August 09, 2021

Nelcast Limited: Ratings reaffirmed; outlook revised to Stable

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Term Loans	151.07	141.0	[ICRA]A(Stable); reaffirmed and outlook revised to Stable from Negative
Long-term Fund-based Limits	160.00	160.00	[ICRA]A(Stable); reaffirmed and outlook revised to Stable from Negative
Short-term Fund-based Limits	20.00	30.00	[ICRA]A1; reaffirmed
Short-term Fund-based Sub-limits	(50.00)	(50.00)	[ICRA]A1; reaffirmed
Short-term Non-fund Based Limits	9.00	17.00	[ICRA]A1; reaffirmed
Commercial Paper Programme (CP)	30.00	30.00	[ICRA]A1; reaffirmed
Proposed Long-term/Short-term Fund-based Limits	9.93	2.00	[ICRA]A(Stable)/ [ICRA]A1; reaffirmed and outlook revised to Stable from Negative
Total	**380.00**	**380.00**	

**Instrument details are provided in Annexure-1*

Rationale

The rating reaffirmation and revision in outlook to Stable factor in the healthy revival in Nelcast Limited's (Nelcast) performance in H2 FY2021 (resulting in YoY revenue growth of 8% in FY2021) and expectation that the company's growth momentum will continue to sustain in FY2022 driven by the likelihood of strong performance in medium and heavy commercial vehicles (M&HCV) as well as exports. Over the medium term, the company's revenue growth and profitability will be driven by new product addition and increased wallet share with key domestic OEM customers and incremental orders from its overseas clientele. Moreover, with commencement of the Pedapriya plant (in Andhra Pradesh) and expected improvement in overall capacity utilisation, the profitability and return indicators are likely to improve. In the absence of any major capex plans, ICRA expects company's coverage indicators to improve with net-debt/OPBIDTA reducing from 3.2x in FY2021 to below 2.5x in FY2022, and remaining below 2.5x over the medium term.

The rating continues to factor in Nelcast's established relationships with its reputed customers, which have supported repeat orders, provided healthy order visibility, healthy wallet share and opportunities to focus on higher margin orders. In addition, Nelcast's credit profile remains supported by its low leverage, comfortable liquidity position on the back of adequate cash reserves and unutilised lines of credit. These ratings strengths are offset by moderate scale of operations and intense competition in the domestic foundry industry, limiting pricing flexibility. Moreover, the company's return indicators remain suppressed due to modest profitability and under-utilisation of its manufacturing unit. The ratings also consider the inherent cyclicality in the key end-user sectors (both domestic M&HCV and tractor segments) that has constrained its operating performance.

Key rating drivers and their description

Credit strengths

Established relationship with major OEMs – Nelcast is an established player in the domestic ferrous castings market, generating most of its sales from leading domestic OEMs. Nelcast enjoys established relationships with major M&HCV and tractor OEMs, with a healthy wallet share in the key products supplied to its customers. Its key customers include top OEMs and tier-I suppliers, such as Ashok Leyland Limited, Tata Motors Limited (M&HCV), TAFE Limited, SAME Deutz-Fahr India Private Limited and International Tractors Limited (tractors). Established relationships and healthy wallet shares with its customers have supported repeat orders, healthy order visibility and opportunities to focus on higher margin orders.

Diversified clientele and segmental presence – Nelcast has a diversified segmental and customer profile of several leading auto OEMs and tier-I suppliers. In recent years, it has diversified its product profile to include the railways segment as well. Its diversified business profile, continuous product additions and a growing export base have supported its performance over the years. In FY2021, the company derived around 45% of its revenue from its top three customers, indicating moderate customer concentration risk. However, ICRA expects Nelcast's customer diversification to improve in the medium term. Moreover, healthy wallet share with its customer provides comfort. In terms of segmental diversification, in FY2021, its domestic M&HCV segment drove 32% of its revenues, followed by the tractor segment (40%) and exports (21%). In FY2021, revenue growth in the tractor segment (~36%) supported its overall revenue growth (~8%). In FY2022, ICRA expects the company's revenue growth at over 35%, likely to be driven by robust growth in the M&HCV and export segments.

