October 06, 2023

ZF Hero Chassis Systems Private Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term – Fund-based – Cash credit	30.00	30.00	[ICRA]A- (Stable); reaffirmed
Short-term – Non-fund based – Working capital	4.00	4.00	[ICRA]A2+; reaffirmed
Total	**34.00**	**34.00**	

**Instrument details are provided in Annexure-I*

Rationale

The reaffirmation of ratings for ZF Hero Chassis Systems Private Limited (ZF Hero) factors in the company's steady performance in FY2023, marked by healthy revenue growth and accrual generation. The ratings are further supported by ZF Hero's stable operational profile as the leading chassis systems supplier to BMW, as well as healthy demand in the luxury passenger vehicle (PV) market in India. ZF Hero is a 50:50 joint venture (JV) between ZF India Private Limited (100% subsidiary of ZF Friedrichshafen AG, Germany, wherein Foxconn Technology Group has recently acquired a 50% stake in ZF's Chassis Modules Product line) and Hero Cycles Limited (HCL). It benefits from its strong parentage in terms of access to the latest technologies and a global client base. The strong relationships enjoyed by the ZF Group with European PV original equipment manufacturers (OEMs) globally, including BMW, and its strong technical capabilities in car-chassis technology have supported ZF Hero in securing business from BMW in India.

ZF Hero's established business position as a single-source supplier of key chassis components for all existing and successor models of BMW in India has benefitted the company over the years. Going forward, further scale up of its products in the domestic luxury car market is expected to support its growth prospects and provide revenue visibility over the near- to medium-term. Moreover, the ratings continue to favourably factor in the healthy financial risk profile of the entity, characterised by minimal debt on its balance sheet, strong liquidity and no major capital expenditure requirements. Additionally, its cash accrual generation remained healthy despite a sizeable dividend payout in the previous fiscal. Dividend payments are likely to continue, going forward. Nonetheless, steady internal accrual generation and low dependence on external borrowings are expected to continue to result in healthy coverage indicators in the future. ICRA also notes the JV partners' willingness to financially support the company in case of exigencies.

The ratings, however, remain constrained by the company's high customer concentration with BMW being its sole customer. Nonetheless, ZF Hero's single-source supplier status for chassis assemblies for the OEM and its established global relationships with the ZF Group mitigate this risk to a large extent. Moreover, the company faces significant import dependence as most of the components are sourced from ZF Group's global supply chain. This exposes the company to fluctuations in foreign exchange (forex) rates; however, such risks have been prudently managed by the company's hedging practices in the past. The management's ongoing plans to diversify the customer base with key OEMs of the domestic luxury market in the coming years are further expected to provide additional comfort.

Additionally, ZF Hero has a moderate scale of operations because of its niche product segment of luxury cars and single clientele. As the scope of its operations is limited to the assembly of front and rear axles, the company's business profile is also characterised by relatively lower value addition along with limited opportunities to backward integrate its operations. Nonetheless, the business derives strength from India's duty structure, which favours OEMs to localise manufacturing and assemble key vehicle aggregates. Going forward, any change in the duty structure for imports, or BMW's decision to move assembly operations in-house, would impact ZF Hero's business viability and the same would remain a key monitoring factor.

The Stable outlook on the long-term rating reflects ICRA's opinion that ZF Hero will continue to benefit from its strong parentage in terms of technical and financial support, and the established relationship of the ZF Group with BMW globally. This will enable ZF Hero to generate steady accrual and maintain healthy coverage metrics, supporting its credit profile.

Key rating drivers and their description

Credit strengths

Strong parentage, as JV between ZF India and HCL India ensures access to technical and financial support – ZF Hero's operational profile derives strength from its strong parentage, characterised by a 50:50 JV between the ZF Group and HCL. The company's ability to gain business because of the strong relationships between ZF Germany and European car OEMs provides additional comfort. Moreover, the JV partners supported the company through a periodic infusion of equity during the initial years of operations, thereby minimising its dependence on external borrowings and keeping the capital structure healthy. Going forward, although the company is expected to be self-sustaining in meeting its funding requirements, the JV partners are expected to support in the event of any contingency.

Established relationship with BMW and a strong share of business ensure revenue visibility over the medium term – ZF Hero enjoys a healthy share of business with BMW across its major models in the domestic market. It has also gained business for supplying chassis assemblies for several new models of BMW in India. The strong market position of BMW in the Indian luxury car segment, characterised by its status as the second-largest luxury car manufacturer in the industry, and ZF Hero's established relationship with the OEM ensure revenue visibility over the medium term and reduce business risks for the company.

Comfortable capital structure with nil debt and healthy coverage indicators – The company's capital structure remains comfortable, which is supported by low dependence on debt and steady accreditation to reserves, despite a sizeable dividend payout in FY2023. Moreover, coverage indicators remained healthy with total outside liabilities/total net worth (TOL/TNW) stood at 0.9 time in FY2023. Additionally, reliance on debt is likely to remain low, going forward, due to the steady accrual generation and no major capex plans, supporting ZF Hero's credit profile.

