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India Ratings Downgrades Titagarh Wagons to ‘IND BBB+’/Stable; Off RWN

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India Ratings and Research (Ind-Ra) has downgraded Titagarh Wagons Limited’s (TWL) Long-Term Issuer Rating to ‘IND BBB+’ from ‘IND A-’ while resolving the Rating Watch Negative (RWN). The Outlook is Stable. The instrument-wise rating actions are given below:

Instrument Type	Date of issuance	Coupon Rate	Maturity Date	Size of Issue (billion)	Rating/Outlook	Rating Action
Fund-based Facilities	-	-	-	INR1.4	IND BBB+/Stable/IND A2+	Downgraded; Off RWN
Non-fund-based facilities	-	-	-	INR6.008	IND A2+	Affirmed: Off RWN

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 factors in TWL’s continued negative free cash flow, rising net debt levels and weaker-than-expected credit profile in 1HFY20. However, the company’s liquidity profile has begun to improve in 2HFY20, backed by improved domestic operational performance along with an inflow of interest-free mobilisation advances. This has led to the RWN resolution and the Stable Outlook for the company.

KEY RATING DRIVERS

Incremental Working Capital Requirements Resulting in Negative Free Cash Flows: The working capital requirement of the company increased in FY19, with the net working capital cycle stretching to 182 days at the end of the financial year (FYE18: 154 days), mainly on account of stoppage of free supply items such as wheel sets, spares etc. by Indian Railways (IR) in its wagon allocations. This coupled with poor operational performance of the foreign entities resulted in higher reliance on working capital debt. Consequently, the average fund-based utilisation was higher at 90%-95% for the 12 months ended September 2019. At the end of 1HFY20, the cash flow from operations (CFO) remained negative at INR1.3 billion (FY19: negative INR1.418 billion) and free cash flow (FCF) remained negative at INR1.4 billion (FY19: negative INR 2.1 billion).

However, the CFO of TWL is likely to turn positive in 2HFY20 on account of inflow of interest free mobilisation advances amounting to INR 1.5 billion for the execution of the Pune metro orders that the company had received in 1HFY20. The company has been able to tie up incremental bank financing; however; the availability of adequate liquidity on its own balance sheet on a sustained basis will be a key monitorable. Ind-Ra expects the working capital requirement to be supported by the recent correction in the inverted duty structure of rail wagons, which would release the working capital locked up on account of GST receivables; however, the entity is likely to be dependent on incremental working capital bank loans, mainly on account of the existing railway wagon allocation policy.

Delay in Deleveraging Led to Weak Credit Profile: The credit metrics have remained weak since FY18 owing to negative free cash flows, higher reliance on external debt, and weak operating performance. Although the net adjusted leverage (net adjusted debt/EBIDTA) improved marginally due to an improvement in operational performance, it remained high at 7.4x in 1HFY20 (FY19: 8.5x; FY18: EBITDA loss; FY17: 2.5x). The interest coverage (EBIDTA/interest cost) remained almost stable at 1.4x (FY19: 1.3x; FY18: EBITDA loss; FY17: 3.3x).

However, the first half of the year is usually a lean season for wagon manufacturers. Furthermore, the company recently won an arbitration award pertaining to an old dispute with IR in FY98, wherein Cimmco Limited would be receiving the 887 wagons that it had earlier subleased to IR. The management plans to sell these wagons in 2HFY20 and the resultant cash flows would be used for debt deleveraging. Hence, Ind-Ra believes the credit profile would improve over the near-to-medium term, with net leverage at 4.0-4.2x in FY21. The improvement in credit profile would also be supported by growth in the scale of operations to around INR23 billion-24 billion by FY21, with EBIDTA margins of 7%. However, any change in Ind-Ra's expectations or any further delay in deleveraging would be negative for the ratings.

Liquidity Profile-Adequate: With operational issues pertaining to its foreign operations resulting in lower profitability margins in the past couple of years, the cash balances declined to INR0.4 billion at the end of 1HFY20 (FY19: INR 1.7 billion; of this, INR0.6 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 wagon orders, which were not backed by advances and the free supply items used in wagon manufacturing from IR.