Credit challenges

Moderate scale of operations; exposed to cyclicality in the automotive industry – With the company's presence limited to casting products, its scale of operations remains moderate relative to the size of the operations of its customers. Combined with intense competition in the industry, this has limited its bargaining power and scope for margin expansion. With Nelcast the M&HCV and tractor segments driving its revenues, its operating income remains vulnerable to the cyclicality in these segments. Its revenue growth in the last three years was impacted by the demand slowdown in these sectors on account of various factors, such as a weak economic scenario, the pandemic lockdown, regulatory disruptions like axle-load norms, GST implementation and transition to BS-VI vehicles, etc.

Subdued return indicators and modest debt coverage indicators - Nelcast was under an investment phase during FY2019-FY2021, which resulted in a high debt level without commensurate contribution to cash flows. Nelcast had undertaken more than Rs. 200 crore of capex during the last three years. However, during this period, the company's finance performance was subdued (with revenue declining to Rs. 615 crore in FY2021 from Rs. 745 crore in FY2018) on account of demand slowdown in the industry due to culmination of various factors, such as regulatory interventions, the pandemic induced lockdown and other exogenous factors. With high debt levels and subdued cash accrual, Nelcast's debt protection metrics had recently weakened as reflected by weakening of its net debt/ OPBDITA and interest coverage to 2.7x and 3.2x, respectively, in FY2021 from 8.5x and 1.8x in FY2019. Moderate profitability and low asset turnover also resulted in subdued return indicators (RoCE of 5% during FY2021).

Nonetheless, going forward, with expectation of revenue growth over 35% in FY2022 and improvement in operating margin to over 9% (because of improved focus on high margin-products and exports, and higher scale of operations), ICRA expects the company's net debt/ OPBDITA to improve to less than 2.5x in FY2022 and less than 2.0x by FY2023. However, it is to be noted that any sustained elevation in raw-material prices or any recurrence of disruptions on account of the ongoing pandemic may play spoilsport to the performance metrics.

Liquidity position: Adequate

The company's liquidity position continues to remain healthy, backed by healthy cash balances (of around Rs. 40-50 crore) and undrawn limits (of around Rs. 30-40 crore) available in the system. The company plans to increase its bank limits from Rs. 120

crore to Rs. 150 crore to support revenue growth. While the company has sizable debt repayment obligation of Rs. 33 crore in FY2022, the liquidity is expected to remain comfortable with expectation of healthy cash accruals, moderate capex plans (Rs. 30 crore in FY2022) along with healthy cash balances and undrawn limits.

Rating sensitivities

Positive factors – The ratings may be upgraded if there is a strong sustained recovery in volumes and earnings in the coming quarters, which in turn would improve its credit metrics. Specific metrics that may lead to a change in the outlook include net debt/OPBDITA reducing to less than 2x on a sustained basis.

Negative factors – Ratings may be downgraded if there is a sustained pressure on revenues and earnings in the coming quarters, which would adversely impact its credit metrics and liquidity position. Specific metrics that may result in a downgrade include net debt/OPBDITA remaining above 2.5x on a sustained basis

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Auto Component Manufacturers
Parent/Group Support	Not applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of Nelcast Limited

About the company

Incorporated in 1982, Nelcast manufactures grey and ductile castings for the M&HCV and tractor industry segments. Around 20% of its overall revenues is also generated from export markets. Key products supplied to its M&HCV clients include wheel hubs, brake drums, axle housing and brackets, among others. For the tractor segment, the company's major products are transmission casing, centre housing, axle housing and hydraulic lift cover. It also supplies ribbed plates and brake discs for metro rail projects and the railways. Nelcast has an aggregate installed production capacity of 160,000 tonnes per annum. Its factories are located at Ponneri in Tamil Nadu, and at Gudur and Pedapariya in Andhra Pradesh.

