December 03, 2021

Veljan Denison Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund based – Cash Credit	32.00	32.00	[ICRA]BBB+ (Stable); Reaffirmed
Bank Guarantee	7.00	7.00	[ICRA]BBB+ (Stable); Reaffirmed
Letter of credit	6.00	6.00	[ICRA]A2; Reaffirmed
Unallocated	12.00	12.00	[ICRA]BBB+(Stable); Reaffirmed
Total	**57.00**	**57.00**	

**Instrument details are provided in Annexure-1*

Rationale

The rating reaffirmation positively factors in the established track record of Veljan Denison limited (VDL) as a manufacturer of hydraulic pumps, valves and power pack systems, and its comfortable capital structure and healthy coverage indicators with negligible debt levels. The operating profit margins had been healthy at above 25% in the past given its presence in the niche hydraulic pump manufacturing. Though the margins declined to 18.29% in FY2021, they recovered to 23.65% in 6M FY2022. The ratings also note VDL's diversified customer base comprising both domestic and overseas customers.

The ratings are, however, constrained by the company's moderate scale of operations with VDL's revenues in the range of Rs. 70-100 crore in the past five years owing to intense competition from cheaper imports and demand linked to capital expenditure across the industries. The ratings also take into account the high working capital intensity owing to the high debtor and inventory days. Despite this, the liquidity position is comfortable with liquid cash balance of Rs. 43.95 crore as on September 30, 2021 and nil utilisation of working capital limits. ICRA also takes note of the vulnerability of the profitability to the adverse fluctuation in raw material prices.

The Stable outlook on the [ICRA]BBB+ rating reflects ICRA's opinion that VDL's credit profile will remain stable, given the long track record of its operations and the geographically diversified customer base comprising distributors (domestic and export) and OEMs.

Key rating drivers and their description

Credit strengths

Long track record in manufacturing hydraulic pumps and valves – VDL has more than five decades of experience in the manufacturing of vane-based hydraulic pumps, valves and power pack systems. The company's customer base is geographically diversified as VDL caters to around 250 customers domestically and internationally. Over these years, the company has been able to forge a strong relationship with reputed OEMs.

Healthy operating profit margins – The operating profit margins had remained healthy at above 25% in the past five years given the presence of VDL in the niche hydraulic pump manufacturing segment. Although the operating profit margins fell to 18.29% in FY2021 owing to a decline in revenues mainly from exports, the margins improved to 23.65% in 6M FY2022. VDL's revenues declined to Rs. 73.57 crore in FY2021 from Rs. 82.79 crore in FY2020 owing to an adverse impact of the pandemic on its operations as well as lower demand of its products.

Comfortable capital structure and moderate debt metrics- VDL's capital structure remains comfortable, characterised by a gearing of 0.06 times as on March 31, 2021 and 0.0 times as on September 30, 2021. Healthy profitability levels coupled with low dependence on debt ensured that the coverage indicators remained robust as seen in an interest coverage of 31.96 times and TD/OPBDITA of 0.72 times in FY2021. Despite the expected addition of debt for the envisaged capex over the medium term, the capital structure and debt coverage metrics are expected to remain comfortable.

Credit challenges

High working capital intensity – The working capital intensity has remained high at 81% in FY2021 owing to high debtor (142 days in FY2021) and inventory days (261 days in FY2021). The company keeps an inventory of major raw materials like castings and steel owing to the long lead time in procurement. Despite this, the liquidity position is comfortable with free cash and bank balance of Rs. 44.78 crore as on March 31, 2021 and negligible utilisation of the working capital limits. The modest capacity utilisation levels and high working capital intensive nature of operations kept the core RoCE at modest levels of around ~14.24% in FY2020, which fell to 7.06% inFY2021 with the decline in profitability.

Modest scale of operations – The scale of operations has been modest with revenues of less than Rs. 100 crore recorded in the past five years owing to the intense competition from cheaper imports and the demand linked to capital expenditure across industries. The operating income declined 11% to Rs. 73.57 crore in FY2021 from Rs. 82.79 crore in FY2020 mainly on account of the outbreak of the pandemic. The revenues increased to Rs. 42.66-crore in H1 FY2022 from Rs. 27.1 crore in H1 FY2021 and are expected to see a healthy growth of ~20-30% in the current fiscal along with an improvement in profitability.