However, TWL was able to refinance the short-term working capital debt with favourable working capital term loans in TFA, its Italy-based subsidiary, providing liquidity cushion backed by low-cost debt and 39 months of moratorium. Out of the overall term loan of around INR6.0 billion, around INR40 billion was refinanced in TFA, with a repayment schedule from FY22-FY27. Moreover, during October-November 2019, TWL had received interest-free mobilisation advances of around INR1.5 billion, which would provide adequate support to the liquidity. This along with lower term loan obligation to be serviced in FY20 of INR0.27 billion, with DSCR of above 1.0x for FY21 and FY22, provides adequate liquidity comfort. Moreover, the company was able to tie part of the working capital enhancements of INR 3.5 billion (fund-based limits: INR 0.45 billion) out of the INR 5.2 billion (fund-based limits: INR 0.69 billion) that was intimated to the agency in March 2019; the agency believes that the tie up would happen in 2HFY20.

Revival of Wagon Sector in Process: The outlook of the wagon industry is mainly dependent on the demand from the IR and the budgeted allocation for such outlays. As per the union budget for 2019-20, the overall allocation to railways has increased by 23%. This would translate into higher orders for railway equipment manufacturers and the capital goods sector, including coach and wagon manufacturers, metal fixtures, pipes, etc. Furthermore, in the union budget, the capital outlay for metro projects was increased to INR17.7 billion from INR14.9 billion. Additionally, the government of India has maintained its focus on improving railway infrastructure, ensuring faster development and completion of tracks, rolling stock manufacturing and delivery of passenger freight services.

The recent revision in GST structure along with the approval to import free supply items such as wheel sets, spares etc. from other parties for execution of private wagon orders, which is expected to be implemented in 2HFY20, would also benefit the wagon sector. Furthermore, at the end of 1HFY20, IR allowed wagon manufacturers to import required components and IR started procuring axles required to supply free supply items for its wagons. Ind-Ra believes that in case IR issues the future wagon allocations backed by free supply items in FY20-FY21 would result in reduced working capital requirements for the wagon manufacturers and would stabilise the industry.

Strong Revenue Visibility: The consolidated order book (after excluding TWAFR's order book) of the company remained stable at INR 51.3 billion at end-September 2019, around 3.6x of the revenue in FY19 (FY19: INR51.0 billion around 3.3 times the revenue of FY19), mainly on account of inflow of new orders worth INR1125 billion for the design, manufacture and supply of 102 metro coaches for Pune Metro Rail. Out of the total orders worth INR15.6 billion that were allocated in December 2018, most are likely to be completed in FY20 and 1QFY21, indicating strong revenue visibility.

As per the tender 3 car prototype, metro train sets are to be supplied within 78 weeks and the balance 31 train sets within 160 weeks from the date of sanction. The company has initiated the process of manufacturing the 3 prototype metro coaches in its factories in Italy and Nagpur post receiving all the approvals. This apart, TWL has participated in the bid for 6,000 wagon orders raised by IR in August 2019 and is likely to win at least 25% of these orders. These orders are backed by the reverse auction mechanism, which would result in lower margins, and hence, may impact the margin profile of domestic operations till FY21. However, Ind-Ra draws comfort from the inflow of revenue from execution of metro orders from FY21 onwards, which would offer cushion to maintain the existing margins in the medium term.

Improved Operational Performance from Domestic Operations: Revenue from domestic operations improved in 1HFY20, with revenue generation of around INR8.0 billion (1HFY19: INR3.9 billion; FY19: INR10.8 billion), owing to increased execution of domestic wagon orders from both IR and private players. The capacity utilisation stood at 60.8% in 1HFY20 (FY19: 34%), driven by increased execution on account of higher closing order book at end-March 2019. However, the EBIDTA margin declined marginally to 7.3% in 1HFY20 (FY19: 8.1%; 1HFY19: 3.5%) on account of increased execution of low-margin IR orders.