Key financial indicators (audited)

Nelcast (Consolidated)	FY2019	FY2020	FY2021
Operating Income (Rs. crore)	860.2	570.9	615.0
PAT (Rs. crore) (*excluding share from JV)	38.4	36.0	9.0
OPBDIT/OI (%)	9.3%	9.2%	7.5%
PAT/OI (%)	4.5%	6.3%	1.5%
Total Outside Liabilities/Tangible Net Worth (times)	1.0	0.9	0.9
Total Debt/OPBDIT (times)	2.5	4.3	4.6
Net Debt/OPBDIT (times)	1.8	3.4	3.2
Interest Coverage (times)	8.5	4.2	2.7

Source: Company Annual Reports; ICRA research; PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation

Note: Some figure are adjusted as per ICRA.

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 as of Mar 31, 2021 (Rs. crore)	Date & Rating in	Date & Rating in FY2021		Date & Rating in FY2020		Date & Rating in FY2019	
					Aug 09, 2021	8-Dec-2020	29-Jun-2020	5-Dec-2019	1-Aug-2019	4-Mar-2019	5-July-2018
1	Long-term Term Loans	Long Term	141.0	141.0	[ICRA]A (Stable)	[ICRA]A (Negative)	-	-	-	-	-
2	Long-term Fund-based Limits	Long Term	160.00	73.7	[ICRA]A (Stable)	[ICRA]A (Negative)	[ICRA]A (Negative)	[ICRA]A+ (Negative)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Positive)
3	Short-term Fund-based Limits	Short Term	30.00	--	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
4	Short-term Fund-based Sub-limits	Short Term	(50.00)	-	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
5	Short-term Non-fund Based Limits	Short Term	17.00	-	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1+	-	-
6	Commercial Paper Programme (CP)	Short Term	30.00	-	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
7	Proposed Long-term/Short-term Fund-based Limits	Long-Term/ Short Term	2.00	-	[ICRA]A (Stable)/ [ICRA]A1	[ICRA]A (Negative)/ [ICRA]A1	[ICRA]A (Negative)/ [ICRA]A1	[ICRA]A+ (Negative)/ [ICRA]A1	[ICRA]A+ (Stable)/ [ICRA]A1+	[ICRA]A+ (Stable)/ [ICRA]A1+	[ICRA]A+ (Positive)/ [ICRA]A1+

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term Term Loans	Simple
Long-term Fund-based Limits	Simple
Short-term Fund-based Limits	Simple
Short-term Fund-based Sub-limits	Simple
Short-term Non-fund Based Limits	Very Simple
Commercial Paper Programme (CP)	Very Simple
Proposed Long-term/Short-term Fund-based Limits	NA
Long-term Term Loans	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: Click Here

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	Long-term Term Loans	FY2018	NA	FY2026	141.0	[ICRA]A (Stable)
NA	Long-term Fund-based Limits	NA	NA	NA	160.0	[ICRA]A (Stable)
NA	Short-term Fund-based Limits	NA	NA	NA	30.0	[ICRA]A1
NA	Short-term Fund-based Sub-limits	NA	NA	NA	(50.0)	[ICRA]A1
NA	Short-term Non-fund Based Limits	NA	NA	NA	17.0	[ICRA]A1
NA*	Commercial Paper Programme (CP)	NA	NA	NA	30.0	[ICRA]A1
NA	Proposed Long-term/Short-term Fund-based Limits	NA	NA	NA	2.0	[ICRA]A(Stable)/ [ICRA]A1

Source: *Company * yet to be issued*

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Direct Subsidiaries		
NC Energy Limited	93.44%	Full Consolidation

Source: *Nelcast annual report FY2021*

ANALYST CONTACTS

Shamsher Dewan
+91 124 4545328
shamsher.dewan@icraindia.com

Kinjal Shah
+91 22 6114 3442
kinjal.shah@icraindia.com

Rathina Pradeep
+91 44 4596 4307
rathina.pradeep@icraindia.com

Ashish Modani
+91 44 206606 9912
ashish.modani@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:

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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