April 07, 2022

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-1*

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 ~30% market share in the excavator segment supported by its strong product quality and 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 a strong promoter Group lends financial flexibility to the company and helps in raising funds at competitive rates. THCM's liquidity profile remains comfortable, supported by cash & liquid investments and undrawn lines of ~Rs. 300 crore as in February 2022-end. The long-term demand prospects for THCM remain favourable driven by the government's thrust on infrastructure sector, the expected by increase in the pace of road, real estate and other infrastructure development due to budgetary allocations and the upcoming elections.

The ratings are, however, constrained by the high product concentration with over 80% of the revenue generated from excavators and the exposure to intense competition (in both excavator and backhoe loader segments) in a highly cyclical industry. This limits THCM's ability to pass on adverse price hikes to its customers. In the recent past, with the steep increase in prices along with logistic costs, the operating margins have contracted to 5% in FY2021 (from a peak of 14.3% in FY2018) and are expected to contract by around 150-200 basis points in FY2022 as the company has been unable to entirely pass on the input price increase to its customers amid volatile demand. Further, with a high import content of ~45-50% and borrowings in foreign currency, the company continues to be exposed to foreign currency fluctuations though the risk is mitigated to an extent by hedging 70-80% of the exposure. The company imports sizeable components from HCMC Group entities, where the payment terms are relatively relaxed, resulting in low dependence on bank borrowings (to fund WC requirement) though the TOL/TNW was in the range of 1.5-2.0 times. Going forward, the company's ability to scale up its volume and improve its margin remains crucial from a credit perspective.

ICRA also notes the increased working capital borrowings on account of significant inventory built-up as on December 2021 end, which resulted in elevated short-term borrowings and consequently moderated THCM's credit metrics with TD/OPBDITA expected to remain ~5x in FY2022 from 1.8x as on March 31, 2021. However, in the backdrop of an expected improvement in operating margin, the TD/OPBIDTA is likely to reduce below 2.0 times in FY2023e. Going forward, the company's ability to prune its working capital cycle remains crucial to improve the overall leverage and coverage indicators.

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 and the financial flexibility of being part of a strong promoter Group.

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 (HCMC), 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.

Strong market position in excavators – THCM has an established position in the domestic mining and construction equipment (MCE) industry with a ~30% market share in the excavator segment, though the same has moderated over years from ~35% in FY2016-FY2017 to ~28-30% at present.

Favorable long-term demand prospects: The long-term demand prospects for the MCE industry and thereby THCM remain favourable, driven by the government's thrust on infrastructure sector, the expected increase in the pace of road, real estate and other infrastructure development supported by budgetary allocations and the upcoming elections.

Credit challenges

Cyclical demand for MCE, high product concentration creates earnings volatility; margins vulnerable to volatility in raw material costs and foreign exchange rates – THCM has high product concentration with over 80% of the revenue generated from excavators in a highly cyclical and competitive industry. This limits THCM's ability to pass on any adverse price hike to its customers. In the recent past, with the steep increase in prices along with logistic costs, the operating margins have contracted to 5% in FY2021 (from a peak of 14.3% in FY2018) and are expected to contract by around 150-200 basis points in FY2022 as the company has been unable to entirely pass on the input price increase to its customers amid volatile demand. Further, with a high import content of ~45-50% and borrowings in foreign currency, the company continues to be exposed to foreign currency fluctuations though the risk is mitigated to an extent by hedging 70-80% of the exposure. The company imports sizeable components from HCMC Group entities, where the payment terms are relatively relaxed, resulting in low dependence on bank borrowings (to fund WC requirement) though TOL/TNW was in the range of 1.5-2.0 times. Going forward, the company's ability to scale up its volume and improve its margins remains crucial from a credit perspective.

Intense competition – Although the company is a leader in the Indian excavator segment supported by its strong product quality and service capabilities, it continues to face intense competition that constrains its pricing flexibility to an extent. THCM also faces competition from strong incumbents in the backhoe loader segment, where it is a marginal player despite YoY growth till FY2021.

Increased working capital borrowings on account of inventory built-up– A significant inventory built-up as on December 31, 2021, coupled with a moderation in the credit period from suppliers, has increased the dependence on working capital borrowings. The short-term borrowings increased to ~Rs. 709 crore in December 2021-end from Rs. 161.2 crore in March 2021-end. Consequently, the TD/OPBDITA is expected to increase to ~5x in FY2022 from 1.8x as on March 31, 2021. However, an expected improvement in the operating margin is likely to reduce the TD/OPBIDTA below 2.0 times in FY2023e. The company's ability to prune its working capital cycle remains crucial to improve the overall leverage and coverage indicators.

Liquidity position: Adequate

THCM's liquidity is adequate supported by undrawn working capital limits and free cash balance of ~Rs. 300 crore in February 2022-end. The company's average working capital utilisation has been ~52% of the sanctioned limits during the 12 months ended February 2022. The company's current liquidity buffer is adequate to service the debt obligations and the capex requirements over the near to medium term.

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 consequently results in better liquidity and credit metrics. The company's ability to substantially improve its leverage with net TOL/TNW below 1.0 times on a sustained basis is also crucial for any upward revision in 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 net TOL/TNW above 1.75 times or operating margin below 4.5% on a sustained 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 group

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 around 30% 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 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).

Key financial indicators

	FY2020	FY2021	9MFY2022 (Provisional financials)
Operating Income (Rs. crore)	3,285.8	3,476.5	2704.0
PAT (Rs. crore)	2.0	56.1	0.3*
OPBDIT/OI (%)	4.6%	5.0%	2.8%
PAT/OI (%)	0.1%	1.6%	0.0%*
Total Outside Liabilities/Tangible Net Worth (times)	2.3	1.8	-
Total Debt/OPBDIT (times)	5.7	1.8	7.1
Interest Coverage (times)	2.9	5.6	10.7

*PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation, *profit before taxation*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2022)				Chronology of Rating History for the past 3 years			
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating on	Date & Rating in FY2021		Date & Rating in FY2020	Date & Rating in FY2019
					07-Apr-2022	29-Jan 2021	04-May 2020	04-Oct 2019	10-Sep 2018
1	Fund based/ Non-Fund based – Interchangeable facilities	Long-term/Short term	900.00	-	[ICRA]AA (Stable)/[ICRA] A1+	[ICRA]AA (Stable)/[ICRA] A1+	[ICRA]AA (Negative)/[ICRA]A1+	[ICRA]AA (Stable)/[ICRA]A1+	[ICRA]AA+ (Stable)/[ICRA]A1+

Complexity level of the rated instrument

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, is available on ICRA's website: www.icra.in

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	NA	NA	NA	900.00	[ICRA]AA (Stable)/[ICRA]A1+

Source: *Company*

Annexure-2: List of entities considered for consolidated analysis

Not Applicable

ANALYST CONTACTS

Rajeshwar Burla
+91 40 4067 6527
rajeshwar.burla@icraindia.com

Ashish Modani
+91 22 6114 3414
ashish.modani@icraindia.com

Mayank Agrawal
+91 40 4027 1514
mayank.agrawal@icraindia.com

Anuja Shah
+91 79 4027 1530
anuja.shah@icraindia.com

RELATIONSHIP CONTACT

Jayanta Chatterjee
+91 80 4332 6401
jayantac@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