August 01, 2019

Nelcast Limited: Ratings reaffirmed; rated amount enhanced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Fund-based Limits	72.00	160.00	[ICRA]A+(stable); re-affirmed
Proposed Long-term/Short-term Fund-based Limits	18.00	11.00	[ICRA]A+(stable)/[ICRA]A1+; re-affirmed
Short-term Fund-based Limits	18.00	20.00	[ICRA]A1+; re-affirmed
Short-term Non-fund Based Limits	9.00	9.00	[ICRA]A1+ (reaffirmed)
Short-term Fund-based sub-limits	0.00	(50.00)	[ICRA]A1+; re-affirmed
Long-term/Short-term Fund-based sub-limits	(72.00)	-	-
Commercial Paper Programme (CP)	30.00	30.00	[ICRA]A1+ reaffirmed
Total	**147.00**	**230.00**	

**Instrument details are provided in Annexure-1*

Rationale

The ratings re-affirmation reflects the steady performance of Nelcast Limited (Nelcast) in FY2019, and the expected stable earnings and credit metrics over the medium term. Nelcast's revenues continued to grow at a healthy pace in FY2019 driven by the corresponding strong growth in the medium & heavy commercial vehicle (M&HCV) and tractor industry segments, with its growth limited to around 15% because of capacity constraints. However, operating performance in the current fiscal is likely to be weaker-than earlier expectations on the back of lower-than-anticipated demand in its key end-user segments. ICRA expects Nelcast's revenues in FY2020 to be largely in-line with the FY2019 levels, driven by the continued healthy growth in exports (which grew by more than 40% in FY2019). Performance remains supported by its established relationships with leading M&HCV and tractor original equipment manufacturers (OEMs) and healthy volume share enjoyed in key products supplied to major customers. The company's operating profit margins are also likely to remain stable at moderate levels of around 9.5%, aided by increasing revenues from higher-margin export segment and better contribution levels on the back of favourable commodity prices expected in the current fiscal. Any improvement in margins over the medium term is likely to be limited because of the increase in fixed costs post commercialisation of the new capacity in FY2021, as against the expected gradual ramp-up of its utilisation.

The ratings also consider the comfortable financial profile, characterised by adequate credit metrics and strong liquidity position. Despite the ongoing debt-funded capacity expansion (Rs. 150-crore debt drawn to fund its Rs. 230-crore capital expenditure), its leverage indicators and coverage metrics have remained comfortable and in line with the category medians supported by steady earnings from operations. Key ratios including net debt to operating profits and interest coverage are expected to be at around 2 times and 6 times respectively for FY2020 and improve to ~1.5 times and 6 times respectively for FY2021. The ratings also consider the inherent cyclicality in the key end-user segments (both the domestic M&HCV and tractor segments) that has constrained operating performance in the past, relatively high customer concentration and intense competition in the domestic foundry industry. The ability of the company to sustain its revenues and earnings in the coming quarters, amid modest demand conditions, would be the key rating sensitivity.

Outlook: Stable

ICRA believes that Nelcast's performance will continue to be supported by its established presence, improving business diversification with a widening product and customer base, and ongoing capacity additions. The outlook may be revised to Positive if revenues and earnings significantly exceed estimates and strengthen the financial risk profile. The outlook may be revised to Negative if the revenues and earnings are weaker than expected and consequently result in higher dependence on external debt, which would adversely impact its credit metrics.

Key rating drivers

Credit strengths

Strong market position in key product categories – Nelcast is an established player in the domestic ferrous castings market, generating ~80% of its sales from the leading domestic OEMs. Steady demand, strong volume share for key products, continuous product additions and growing export base have aided Nelcast's operating performance in the past few fiscals. Nelcast recently expanded its capacity to support growing customer requirements – with an 18,000 TPA unit (phase I at Pedapariya, Andhra Pradesh) commercialised in September 2018 and is in the process of further increasing it by another 42,000 TPA (phase II at the same location) by Q2 FY2021.

Comfortable financial profile – Nelcast's financial profile is characterised by a conservative capital structure and adequate credit metrics. Despite an increase in long-term debt levels, drawn to fund the expansion undertaken across both phases, consistent earnings from operations have supported the leverage indicators and coverage metrics. Gearing, net debt to operating profits and interest coverage stood at around 0.5 times, 1.8 times and 9 times, respectively in FY2019.

Credit challenges

Operating performance exposed to inherent cyclicality in the key end-user segments – Nelcast derives ~80% of its sales from the domestic M&HCV and tractor segments, which are both exposed to inherent demand cyclicality. Any sustained weak demand from its key end-user segments, as witnessed in the recent months, would adversely impact its revenues and earnings profile. The risk is accentuated by the sizeable capacity being added in its second phase of expansion. Presence across two automotive segments, which supported volumes during alternating periods of slowdown (as witnessed over the years), healthy growth in exports and ongoing efforts to further widen its product portfolio to effectively utilise the new capacities, provide some comfort.

