

June 29, 2020

Nelcast Limited: Long-term rating downgraded to [ICRA]A(Negative); short-term rating re-affirmed at [ICRA]A1

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Fund-based Limits	160.00	160.00	[ICRA]A(Negative); downgraded from [ICRA]A+(Negative)
Short-term Fund-based Limits	20.00	20.00	[ICRA]A1; re-affirmed
Short-term Non-fund Based Limits	9.00	9.00	[ICRA]A1; re-affirmed
Short-term Fund-based sub-limits	(50.00)	(50.00)	[ICRA]A1; re-affirmed
Commercial Paper Programme (CP)	30.00	30.00	[ICRA]A1; re-affirmed
Proposed Long-term/Short-term Fund-based Limits	11.00	11.00	Long-term rating downgraded to [ICRA]A(Negative) from [ICRA]A+(Negative); short-term rating re-affirmed at [ICRA]A1
Total	230.00	230.00	

*Instrument details are provided in Annexure-1

Rationale

The revision in the long-term rating reflects the weaker-than-expected performance of Nelcast Limited (Nelcast) in the recent quarters on the back of demand slowdown in the domestic automotive industry and the continued pressure on its performance anticipated in the near term post the novel coronavirus (Covid-19) pandemic. Nelcast's revenues and operating profits declined by more than 30% in FY2020 because of a sharp fall in supplies to the domestic medium and heavy commercial vehicle (M&HCV) and tractor industry segments (down by ~50% and 25%, respectively). Revenue de-growth was limited to some extent by the continued steady growth in exports. Lower earnings, coupled with the increase in debt levels to fund Nelcast's ongoing capital expenditure also resulted in deterioration of its leverage indicators.

The long-term rating outlook remains Negative because of the expected impact of the pandemic on the Indian auto component industry and is in line with ICRA's Negative outlook for the sector. Most automotive sectors are expected to post a sharp double-digit decline in India and globally in FY2021. ICRA expects the Indian M&HCV (trucks) segment to decline by over 25% and the Indian tractor sales to decline by 6-8% in FY2021. While the strength of the eventual recovery will be contingent on the duration and breadth of the pandemic, a relatively prolonged period of curtailed automotive demand is expected as consumers remain wary of large capital commitments. As against industry expectations, ICRA expects Nelcast's revenues and earnings to be largely stable in the current fiscal, driven by the recovery in supplies to the tractor segment and continued healthy growth in exports. Increase in volume share with existing customers, customer additions and new products are expected to drive revenue growth in the tractor segment and exports. Margins are likely to be supported by the continued healthy growth in revenues from the higher-margin export segment and favourable raw material prices. While the adverse impact of the pandemic is expected to be buffered by its diversified presence across segments, performance in FY2021 is still expected to be weaker than the earlier estimates owing to the continued sharp fall in the M&HCV volumes.

Thus, lower-than anticipated revenues and earnings in FY2021, coupled with the firm debt levels are likely to result in Nelcast's leverage indicators remaining at moderate levels over the medium term. Its net debt to operating profit is

expected to remain at more than 3 times in FY2021, and subsequently improve to ~2 times in FY2022. Nevertheless, its coverage metrics and liquidity position continue to remain at adequate levels, with interest coverage and debt service coverage ratios (DSCR) likely to be at around 4 times and 1.7 times, respectively in FY2021 (albeit lower than the past healthy levels). Its credit profile remains supported by the cash reserves held and adequate unutilised lines of credit, lending financial flexibility. The ratings continue to factor in Nelcast's operational strengths, including 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 ratings also consider the inherent cyclicity in the key end-user segments (both the domestic M&HCV and tractor segments) that has constrained the operating performance in the past, relatively high customer concentration and intense competition in the domestic foundry industry, limiting pricing flexibility.

Key rating drivers and their description

Credit strengths

Strong market position in key product categories – Nelcast is an established player in the domestic ferrous castings market, generating a major portion of its sales from the leading domestic OEMs. A diversified business profile, strong volume share, continuous product additions and a growing export base have supported Nelcast's performance over the years (except in FY2020 when a sharp slowdown in demand across domestic automotive segments adversely impacted performance).

Comfortable coverage metrics – Despite an increase in the long-term debt levels (to fund the expansion undertaken) and lower-than-expected cash flows from operations witnessed in the recent past, Nelcast's coverage metrics remained at adequate levels. Its interest coverage and DSCR stood at around 5.7 times and 1.8 times, respectively in FY2020, further backed by its healthy cash reserves and adequate unutilised lines of credit.

