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India Ratings Downgrades Titagarh Wagons to 'IND A-' /Negative

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India Ratings and Research (Ind-Ra) has downgraded Titagarh Wagons Limited's (TWL) Long-Term Issuer Rating to 'IND A-' from 'IND A+'. The Outlook is Negative. The instrument-wise rating actions are given below:

Instrument Type	Date of issuance	Coupon Rate	Maturity Date	Size of Issue (million)	Rating/Outlook	Rating Action
Fund-based Facilities	-	-	-	INR1,400	IND A-/Negative/IND A2+	Downgraded
Non-fund-based facilities	-	-	-	INR6,008	IND A2+	Downgraded
Commercial paper (CP)	-	-	360 days	INR500	WD	Withdrawn (the company did not proceed with the instrument as envisaged)

Analytical Approach: Ind-Ra continues to take a consolidated view of TWL and its subsidiaries, as the debt of the subsidiaries is guaranteed by TWL.

The downgrade and the Negative Outlook factor in the change in Ind-Ra's expectations regarding a recovery in the net leverage (net adjusted debt/EBIDTAR) to around 4.0x by FY20 (FY18: negative 6.5x; FY17: 2.5x). The rating actions also reflect the negative cash flow from operations being generated by the group since FY16, resulting in a moderate liquidity profile, along with the modest operational performance of the group in 9MFY19.

KEY RATING DRIVERS

Delay in Recovery of Credit Metrics: TWL's credit profile weakened in FY18 as the company incurred EBIDTA loss, majorly on account of a one-time provision of INR809.8 million in its Italy-based subsidiary, Titagarh Firema S.p.A (TFA), and delay in allocation of wagon orders by Indian Railways (IR). The recovery in the company's net leverage has been delayed, largely because of the subdued operational performance of TWL's foreign subsidiaries in FY19. In FY19, TFA has been executing the low-margin/ loss-making orders it had inherited at the time of its acquisition, while Titagarh Wagons AFR (TWAFR), the company's France-based subsidiary, has been facing issues pertaining to demand-supply gaps and the increase in global stainless steel prices.

However, TFA won fresh orders for manufacture and supply of metro coaches in 4QFY19, which are expected to generate revenues by FY21. Nevertheless, with most of TFA's inherited orders being executed in FY19 and FY20, and the issues plaguing TWAFR, Ind-Ra expects the recovery process to be delayed by another two years at least. The agency believes the net leverage would recover to 4.0-4.5x by FY21; any further change in the expectations could result in a negative rating action.

Moderate Liquidity: With the group generating negative cash flow from operations since FY16, the cash balances declined to INR1.3

billion in FY18; of this, INR0.5 billion of investments in tax-free bonds were pledged to manage the company's working capital requirement. In addition, the company had to execute low-margin orders, which were not backed by advances and the free supply items used in wagon manufacturing from Indian Railways (IR). These factors led to the elongation of the working capital cycle (FY18: 131 days; FY17: 98 days), which pushed up working capital utilisations; the average fund-based utilisation stood at around 96% in FY19 (FY18: 46%).

The delay in working capital enhancements and partial usage of the free cash balances to manage the working capital cycle would result in a decline in the available free cash balances at FYE19. Any delay in tying up of new working capital limits or increased loss funding to the foreign subsidiaries would cause the company's liquidity profile to deteriorate further and would consequently impact its debt-servicing ability. This could have a negative impact on the ratings.

Modest Operational Performance of Domestic Entities: TWL's domestic units recorded modest performance in 9MFY19, as IR's policy of not allotting the free supply items exerted additional pressure on the working capital requirements of wagon manufacturers. Moreover, the wagon manufacturers are required to procure these items from IR-approved vendors; the resultant demand-supply imbalance impacted the entire supply chain management for most part of FY19. Despite repeated requests by wagon manufacturers, IR did not provide free supply items in the wagon allocation released in December 2018.

However, the domestic operations improved on a yoy basis in 9MFY19, with revenue generation of around INR7.0 billion (FY18: INR4.4 billion) and EBIDTA margin of 5.0% (negative 0.3%), backed by an increase in wagon capacity utilisations to 27.4% (FY18:15.3%). The credit profile remained modest in 9MFY19, as the execution of the order for 2,338 wagons allocated by IR in 3QFY18, which involve low margins and higher working capital requirement, pushed up the interest cost interest coverage ratio (EBIDTA/interest cost) of 1.1x (9MFY18: 1.1x). Considering the new order allocations by IR in 3QFY19, and with around 33% of these being likely to be completed by 1HFY20 in line with the contract, Ind-Ra believes that the revenue from domestic operations are likely to increase by around 15-20% in FY20, though the growth would be constrained by the company's working capital needs. Ind-Ra believes that TWL's working capital cycle would continue to belong in FY20. Any further delay in tying up additional working capital limits would impact the execution capability of the company, leading to deterioration in the business profile.

