July 18, 2023

Tata Hitachi Construction Machinery Company Private Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based/ Non-fund based – Interchangeable facilities	900.00	900.00	[ICRA]AA (Stable)/[ICRA]A1+; reaffirmed
Total	**900.00**	**900.00**	

**Instrument details are provided in Annexure I*

Rationale

The reaffirmation of the ratings continues to favourably consider Tata Hitachi Construction Machinery Company Private Limited's (THCM) established position in the domestic mining and construction equipment (MCE) industry with a ~25% market share in the excavator segment, which is driven by its widespread service network and capabilities. The company enjoys strong technological and operational support from its promoter, Hitachi Construction Machinery Company Limited (HCMC), which is one of the global leaders in the hydraulic excavator industry. Moreover, being part of reputed Hitachi and Tata Group lends financial flexibility to the company and helps in raising funds at competitive rates. THCM's liquidity is supported by free cash and undrawn lines of Rs. 607 crore as on March 31, 2023. The demand prospects remain favourable over the medium term, aided by the Government's continued thrust on infrastructure development, improving mechanisation levels in projects and upcoming change in emission norms (CEV IV to V w.e.f., April 2024), which are expected to be favourable for the excavator segment (lowering price differential with backhoe loaders).

The strengths are partially offset by the intense competition in the MCE industry and susceptibility of THCM's performance to the cyclicality in the construction industry. The ratings factor in the vulnerability of the company's operations to the fluctuations in input prices and forex movement and limited ability to pass on the same to the end users, thereby keeping the profitability margins volatile. It is also exposed to product concentration risk, given that 80% of revenues are generated from the excavators.

In the recent past, the company recorded a moderation in its volume growth (vis-à-vis industry) resulting in a decline in market share by ~3% due increasing competition. Further, sharp rise in steel prices and logistic costs led to deterioration in operating profit margins (OPM) to 2.9% in FY2022 from 9.8% in FY2019. While the OPM recovered in FY2023 to 6.5% p.a., benefiting from cost rationalisation and improvement in sales realisation (despite lower volume growth), the overall operating profitability remains lower than historical levels of ~10%. With a high import content of ~40%, the company remains exposed to foreign currency fluctuations. It hedged ~67% of its exposure in FY2023 mitigating this risk to an extent. However, given the high forex volatility and hedging cost, it intends to change its forex policy in FY2024 by making faster payments to its import creditors (which include sizeable imports from HCMC Group entities) within ~60-90 days and keeping its forex position open instead of the earlier mechanism of availing long tenure foreign currency denominated buyer's credit and hedging it. The Company management expects net savings because of revised forex policy, in the backdrop of lower forex exposure and reduction in hedging related expenses. ICRA notes that this policy change would lead to an increase in the company's working capital borrowings. In addition, shift from low-cost foreign currency buyer's credit would result in increased interest expenses and lead to some moderation in THCM's debt protection metrics. However, these are likely to remain at comfortable levels, with expected interest coverage of ~8 times in FY2024. Going forward, the company's ability to materially improve its operating margins and improve its working capital cycle will be crucial from the credit perspective.

The Stable outlook on the long-term rating reflects ICRA's opinion that the company will continue to benefit from its market leadership position in the excavator segment, expected improvement in EBITDA margins and the favourable demand outlook for excavators in the Indian MCE segment.

Key rating drivers and their description

Credit strengths

Strong operational support from HCMC, one of the leading global MCE OEM – The company derives considerable technological and operational support from the promoter Group, Hitachi Construction Machinery Company Limited, which is one of the global leaders in the hydraulic excavator industry. Moreover, being part of a strong promoter Group lends financial flexibility to the company and helps it raise funds at competitive rates.

Market leadership position in excavators – THCM has an established position in the domestic MCE industry with a ~25% market share in the excavator segment, though the same has moderated from ~35% in FY2016-FY2017 and ~29% in FY2021-FY2022, led by stiff competition from other established players and increase in the number of OEMs in the segment.

Favourable long-term demand prospects – The healthy allocation for capital spending in the Union Budget 2023-24, coupled with ambitious targets set under the National Infrastructure Pipeline (NIP) are expected to lead to ramp-up in infrastructure development in segments like roads, metros, railways, etc, in the medium term, which would drive volumes for the MCE industry (and for THCM).

Credit challenges

Cyclical demand for MCE, increased competition and high product concentration creates earnings volatility – MCE is a cyclical industry, prone to sharp swings in demand. In addition, India is a growing market, which has led to new players entering the market and increasing the competition (especially during industry downturns). THCM has a high product concentration with over 80% of the revenue generated from excavators. All these factors limit its ability to pass on any adverse input price hikes to its customers. THCM also faces competition from strong incumbents in the backhoe loader segment, where it remains a marginal player despite YoY growth.