High customer concentration – Nelcast's top three customers account for around 50% of its revenues. Though revenues in the M&HCV segment are relatively diversified across the key industry players, a substantial portion of the revenues in the tractor segment is generated from a single customer. This exposes the company's earnings to client concentration risks. Nevertheless, Nelcast's long relationship with the leading OEMs in both the segments provides comfort.

Liquidity position

Nelcast's liquidity position remains comfortable, supported by steady internal accruals, despite the funding requirements towards the ongoing capital expenditure (cash balance of around Rs. 59 crore as on March 31, 2019). The average utilisation of fund-based limits was at around 70% for the 12-month period ending June 2019. While the expected increase in working capital requirements (with growing scale of operations) and the ongoing capital expenditure could limit free cash flows generated, consistent earnings from operations, cash reserves held and adequate unutilised lines of credit post the recent enhancement of limits are likely to support the liquidity position of the company.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	[Corporate Credit Rating Methodology] [Rating Methodology for Construction Equipment Manufacturers]
Parent/Group Support	Not applicable
Consolidation	For arriving at the ratings, ICRA has considered the consolidated financial statements of Nelcast and the details of its subsidiary are mentioned in Annexure-2

About the company

Incorporated in 1982, Nelcast manufactures grey and ductile castings for the M&HCV and tractor industry segments. Key products supplied to the M&HCV segment includes 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 used in metro rail projects and railways. Nelcast has an aggregate installed effective capacity of 118,000 tonnes per annum at its factories at Ponneri in Tamil Nadu and Gudur and Pedapariya in Andhra Pradesh. The capacity would be increased to 160,000 TPA upon commercialisation of its second phase at Pedapariya in the next fiscal.

Key financial indicators (Consolidated and audited)

	FY2018	FY2019
Operating Income (Rs. crore)	746.17	860.23
PAT (Rs. crore)	38.26	38.44
OPBDITA/OI (%)	9.81%	9.28%
RoCE (%)	13.98%	13.62%
Total Debt/TNW (times)	0.26	0.50
Total Debt/OPBDITA (times)	1.34	2.50
Net Debt*/ OPBDITA (times)	0.58	1.77
Interest coverage (times)	13.19	8.54

**Note: Net debt is total debt adjusted for cash and bank balances held*

Source: Nelcast and ICRA research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

	Instrument	Current Rating (FY2020) Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs Crore)	Date & Rating Aug 2019	Chronology of Rating History for the past 3 years: Date & Rating in FY2019 Mar 2019	Date & Rating in FY2019 July 2018	Date & Rating in FY2018 July 2017	Date & Rating in FY2017 July 2016
1	Fund-based Limits	Long Term	160.00	-	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Positive)	[ICRA]A+ (Positive)	[ICRA]A+ (Stable)
2	Fund-based sub-limits	Long-Term/ Short Term	0.00	-	-	[ICRA]A+ (Stable)/ [ICRA]A1+	[ICRA]A+ (Positive)/ [ICRA]A1+	[ICRA]A+ (Positive)/ [ICRA]A1+	[ICRA]A+ (Stable)/ [ICRA]A1+
3	Proposed Fund-based Limits	Long-Term/ Short Term	11.00	-	[ICRA]A+ (Stable)/ [ICRA]A1+	[ICRA]A+ (Stable)/ [ICRA]A1+	[ICRA]A+ (Positive)/ [ICRA]A1+	[ICRA]A+ (Positive)/ [ICRA]A1+	[ICRA]A+ (Stable)/ [ICRA]A1+
4	Fund-based Limits	Short Term	20.00	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
5	Non Fund-based Limits	Short Term	9.00	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
6	Fund-based sub-limits	Short Term	(50.00)	-	[ICRA]A1+	-	-	-	-
7	Commercial Paper	Short Term	30.00	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+

Source: Nelcast

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	Fund-based Limits	-	-		160.00	[ICRA]A+(Stable)
NA	Fund-based sub-limits	-	-		(50.00)	[ICRA]A1+
NA	Proposed Fund-based Limits	-	-		11.00	[ICRA]A+(Stable)/[ICRA]A1+
NA	Fund-based Limits	-	-		20.00	[ICRA]A1+
NA	Non-Fund-based Limits	-	-		9.00	[ICRA]A1+
NA	Commercial Paper				30.00	[ICRA]A1+

Source: Nelcast

Annexure-2: List of entities considered for consolidated analysis

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

Source: Nelcast

ANALYST CONTACTS

Jayanta Roy
+91 33 7150 1120
jayanta@icraindia.com

Balaji M
+91 44 4596 4317
balajim@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

Corporate Office
Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002
Tel: +91 124 4545300
Email: info@icraindia.com
Website: www.icra.in

Registered Office
1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001
Tel: +91 11 23357940-50

Branches

Mumbai + (91 22) 24331046/53/62/74/86/87
Chennai + (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,
Kolkata + (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008,
Bangalore + (91 80) 2559 7401/4049
Ahmedabad+ (91 79) 2658 4924/5049/2008
Hyderabad + (91 40) 2373 5061/7251
Pune + (91 20) 2556 0194/ 6606 9999