Vulnerability of profitability to adverse fluctuations in the input and steel prices – The company keeps an inventory of major raw materials like castings and steel owing to the long lead time in procurement. Hence, its margins are exposed to the adverse fluctuations in the prices of key inputs used to manufacture the end products. Though company revises the prices periodically, the minor fluctuations cannot be passed on immediately so as to remain competitive in the market.

Liquidity position: Strong

VDL's liquidity position is strong with healthy cash accruals. It had a liquid cash surplus of Rs. 43.95 crore as on September 30, 2021 and a cushion of Rs. 30 crore in working capital limits with no fixed debt repayment obligations in the near future. The average fund-based limit remains largely unutilised which provide the additional cushion.

Rating sensitivities

Positive factors: The ratings could be upgraded if there is a substantial improvement in the scale of operations and profitability margins along with an improvement in the working capital cycle on a sustained basis. A specific credit metrics that could lead to an upgrade includes an increase in the core RoCE to more than 16.00% on a sustained basis.

Negative factors: The ratings could be downgraded if there is a significant decline in revenues or margins or any further deterioration in the working capital cycle, adversely impacting the liquidity position.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	Not applicable
Consolidation/Standalone	Standalone

About the company

Veljan Denison Limited (VDL), incorporated in 1973, is a listed company on the BSE. It manufactures hydraulic vane pumps, motors, valves and power pack systems. The company has its manufacturing unit at Patancheru, Hyderabad. The company is promoted by Mr. V C Janardan Rao, a qualified engineer with specialisation in fluid power. The company indigenously manufactures precision engineering components and has its own research and development (R&D) wing.

Key financial indicators

VDL	FY2020	FY2021	6MFY22*
Operating Income (Rs. crore)	82.79	73.57	42.66
PAT (Rs. crore)	13.44	6.85	6.71
OPBDIT/OI (%)	26.06%	18.29%	23.65%
RoCE (%)	12.42%	5.89%	11.22%
Core RoCE (%)	14.24%	7.06%	12.92%
Total Outside Liabilities/Tangible Net Worth (times)	0.19	0.20	0.15
Total Debt/OPBDIT (times)	0.29	0.72	0.00
Interest Coverage (times)	27.39	31.96	52.79
DSCR (times)	8.57	15.74	48.44

*PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; ROCE: PBIT/Avg (Total Debt + Tangible Net Worth + Deferred Tax Liability - Capital Work in Progress); Core ROCE: PBIT/Avg (Total Debt + Tangible Net Worth + Deferred Tax Liability - Capital Work in Progress-investments-loans and advances-liquid investments-cash and bank balance); DSCR: (PBIT + Mat Credit Entitlements - Fair Value Gains through P&L - Non-cash Extraordinary Gain/Loss)/(Interest + Repayments made during the Year), *Provisional.*

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 on Mar 31, 2021 (Rs. crore)	Date & Rating	Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2019
					Dec 03, 2021	Feb 16, 2021	Dec 17, 2019	Dec 24, 2018
1	Fund based – Cash Credit	Long-term	32.00	-	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)
2	Bank Guarantee	Long-term	7.00	-	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)
3	Letter of credit	Short-term	6.00		[ICRA]A2	[ICRA]A2	[ICRA]A2	[ICRA]A2
4	Unallocated	Long-term	12.00	-	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)

Complexity level of the rated instruments

Instrument	Complexity Indicator
Cash Credit	Simple
Bank Guarantee	Very Simple
Letter of credit	Very Simple
Unallocated	Not applicable

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/Banker's name	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Cash Credit	NA	NA	NA	32.00	[ICRA]BBB+ (Stable)
NA	Bank Guarantee	NA	NA	NA	7.00	[ICRA]BBB+ (Stable)
NA	Letter of credit	NA	NA	NA	6.00	[ICRA]A2
NA	Unallocated	NA	NA	NA	12.00	[ICRA]BBB+ (Stable)

Annexure-2: List of entities considered for consolidated analysis- Not applicable

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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