Margins vulnerable to volatility in raw material costs and foreign exchange rates – THCM's profitability remains vulnerable to any increase in raw material prices as the same accounts for over 60% of the cost structure. Further, with a high import content of ~40%, it is exposed to foreign currency fluctuations. The company's OPM contracted from ~10% in FY2019 to 3% in FY2022 before recovering to 6.5% in FY2023. It hedged ~67% of its exposure in FY2023 mitigating this risk to an extent. However, given the high forex volatility and hedging cost, it intends to change its forex policy in FY2024 by making faster payments to its import creditors (which include sizeable imports from HCMC Group entities) within ~60-90 days and keeping its forex position open instead of the earlier mechanism of availing long tenure foreign currency denominated buyer's credit and hedging it. The Company management expects net savings because of revised forex policy, in the backdrop of lower forex exposure and reduction in hedging related expenses. While this policy change would lead to an increase in working capital borrowings and some moderation in THCM's debt protection metrics in FY2024, these are expected to continue remaining at comfortable levels. Going forward, the company's ability to materially improve its operating margins and improve its working capital cycle will be crucial from the credit perspective.

Liquidity position: Adequate

THCM's liquidity is adequate, supported by undrawn working capital limits of ~Rs. 533 crore and free cash balance of ~Rs. 74 crore as on March 31, 2023. The company's average working capital utilisation was ~63% of the sanctioned limits during the 12 months ending in March 2023. It has no long-term debt on its books but intends to incur capex of Rs. 170-190 crore in FY2024. Its current liquidity buffer and expected cash flows from operations are adequate to service the debt obligations and the capex funding requirements.

Rating sensitivities

Positive factors – The company's ratings can be upgraded if there is a sustained healthy growth in revenues along with a significant improvement in profitability, which results in better liquidity and credit metrics. The company's ability to substantially improve its leverage with TOL/TNW below 1.0 times, on a consistent basis, is crucial for any upward revision in the rating.

Negative factors – Negative pressure on THCM's ratings could arise with a sustained pressure on margins or if the leverage or coverage metrics deteriorate on account of stretched working capital or higher-than-expected capex spend. Specific credit metrics that could lead to a downgrade include TOL/TNW above 1.75 times on a consistent basis.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating Methodology for Construction Equipment Industry
Parent/Group support	Not Applicable
Consolidation/Standalone	The ratings are based on the standalone financial statements of the company

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 MCE industry with around 25% 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 its manufacturing facilities in Dharwad (Karnataka) and Kharagpur (West Bengal).

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 the 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). The board of directors includes representatives from HCMC and TML, and Mr. Girish Wagh (Executive Director – Tata Motors Limited) is Chairman of THCM.

Key financial indicators

	FY2021	FY2022	FY2023*
Operating income	3,476.5	3,943.2	4,401.2
PAT	56.1	6.2	49.1
OPBDIT/OI	4.6%	2.9%	6.5%
PAT/OI	1.6%	0.2%	1.1%
Total outside liabilities/Tangible net worth (times)	1.8	2.1	1.9
Total debt/OPBDIT (times)	1.9	5.0	1.5
Interest coverage (times)	5.3	6.0	9.5

*Source: ICRA Research, Company; PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation, * provisional*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2024)				Chronology of rating history for the past 3 years			
		Type	Amount rated (Rs. crore)	Amount outstanding as on Mar 31, 2023 (Rs. crore)	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021	
					July 18, 2023	Apr 07, 2022	-	Jan 29, 2021	May 04, 2020
1	Fund-based/ Non-fund based – Interchangeable facilities	Long term/ Short term	900.00	363.7	[ICRA]AA (Stable)/ [ICRA] A1+	[ICRA]AA (Stable)/ [ICRA] A1+	-	[ICRA]AA (Stable)/ [ICRA] A1+	[ICRA]AA (Negative)/ [ICRA]A1+

Complexity level of the rated instruments

Instrument	Complexity Indicator
Fund-based/ Non-fund based – Interchangeable facilities	Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	**Fund-based/ Non-fund based – Interchangeable facilities**	NA	NA	NA	900.00	[ICRA]AA (Stable)/ [ICRA]A1+

Source: Company

Please click here to view details of lender-wise facilities rated by ICRA

Annexure II: List of entities considered for consolidated analysis- Not applicable

ANALYST CONTACTS

Rajeshwar Burla
+91 40 4547 4829
rajeshwar.burla@icraindia.com

Ashish Modani
+91 20 6606 9912
ashish.modani@icraindia.co.in

Ritu Goswami
+91 124 4545 826
ritu.goswami@icraindia.com

Anuja Shah
+91 79-40271530
anuja.shah@icraindia.com

RELATIONSHIP CONTACT

L. Shivakumar
+91 22 61143406
shivakumar@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

ICRA Limited

Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001
Tel: +91 11 23357940-45

Branches