Credit challenges

High customer concentration risk with BMW as sole customer; established relationship with OEM mitigates risk to some extent – ZF Hero is engaged in chassis assembly services for BMW, which is its sole customer. This exposes the company to high concentration risk with its performance linked to the demand for BMW's models in India. However, ZF Hero's single-source status for chassis assemblies for the OEM and its established global relationship with the ZF Group (Germany) mitigates the risk to a large extent. Moreover, the company's ongoing efforts to diversify with new OEMs also provide some comfort.

Significant import dependence exposes company to forex fluctuations – ZF Hero imports its entire raw material from global vendors, who form part of the ZF Group's and BMW's global supply chains. This factor exposes ZF Hero to adverse fluctuations in the forex rates. However, ZF Hero hedges its forex exposure, which mitigates the risk to an extent.

Modest scale of operations and limited scope for value addition – ZF Hero has a modest scale of operations due to its presence in a niche product segment with a sole customer. As the scope of operations is limited to the assembly of front and rear axles, with entire components being imported and limited manufacturing being done in-house, ZF Hero's business profile is characterised by relatively lower value addition. This further limits opportunities to backward integrate its operations. Nonetheless, the business derives strength from India's import duty structure, which encourages OEMs to localise manufacturing and even assemble key vehicle aggregates. Any change in the import duty structure, or BMW's decision to move assembly operations in-house, would impact the company's business profile and the same would remain a key monitoring factor.

Liquidity Position: Strong

ZF Hero's liquidity position remains strong, supported by free cash and bank balances of Rs. 70.7 crore, as of June 30, 2023, with a healthy cushion available in the working capital limits, reflected by average limit utilisation of 9% (against sanctioned limits) over the past 12-month period ended July 2023. In line with FY2023, the company is likely to continue to pay dividends to its shareholders. However, minimal capex plans and no debt repayments, coupled with healthy accrual generation are expected to continuously support ZF Hero's liquidity profile.

Rating Sensitivities

Positive factors – The company's ability to scale up its business and strengthen its business profile by securing new customers will be considered favourably for ratings to be upgraded. A continued strengthening of the financial risk profile aided by healthy operating performance may also lead to improved ratings.

Negative factors – Negative pressure on the ratings could arise in case of loss of business from BMW or weakening of the financial risk profile due to any large debt-funded capex or pressure on the profit margins with core RoCE below 16% on a sustained basis. Moreover, negative pressure on the ratings could also arise in case of considerably higher than anticipated dividend payout leading to a weakening of the liquidity position, or in case of deterioration in the credit profile of the parent companies, or weaker than expected support from them.

Analytical Approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating Methodology for Auto Component Suppliers
Parent/Group support	**Parent/Holding Company: ZF India Private Limited and Hero Cycles Limited** ICRA expects ZF Hero's parents, ZF India and HCL, to be willing to extend financial support to it, should there be a need, given the high strategic importance that ZF Hero holds for its parents for meeting their diversification objectives.
Consolidation/Standalone	Standalone

About the company

ZF Hero is involved in assembly operations of key chassis components such as front suspension, rear axle and corner module for passenger car OEMs. It has an assembly facility in Chennai, Tamil Nadu, for supplies to BMW, which has a production capacity of 14,877 units annually on a single-shift basis. The company was initially set up to cater to General Motors India (GM) and had been supplying to the OEM from its plants in Halol (Gujarat) and Talegaon (Maharashtra). However, with GM's exit from the Indian market, both plants were closed.

The company was incorporated in March 2010, as a 50:50 JV between Hero Motors Limited (HML) and ZF India Private Limited (100% subsidiary of ZF Friedrichshafen AG, Germany, wherein Foxconn, a leading Taiwanese electronics component manufacturer, has recently acquired a 50% stake in ZF's Chassis Modules Product line). During FY2017, with the demerger of HML into HCL, the latter become a 50% JV partner, providing added strength to the promoter profile.

About the parent companies

ZF Group: ZF Group is a global leader in driveline and chassis technology as well as active and passive safety technologies. The Group reported €43.8 billion in sales during 2022 (€38.3 billion during 2021). The company has a global workforce of ~141,000 across approximately 271 locations in 42 countries.

HCL: Incorporated in 1956, HCL is the largest manufacturer of bicycles globally. The company has a manufacturing capacity of 65 lakh bicycles per year, with units in Ludhiana (Punjab), Bihta (Bihar) and Ghaziabad (Uttar Pradesh). The company has augmented its bicycle portfolio in recent years through acquisitions in the space, namely Firefox, Insync and BSH.

HCL is the flagship company of the Late O.P. Munjal faction of the Hero Group. Following an arrangement in FY2011 among members of the Munjal family (the promoters of the Hero Group), HCL is now managed by Mr. Pankaj Munjal (son of Late O.P. Munjal) and family. As a part of the arrangement, HCL hived off its cold-rolled (CR) steel division into a separate company in May 2010.

