

Srinivas Induction Hardening

March 07, 2019

Summary of rating action

Instrument*	Previous Rated Amount(Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based – Term Loan	2.7	0.9	[ICRA]BBB- (Stable); reaffirmed
Unallocated Limits	10.0	11.8	[ICRA]BBB- (Stable); reaffirmed
Total	12.7	12.7	

* Instrument details are provided in Annexure-1

Rationale

The rating reaffirmation considers Srinivas Induction Hardening’s (SIH) healthy revenue growth in FY2018 and 9M FY2019, driven by improving demand from the end-user industries, primarily from the tractor segment. The rating factors in the firm’s healthy financial profile, reflected by comfortable capital structure, robust coverage indicators and liquidity position, supported by minimal external debt, healthy profitability and accruals over the years. The rating draws comfort from the extensive experience of the promoters in the auto-ancillary industry, coupled with strong association with its reputed clientele, which supports SIH’s long-term business sustainability and growth prospects. Besides, the firm’s profitability remains protected from raw material price fluctuations since the ownership of materials lies with the original equipment manufacturers (OEMs). The rating, however, is constrained by the firm’s modest scale of operations, working-capital intensive nature of business because of high receivables as well as the heavy investment required in capital equipment industry owing to its asset heavy model. The firm has been making efforts to diversify its revenue streams by adding new customers. However, the customer concentration remains high with top-five customers accounting for ~97% of the revenues in FY2018. Further, SIH’s operations continue to remain exposed to cyclicity in the tractor segment as it contributes to more than 75% of the total revenues. Going forward, SIH’s ability to scale up operations with the planned capacity addition and maintain profitability while effectively managing working capital requirements would be the key rating sensitivities.

Outlook: Stable

ICRA believes that SIH will continue to benefit from the extensive experience of its promoters in the auto-ancillary industry and established relationship with its customers. The rating may be upgraded if the firm is able to achieve healthy utilisation levels for the planned enhanced capacity, supported by improving demand from the end-user industry, resulting in growth in revenue and cash accruals on expected lines. The outlook may be revised to Negative if the firm reports lower-than-expected accruals, or if any higher-than-anticipated capital expenditure or deterioration in the working capital cycle weakens its liquidity position.

Key rating drivers

Credit strengths

Established track record of the promoters in the auto-ancillary industry – Although SIH was incorporated in 1998, its promoters have over three decades of experience in the industry through its sister concern, Netalkar Engineering Works, which was established in 1965. SIH’s machining unit at Machhe industrial area in Belgaum, Karnataka has an installed processing capacity of 800 crankshafts per day and processes about 36 varieties of crankshafts for single-cylinder to four-cylinder engines.

Healthy revenue growth and profitability; comfortable financial risk profile – The firm’s revenues (though modest due to job-work nature of operations) have witnessed healthy growth in FY2018 (~25% YoY) and 9M FY2019, driven by robust

demand from the end-user industries. Its operating profitability remains healthy, and are largely protected from raw material price fluctuations as raw materials are supplied by its customers and ownership of the same lies with the customers. SIH's financial profile is characterised by a comfortable capital structure on account of minimal external debt coupled with growing net worth with consistent accretion to reserves over the years, and robust coverage indicators.

Established relationship with key customers – The firm's business ties with the fundamentally strong customers and its ability to add new customers, provide stability to revenues. However, the customer concentration remains high with the top-five customers accounting for about 95% of its total revenues in the last three years. Since its inception, SIH is catering to a significant portion of Mahindra & Mahindra Limited's crankshaft demand for its tractor division, which contributed ~75% to the firm's total revenues in the last three fiscals.

Credit challenges

Asset-heavy model due to job-work nature of operations demands continuous capex – The firm follows an asset-heavy model since job-work forms a significant portion of revenue, wherein machineries are specifically procured for processing products as per customers' requirements resulting in continuous capex. SIH, over the last two fiscals incurred significant capex towards addition of new machinery and upgradation of existing ones, which resulted in increase in its capacity to 800 crankshafts per day at present from 740 crankshafts per day in FY2017. Further, SIH plans to enhance it to 1000 crankshafts per day in FY2020 with a capex of ~Rs. 12.0 crore, which is expected to be funded in a 2:1 debt: equity ratio. SIH's ability to ramp up its operations in a timely manner would be important for maintaining healthy profitability and coverage indicators, going forward.

High sectoral concentration – SIH processes semi-finished crankshaft assembly parts, which find application primarily in farm tractors, diesel and oil engines, compressors etc. A significant portion (>75%) of the firm's revenue is derived from the tractor segment, leading to industry concentration risks and makes the firm vulnerable to cyclical business downturns in end-user industries, accentuating the risk of demand volatility.

Risks arising from the partnership nature of the firm – SIH is exposed to the risks inherent in a partnership nature of the business owing to a sizeable interest on partners' capital, although partners have withdrawn a part of it. Withdrawal of share of the retired partner's capital due to reconstitution of the firm in April 2018 is expected to impact SIH's cash accruals in FY2019.

Liquidity Position

SIH's liquidity position remains comfortable, as reflected by positive free cash flows in the last two fiscals and healthy liquid investments and cash balance of Rs. 8.2 crore as on March 31, 2018. Notwithstanding a substantial capex outgo in the near term towards capacity addition and sizeable debt repayment obligations over the medium term, SIH's liquidity position is likely to remain comfortable, supported by expected sanction of fresh term loans and growth in cash accruals.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Auto Component Suppliers
Parent/Group Support	Not Applicable
Consolidation / Standalone	The ratings are based on standalone financial profile of the entity

About the company

Incorporated in 1998, Srinivas Induction Hardening is an ISO:TS16949 certified partnership firm, which primarily undertakes job work for machining finished and semi-finished crankshaft assembly parts for single-cylinder to four-cylinder engines that find application in farm tractors, diesel and oil engines, compressors etc. Mr. Dayanand G Netalkar, Managing Partner, has over three decades of experience in the industry through its sister concern, Netalkar Engineering Works (established in 1965). The firm's manufacturing facility is located in Belgaum, Karnataka with an installed capacity of ~800 crankshafts per day (planned to be increased to ~1,000 crankshafts per day) and employs ~350 workers.

In FY2018, the firm reported a net profit of Rs. 9.2 crore on an operating income of Rs. 32.2 crore compared to a net profit of Rs. 5.8 crore on an operating income of Rs. 25.9 crore in the previous year.

Key financial indicators (Audited)

	FY 2017	FY 2018
Operating Income (Rs. crore)	25.9	32.2
PAT (Rs. crore)	5.8	9.2
OPBDIT/ OI (%)	46.8%	47.2%
RoCE (%)	17.1%	23.8%
Total Debt/ TNW (times)	0.1	0.0
Total Debt/ OPBDIT (times)	0.3	0.1
Interest coverage (times)	15.8	43.0

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

Current Rating (FY2019)					Chronology of Rating History for the past 3 years		
Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding as on Dec 2018	Date & Rating	Date & Rating in FY2018	Date & Rating in FY2017	Date & Rating in FY2016
			(Rs crore)	Mar 2019	Mar 2018	-	-
1	Term Loan	Long Term	0.9	0.9	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	-
2	Unallocated Limits	Long Term	11.8	-	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	-

Complexity level of the rated instrument:

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the 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	Term Loan	FY2014	NA	FY2020	0.9	[ICRA]BBB- (Stable)
NA	Unallocated Limits	NA	NA	NA	11.8	[ICRA]BBB- (Stable)

Source: SIH

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