Improved Revenue Visibility; Increased Dependence on IR: The consolidated order book of the company improved to INR55.0 billion at end-February 2019 (INR26.0 billion at end-December 2017), majorly on account of the new orders allocated by IR in December 2018. Out of the 13,316 wagons (INR41.4 billion) allocated by IR in 3QFY19, around 38% (5,058 wagons worth INR15.6 billion) was allocated to TWL alone. The share of IR in the overall order book increased to around 30.8% in February 2019 (22.5% in December 2017); these orders have higher working capital requirements compared to private orders. Moreover, the closing order book of TFA increased to INR24.4 billion in February 2019 (INR10.8 billion in December 2017), backed by new orders worth INR17.0 billion, which would be executed by FY21-FY22.

Established Market Position: TWL is the second largest wagon manufacturer in India in terms of capacity (after Texmaco Rail & Engineering). TWL and its subsidiary, Cimmco Limited (CL), together have accounted for around 20-25% of the wagon orders placed by Indian Railway (IR) in the past few years. In FY19, IR changed the wagon allocation strategy from the sharing basis to the bucket filling mechanism, based on the existing capacities and the peak capacities delivered by wagon manufacturers in the past five years. This would bolster the domestic position of the Titagarh group entities. Out of the total orders for 22,000 wagons declared by IR earlier in FY19, orders for around 9000 wagons are yet to be allocated; CL is expected to attain a larger chunk of the orders in the second lot.

Moreover, the group is diversifying its presence into various business segments such as defence, shipbuilding, metros, bridges, electrification and propulsion works, for which it has ventured into acquisitions with some foreign companies to acquire technical expertise and qualifications.

RATING SENSITIVITIES

Negative: Any delay in the tying up of working capital facilities, resulting in deterioration in the liquidity profile, which would further impact TWL's ability to execute the order book, resulting in lower scale of operations in both foreign and domestic operations, leading to delays in deleveraging could result in a negative rating action.

Outlook Revision to Stable: Timely execution of existing orders coupled with replenishing of order book with higher margin and advance backed orders, leading to EBITDA margins being sustained at 7%-8% and net adjusted leverage improving to about 4.0x by FY21 could result in the Outlook being revised to Stable.

COMPANY PROFILE

Incorporated in 1997, TWL manufactures various types of wagons, EMUs, bailey bridges, heavy earthmoving and mining equipment, and steel and spheroidal graphite iron castings. The company has three manufacturing facilities, two in Titagarh and one in Uttarpara, with a combined manufacturing capacity of 6,000 wagons and 36 EMU rakes.

CL, has a manufacturing facility in Bharatpur, Rajasthan, with an annual capacity of 2,400 wagons. Titagarh Agrico Private Limited (a wholly-owned subsidiary of TWL merged with CL in FY18), has set up a tractor manufacturing plant in Bharatpur with an annual capacity of 2,400 units. The capacity can be ramped up based on demand.

France-based wagon manufacturer and subsidiary of TWL, Titagarh Wagons AFR has an annual manufacturing capacity of 2,000 wagons. TFA, a step-down subsidiary of TWL, manufactures coaches.

FINANCIAL SUMMARY

Particulars	FY18	FY17
Revenue (INR million)	12,681.9	17,136.0
EBITDA (INR million)	-897.1	1,165.6
EBITDA margin (%)	-7.1	6.8
Total adjusted debt (INR million)	6,626.36	4,071.6
Cash and cash equivalent (INR million)	1319	1,042.0
Net debt (INR million)	5,307.4	3,029.7
Source: TWL (consolidated), Ind-Ra		

RATING HISTORY

Instrument Type	Current Rating/Outlook			Historical Rating/Outlook		
	Rating Type	Rated Limits (million)	Rating	20 April 2018	30 December 2016	9 October 2015
Issuer rating	Long term	-	IND A-/Negative	IND A+/Negative	IND AA-/Stable	IND AA-Stable
Fund-based facilities	Long/ Short term	INR1,400	IND A-/Negative/IND A2+	IND A+/Negative/IND A1	IND AA-/Stable/IND A1+	IND AA-/Stable/IND A1+
Non-fund-based facilities	Short term	INR6,008	IND A2+	IND A1	IND A1+	IND A1+
CP	Short-term	INR500	WD	IND A1	-	-

COMPLEXITY LEVEL OF INSTRUMENTS

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Applicable Criteria

Corporate Rating Methodology

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