Credit challenges

Deterioration in performance in FY2020; near-term performance likely to be limited post the Covid-19 pandemic – With Nelcast's performance remaining largely dependent on the cyclical automotive demand (domestic M&HCV and tractor segments contribute ~70% to its sales), sustained weakness in demand from its key end-user segments would adversely impact its earnings and credit metrics (as witnessed in the recent quarters). The risk is accentuated by the demand-side pressure witnessed because of the pandemic and sizeable new capacity to be commissioned in Q2 FY2021. Nelcast's diversified presence is likely to support volumes in FY2021, with recovery in supplies to the tractor segment witnessed (in line with the past trends with alternating periods of slowdown except in FY2020). Further, expected continued healthy growth in exports and ongoing efforts to further widen its product portfolio to effectively utilise the new capacities also provide some comfort.

High customer concentration – Nelcast's top two customers account for around 40% of its revenues. Though revenues in the M&HCV segment are relatively diversified across 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 risk. Nevertheless, Nelcast's long relationship and strong linkages with the leading OEMs provide comfort.

Liquidity position: Adequate

Nelcast's liquidity position remains comfortable, supported by its free cash and bank balances held and the buffer available in the working capital limits utilised (which together stood at around Rs. 98 crore as on March 31, 2020). The average working capital utilisation stood at ~75% over the last 12 months ending May 2020. While funding requirements are expected to remain high with firm repayment obligations (at around Rs. 13.5 crore in FY2021 and ~Rs. 34 crore in FY2022) and the likely increase in working capital requirements, Nelcast's liquidity position is expected to remain adequate, supported by the liquidity buffer held and an expected improvement in earnings from operations from Q2 FY2020.

Rating sensitivities

Positive triggers – Given the Negative outlook, an upgrade in the ratings is unlikely in the near term. However, the outlook may be revised to Stable if there is a strong 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 to operating profits reducing to less than 2 times and interest coverage improving to more than 5 times on a sustained basis.

Negative triggers – 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 which may result in a downgrade include net debt to operating profits remaining above 2.5 times and interest coverage remaining below 4 times 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 financial statements of Nelcast and the details of its subsidiary have been mentioned in Annexure-2.

About the company

Incorporated in 1982, Nelcast manufactures grey and ductile castings for the M&HCV and tractor industry segments. Around 20% of the overall revenues is also generated from the supplies to various export markets. Key products supplied to the M&HCV segment 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 used in metro rail projects and railways. Nelcast has an aggregate installed effective capacity of 118,000 tonnes per annum at its factories are located at Ponneri in Tamil Nadu and Gudur and Pedapariya in Andhra Pradesh. The capacity would be increased to 1,60,000 TPA upon commercialisation of its second phase at Pedapariya.

Key financial indicators (Consolidated and audited)

	FY2019	FY2020
Operating Income (Rs. crore)	860.23	572.34
PAT (Rs. crore)	38.44	36.00
OPBDITA/OI (%)	9.28%	9.41%
RoCE (%)	13.62%	7.60%
Total Outside Liabilities/Tangible Net Worth (times)	0.96	0.84
Total Debt/OPBDITA (times)	2.50	4.18
Net Debt*/ OPBDITA (times)	1.77	3.29
Interest Coverage (times)	8.54	5.67
DSCR	7.64	1.78

**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 past three years

		Rating (FY2021)		Rating History for the Past 3 Years					
Instrument	Type	Amount Rated	Amount Outstanding	Current Rating	FY2020	FY2019		FY2018	
				29-Jun-2020	5-Dec-2019	1-Aug-2019	4-Mar-2019	5-July-2018	26-July-2017
1 Long-term fund-based limits	Long Term	160.00	-	[ICRA]A (Negative)	[ICRA]A+ (Negative)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Positive)	[ICRA]A+ (Positive)
2 Short-term fund-based limits	Short Term	20.00	-	[ICRA]A1	[ICRA]A1	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
3 Short-term non-fund-based limits	Short Term	9.00	-	[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+	-	-	-
5 Commercial paper programme (CP)	Short Term	30.00	0.00	[ICRA]A1	[ICRA]A1	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
6 Proposed long-term/short-term fund-based limits	Long-Term/Short Term	11.00	-	[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+	[ICRA]A+ (Positive)/[ICRA]A1+

Amount in Rs. Crore; 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	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Long-term fund-based Limits	-	-	-	160.00	[ICRA]A (Negative)
NA	Short-term fund-based limits	-	-	-	20.00	[ICRA]A1
NA	Short-term non-fund-based Limits	-	-	-	9.00	[ICRA]A1
NA	Short-term fund-based sub-limits	-	-	-	(50.00)	[ICRA]A1
NA	Commercial Paper Programme (CP)	-	-	-	30.00	[ICRA]A1
NA	Proposed Long-term/short-term fund-based limits	-	-	-	11.00	[ICRA]A (Negative)/ [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

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