Increased scale of domestic operations coupled with stable EBIDTA margins led to the interest coverage (EBIDTA/Interest cost) ratio improving to around 3.0x at end-1HFY20 (FY19: 1.9x; 1HFY19: 0.7x). However, the interest coverage remained moderate due to an increase in working capital utilisation levels on account of industry-related issues. Ind-Ra believes that the scale of domestic operations would continue to grow in 2HFY20 on account of high IR wagon order book, with overall revenue of INR 17 billion-18 billion and an EBIDTA margin of around 7%-8% from domestic operations in FY20.

Liquidation of France-based Subsidiary: The commercial court of Paris had approved a plan for the transfer of the business of Titagarh Wagons Arbel Fauvet Rail (TWAFR) to another bidder and ordered for the liquidation of TWAFR on 13 August 2019. As per the verdict, TWL would no longer have any control in TWAFR; the impact of the corporate guarantee extended by TWL to TWAFR for INR0.33 billion (FY19: INR0.27 billion) cannot be ascertained unless the liquidation process is completed. However, as per the company, apart from the corporate guarantee, the liquidation would not have a material financial impact on TWL, as the company had already made the entire provision for its investments in TWAFR amounting to INR0.49 billion, as well as its proportionate share through Titagarh Singapore Pte Ltd, a 100% subsidiary of TWL, which held trade receivables and other receivables of around INR0.59 billion and INR 0.19 billion, respectively, from TWAFR in 4QFY19. Ind-Ra believes that any cash outflows on account of the liquidation would be limited to INR0.33 billion i.e., to the extent of the corporate guarantee shared. Any incremental cash outflows would impact the liquidity profile of the company negatively.

Group Consolidation in Process: In May 2019, the board of directors of TWL had given approval for the merger of Cimmco Limited (CL: IND A-/ RWN), a 75% subsidiary of TWL and Titagarh Capital Pvt Ltd, a 100% subsidiary of TWL with the parent to simplify the corporate structure. However, the impact of such merger would not be material for the ratings as Ind-Ra uses the consolidated approach while evaluating the ratings of TWL and CL.

RATING SENSITIVITIES

Negative: The following developments, individually or collectively, may be negative for the rating:

- Any decline in the ability of TWL to execute the order book, resulting in lower scale of operations, further impacting the profitability levels on a sustained basis
- Any change in the liquidity profile of the company
- A further delay in deleveraging, resulting in the net leverage levels not being restored to 4.5x by FY21

Positive: Timely execution of existing orders coupled with replenishing of order book with higher-margin and advance-backed orders, leading to sustained EBITDA margins of 7%-8% and net adjusted leverage improving to below 4.0x by FY21, along with comfortable liquidity, all on sustained basis, could lead to a positive rating action.

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. It would be merged with TWL in FY20.

TFA, a step-down subsidiary of TWL, manufactures coaches in Italy.

FINANCIAL SUMMARY

Particulars	1HFY20 (unaudited)	FY19*	FY18
Revenue (INR billion)	8.99	15.59	12.68
EBITDA (INR billion)	0.56	0.83	-0.89
EBITDA margin (%)	6.2	5.3	-7.1
Total debt (INR billion)	8.34	8.97	6.24
Cash and cash equivalent (INR billion)	0.4	1.7	1.32
Net debt (INR billion)	7.9	7.25	5.31
Source: TWL (Consolidated), Ind-Ra *Restated figures not considering TWAFR stated in 1QFY20			

RATING HISTORY

Instrument Type	Current Rating/Outlook			Historical Rating/Outlook			
	Rating Type	Rated Limits (billion)	Rating	23 August 2019	29 March 2019	20 April 2018	30 December 2016
Issuer rating	Long-term	-	IND BBB+/Stable	IND A-/RWN	IND A-/Negative	IND A+/Negative	IND AA-/Stable
Fund-based facilities	Long-term/ Short-term	INR1.4	IND BBB+/Stable/IND A2+	IND A-/RWN/IND A2+/RWN	IND A-/Negative/IND A2+	IND A+/Negative/IND A1	IND AA-/Stable/IND A1+
Non-fund-based facilities	Short-term	INR6.008	IND A2+	IND A2+/RWN	IND A2+	IND A1	IND A1+

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Applicable Criteria

Corporate Rating Methodology
Parent and Subsidiary Rating Linkage

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