In FY2012, HCL also forayed into the real estate sector with the acquisition of an under-construction hotel property in Gurugram (Haryana), which was housed under its subsidiary, Munjal Hospitality Private Limited (MHPL). HCL diluted 60% stake in MHPL for a consideration of Rs. 438 crore in FY2019.

Key financial indicators

ZF Hero – Standalone	FY2022	FY2023*
Operating income	215.1	282.9
PAT	27.0	35.4
OPBDIT/OI	18.2%	17.8%
PAT/OI	12.6%	12.5%
Total outside liabilities/Tangible net worth (times)	0.9	0.9
Total debt/OPBDIT (times)	0.4	0.2
Interest coverage (times)	25.0	46.7

*PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs. crore, *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 August 31, 2023 (Rs. crore)	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021
					Oct 06, 2023	Aug 01, 2022	Jun 23, 2021	-
1	**Fund-based – Cash credit**	Long-term	30.00	-	**[ICRA]A- (Stable)**	**[ICRA]A- (Stable)**	**[ICRA]A- (Stable)**	-
2	**Non-fund based – Working capital**	Short-term	4.00	-	**[ICRA]A2+**	**[ICRA]A2+**	**[ICRA]A2+**	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Fund-based – Cash credit	Simple
Non-fund based – Working capital	Very 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 – Cash credit**	NA	NA	NA	30.00	[ICRA]A- (Stable)
NA	**Non-fund based – Working capital**	NA	NA	NA	4.00	[ICRA]A2+

Source: Company

Annexure II: List of entities considered for consolidated analysis – Not Applicable

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About ICRA Limited:

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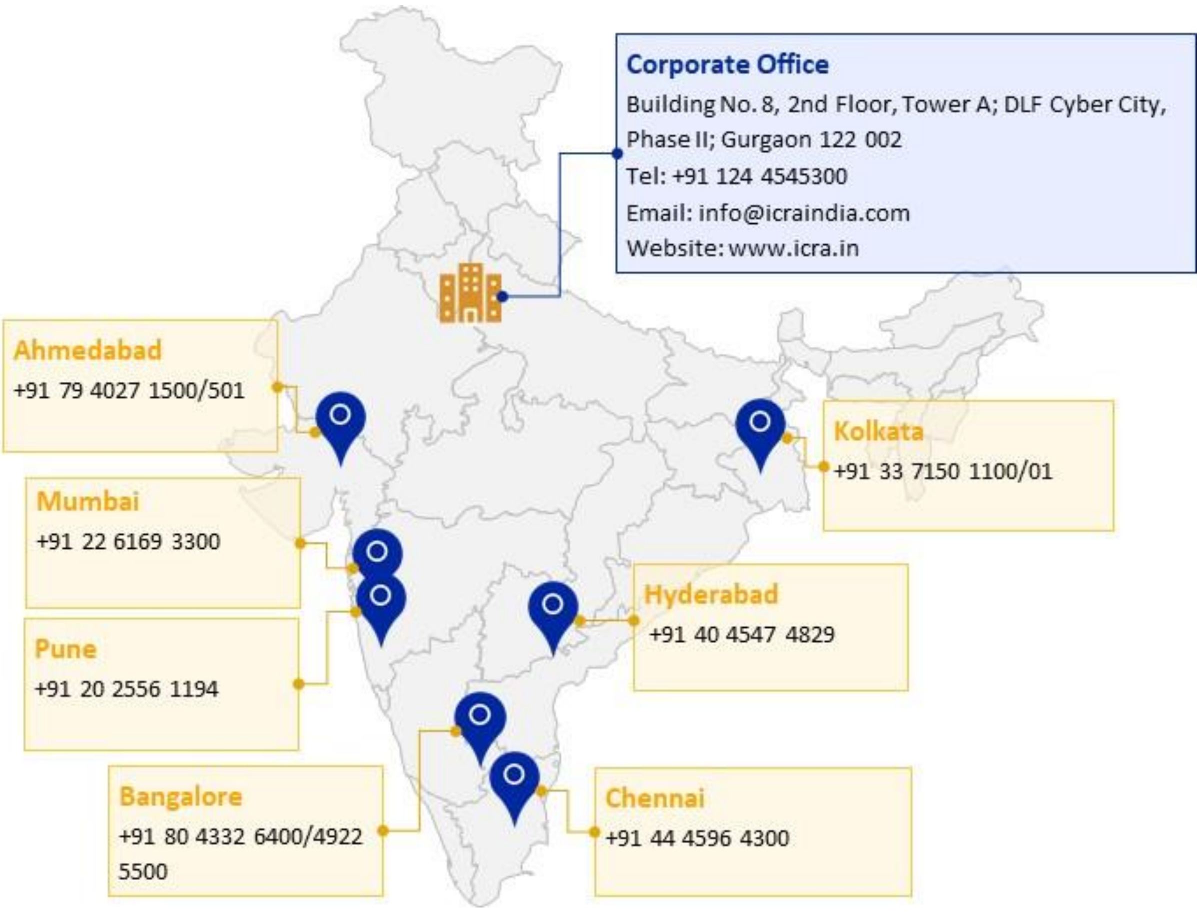

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