upcoming emission norm changes. The consequent price increases for

backhoe loaders and wheeled loaders may impact volumes and thereby margins of the company to a certain extent in FY2022. ICRA will continue to monitor the situation.

Key rating drivers and their description

Credit strengths

Strong global major promoter lends considerable technological support– The company derives considerable technological and trade support from the promoter group, HCMC, one of the largest players in the global excavator market.

Dominant market position of company in excavators – THCM enjoys an established position in the domestic MCE industry with strong market share of 35-40% in the excavator segment. That said, THCM has high product concentration with over 80% of revenue being generated from excavators.

Credit challenges

Cyclical demand for MCE creates earnings volatility – The cyclical nature of the industry leaves THCM's operating performance vulnerable to demand swings that reflect economic cycles. While the company's OPMs peaked at 14.3% when the industry reached its peak volumes in FY2018, the same had contracted to 4.6% in FY2020 following steep decline in volumes. With steep volume decline in H1 FY2021, the OPMs were closer to breakeven levels. While the volumes have recovered to a certain extent in H2 FY2021 (leading to flattish volumes in FY2021 as compared to FY2020), OPM during FY2021 will be relatively subdued. Going forward, revenues and margins are expected to improve in FY2022 and FY2023 with sustained increase in volumes on the back of continued investments in infrastructure and strong demand from the mining segment, and effective cost pass throughs to end customers.

Intense competition – Although the company is the leader in the Indian excavator segment supported by its strong product quality and service capabilities, it continues to face intense competition, thereby constraining its pricing flexibility to a certain extent. THCM also faces competition from strong incumbents in the backhoe loader segment, where it is a marginal player despite healthy yoy growth in its backhoe loader volumes in FY2020 and FY2021.

Margins remain vulnerable to volatility in both foreign exchange and raw material prices – With high import content of ~47-48% and borrowings in foreign currency, the company continues to remain exposed to foreign currency fluctuations. However, the risk is mitigated to some extent by the foreign currency exposure management policy wherein majority of its yen-rupee exposure is hedged. Further, with steel forming major part of the company's raw material costs, the margins are vulnerable to fluctuations in steel prices. The company has taken some price increases in FY2021 to protect its margins given the steady increase in steel prices over the last few months.

Liquidity position: Adequate

THCM's liquidity continues to remain adequate with undrawn working limits of ~Rs. 600 crore and cash balances of ~Rs. 30 crore as on December 31, 2020. The company has repayments of ~Rs. 100 crore in FY2022 in addition to capex requirements (expected to be in line with recent trends) which it plans to fund through internal accruals. The company's average working capital utilization has been ~62% of the sanctioned limits during the 12 months ending December 2020. However, the same had declined in the recent months and stood at ~33% as on December 31, 2020. Overall, ICRA believes that the company's current liquidity buffer is adequate for servicing the debt obligations and capex requirements over the near term. However, the same would remain sensitive to the demand trajectory over the next few quarters. ICRA will continue to monitor the situation and take rating action as and when necessary.

Rating sensitivities

Positive triggers – The company’s ratings can be upgraded if there is sustained revenue growth coupled with profitability reverting to previous highs.

Negative triggers – Negative pressure on THCM’s ratings could arise if there is higher than expected decline in top line and margins due to industry conditions or there is increase in debt on account of stretched working capital position or higher than expected capex spend. Specific credit metrics that could lead to a downgrade of ratings include TD/OPBDITA greater than 2.0x on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating methodology for construction equipment manufacturers
Parent/Group Support	Not applicable
Consolidation/Standalone	The ratings are based on standalone financial statements of the issuer

About the company

Tata Hitachi Construction Machinery Company Private Limited (THCM), formerly Telco Construction Equipment Company Limited, is one of the major players in the Indian mining and construction equipment (MCE) industry with a healthy share in the excavator market in India. Although the company’s product range primarily consists of hydraulic excavators, it also sells other products like crawler cranes, wheel loaders, backhoe loaders, off-highway dumpers, motor graders, soil compacters, dumpers and hydraulic cranes, albeit in low quantities. THCM has manufacturing facilities in Dharwad and Kharagpur.

THCM started off as the construction equipment division of Tata Engineering in 1961 and was incorporated as Telco Construction Equipment Company Limited in 1998 under the ownership of Tata Group. In 2000, HCMC acquired a 20% stake in THCM, subsequently raising it to 40% in December 2005 and 60% in March 2010. In December 2012, the company’s name was changed to Tata Hitachi Construction Machinery Company Limited and subsequently to Tata Hitachi Construction Machinery Company Private Limited. Currently, THCM is a joint venture between HCMC (60% stake) and Tata Motors Limited (40% stake). As per information available in the public domain, TML is engaging with HCMC to look at a stake sale in the company.

Key financial indicators (audited)

LTHL Consolidated	FY2019	FY2020
Operating Income (Rs. crore)	4,337.0	3,285.8
PAT (Rs. crore)	235.9	2.0
OPBDIT/OI (%)	9.8%	4.6%
RoCE (%)	44.7%	4.1%
Total Outside Liabilities/Tangible Net Worth (times)	1.9	2.3
Total Debt/OPBDIT (times)	0.8	5.7
Interest Coverage (times)	16.8	2.9
DSCR (times)	13.7	3.5

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; ROCE: PBIT/Avg (Total Debt + Tangible Net Worth + Deferred Tax Liability - Capital Work in Progress); DSCR: (PBIT + Mat Credit Entitlements - Fair Value Gains through P&L - Non-cash Extraordinary Gain/Loss)/(Interest + Repayments made during the Year); Source: THCM, ICRA research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2021)				Chronology of Rating History for the past 3 years					
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of December 31, 2020 (Rs. crore)	Date & Rating	Date & Rating In FY2021	Date & Rating in FY2020	Date & Rating in FY2019	Date & Rating in FY2018		
					January 29, 2021	May 04, 2020	October 4, 2019	September 10, 2018	March 5, 2018	August 10, 2017	
1	Fund based/ non- fund based (interchangeable) facilities	Long Term/ Short term (interchangeable)	900.0	297.8	[ICRA]AA (Stable)/ [ICRA] A1+	[ICRA]AA (Negative)/ [ICRA] A1+	[ICRA]AA (Stable)/ [ICRA] A1+	[ICRA]AA+ (Stable) / [ICRA]A1+	[ICRA]AA- (Stable) / [ICRA]A1+	[ICRA]A+ (Positive) /A1+	

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website [click here](#)

Annexure-1: Instrument details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (RS Crore)	Current Rating and Outlook
NA	Fund-based/non- fund based (interchangeable) facilities	-	-	-	900.0	[ICRA]AA (Stable) /A1+

Source: Company

Annexure-2: List of entities considered for consolidated analysis: Not Applicable

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