December 17, 2019

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
Fund Based- Term Loan	12.00	12.00	[ICRA]BBB+ (Stable); reaffirmed
Non Fund Based – Bank Guarantee	7.00	7.00	[ICRA]BBB+ (Stable); reaffirmed
Non Fund Based – Letter of Credit	6.00	6.00	[ICRA]A2 reaffirmed
Total	**57.00**	**57.00**	

**Instrument details are provided in Annexure-1*

Rationale

The ratings reaffirmation positively factors in Veljan Denison Ltd's (VDL) comfortable financial risk profile with healthy operating margins of 24.65%, gearing at 0.01 times as on September 30, 2019, interest coverage of 18.96 times and Net cash accruals/total debt of 611% in 6MFY2020. Further, the liquidity profile is strong with liquid surplus of Rs. 21.06 crore as on September 30, 2019. The ratings also consider VDL's established track record as manufacturer of vane based hydraulic pumps, valves and power pack systems; and diversified customer base comprising both domestic and overseas customers. The ratings are however constrained by company's high working capital intensity owing to high debtor and inventory days; and high customer concentration risk with top five customers accounting for 65% of the revenue in FY2019;. The ratings are also constrained by stagnated revenue which remained rangebound between Rs. 80.00-97.00 crore in the past five years owing to increasing competition from cheaper imports and exposure of company's profitability to increase in raw material prices. Further, the company had undertaken capex of Rs. 25.78 crore in FY2019 and plans to incur ~Rs. 2.00 crore towards completion of solenoid coil manufacturing unit in Vizag in FY2020 and ~Rs. 14.00 crore towards completion of castings manufacturing unit in Pashamylaram in FY2021.

Key rating drivers and their description

Credit strengths

Established track record in the manufacturing of 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 exports its products to countries like USA, Australia and Middle east and to OEMs like Escorts Construction Equipment Limited, Action Construction Equipment Limited etc in the domestic market.

Strong financial risk profile: The company's profitability margins have remained healthy over the years with operating margin at 24.65% in 6MFY2020 owing to lower cost of production along with healthy realisation from export markets. Moreover, the gearing is low at 0.01 times as on September 30, 2019 and interest coverage is healthy at 18.96 times for 6MFY2020 owing to low debt levels.

Geographically diversified customer base: The company has a diversified customer base with presence in both domestic and export sales. The company exports to countries like USA, Italy, Australia and middle east countries. The company sells in the domestic market to Original Equipment Manufacturers (OEMs) like Action Construction Equipment Limited, Escorts Limited in addition to large number of dealers.

Credit challenges

High working capital intensity: The business is working capital intensive with NWC/OI at 100% in 6MFY2020 owing to high debtor days and inventory days. The company receives payments from its distributors in around 3-4 months, from OEMs in 2-3 months, from direct exports in 5-6 months and from exports through distributors in around 12-15 months. As on March 31, 2019, the company has greater than six months debtors of Rs. 19.45 crore of the total debtors of Rs. 51.75 crore. The company keeps inventory of major raw materials like castings and vanes owing to long lead time in procurement. However, the company has low dependence on working capital borrowings and the liquidity position remains comfortable with low utilisation of working capital limits in the past 1 year and liquid cash balances of Rs. 21.06 crore as on September 30, 2019.

Stagnant scale of operations: The operating income has remained stagnant between ~Rs. 80.00-Rs. 97.00 crore over the past five years owing to the increasing competitive pressure from cheaper imported products and exposure to the cycles of capital expenditure across the industries high competition in the domestic and export markets. Moreover, the company's operating income reduced to Rs. 87.51 crore in FY2019 from Rs. 96.21 crore in FY2018 owing to reduced exports and domestic sales.

High customer concentration risk: The customer concentration risk is high with top 5 customers accounting for 65% of revenues in FY2019. Also, around 47% of the revenue in FY2019 is derived from group company Veljan Hydrair Limited.

Moderate capex plans in FY2020 and FY2021: The company had incurred capex of Rs. 25.78 crore in FY2019 funded entirely through internal accruals. In addition, the company will be incurring capex of ~Rs. 2.00 crore towards completion of solenoid coil unit in Vizag in FY2020; and ~Rs. 14.00 crore capex towards completion of casting manufacturing unit in Pashamylaram expected in FY2021.

Liquidity position: Strong

VDL's liquidity position is strong with average fund based limit utilization at 39% in the past 12 months ending October 2019. Moreover, the company has free cash balance of Rs. 21.06 crore as on September 30, 2019. The company's cash flow from operation is expected to be ~Rs. 2.00 crore in FY2020 and Rs. 11.00 crore in FY2021 while the capex commitment is ~Rs. 2.00 crore in FY2020 and ~Rs. 10.00 crore in FY2021 and debt repayment is ~Rs. 1.35 crore annually. Overall, ICRA expects VDL to be able to meet its near-term commitments comfortably from internal accruals as well as available cash balance.

Rating sensitivities

Positive triggers: The ratings could be upgraded if the scale of operations and profitability margins improve along with reduction in debtor days on a sustained basis. Specific credit metrics that could lead to an upgrade of VDL's rating include ROCE of more than 16.00% on a sustained basis.

Negative triggers: The ratings could be downgraded if there is a significant decline in revenues or margins or any deterioration in 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	The rating is based on standalone financial statements of the company. However, ICRA has considered the consolidated financials of Veljan Denison Limited and Veljan Hydrair Limited (VHL) as VDL exports its products through VHL.

About the company

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

Key financial indicators

	FY2018	FY2019	H1FY2020*
Operating Income (Rs. crore)	96.21	87.51	39.02
PAT (Rs. crore)	16.28	16.33	5.35
OPBDIT/OI (%)	28.95%	29.81%	24.65%
RoCE (%)	17.44%	15.98%	11.15%
Total Outside Liabilities/Tangible Net Worth (times)	0.29	0.30	0.19
Total Debt/OPBDIT (times)	0.79	0.74	0.08
Interest Coverage (times)	24.95	19.54	18.96

*provisional

Status of non-cooperation with previous CRA: Not Applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2020)				Rating History for the Past 3 Years		
		Type	Amount Rated	Amount Outstanding	Rating	FY2019	FY2018	FY2017
					17-Dec-2019	24-Dec-2018	21-Nov-2017	21-Oct-2016
1	Cash Credit	Long Term	32.00	-	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)
2	Term Loan	Long Term	12.00	-	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	
3	Bank Guarantee	Long Term	7.00	-	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)
4	Letter of Credit	Short Term	6.00	-	[ICRA]A2	[ICRA]A2	[ICRA]A2	[ICRA]A2

Amount in Rs. crore

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		11.75%	-	12.00	[ICRA]BBB+ (Stable)
NA	Cash Credit (HDFC Bank)		10.18%	-	13.00	[ICRA]BBB+ (Stable)
NA	Cash Credit (Canara Bank)		12.25%	-	19.00	[ICRA]BBB+ (Stable)
NA	Bank Guarantee		-	-	7.00	[ICRA]BBB+ (Stable)
NA	Letter of Credit		-	-	6.00	[ICRA]A2

Source: Veljan Denison Limited

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