January 07, 2021

Sterling Tools Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term Loan	76.58	58.88	[ICRA]AA-(Negative); Reaffirmed
Long-term Fund-based Facilities (Cash Credit and Packing Credit)	95.00	90.00	[ICRA]AA-(Negative); Reaffirmed
Non-fund Based Limits	34.09	29.09	[ICRA]A1+; Reaffirmed
Unallocated limits	0.00	27.70	[ICRA]A1+; Reaffirmed
Total	**205.67**	**205.67**	

**Instrument details are provided in Annexure-1*

Rationale

The rating action takes into consideration Sterling Tools Limited's (STL's) established market position as the second largest automotive fastener manufacturer in India with a well-diversified revenue profile as well as its healthy financial risk profile characterised by strong profitability indicators, low debt and a comfortable liquidity position.

STL has established itself as a leading player in the domestic automotive fastener segment, trailing behind only Sundram Fasteners (in terms of revenues). The company enjoys a healthy share of business (SOB) with leading automotive original equipment manufacturers (OEMs) in India, including Maruti Suzuki India Limited (MSIL), Honda Motorcycles and Scooters India Limited (HMSI), Tata Motors Limited (TML) and Ashok Leyland Limited (ALL). With STL's expertise in developing value-added specialised and critical fasteners for the automotive segment, including those used in engine and transmission systems, the company has become a key development partner for auto OEMs for their fastener requirement. Accordingly, the company has been able to improve its SOB with these OEMs over the years.

In addition to its healthy market position, STL's business profile also draws strength from diversified revenue streams, with presence across automotive segments. Apart from the existing automotive segments that it has presence in (commercial vehicles, passenger vehicles, two-wheelers and tractors), the company is also poised to enter the three-wheeler segment through the addition of Piaggio to its clientele, which would further diversify its revenue streams. In terms of geographic exposure, although exports are currently a marginal segment accounting for only 7% of sales in FY2020, the addition of international OEMs such as John Deere and Piaggio would augur well for exports over the long term, as these have global supply chains that the company can cater to. The customer portfolio is well diversified with its largest customer accounting for only 24% of the total sales and its top five customers contributing less than 60% to its revenues in FY2020.

The company has also recently entered into business collaborations to strengthen its business profile. Its collaboration with the leading Japanese fastener manufacturer, Meidoh (acquired 5% stake in the company in FY2018), has helped the company to improve its product development capabilities for specialised fasteners and foster confidence with its Japanese OEM customers like Toyota, Honda and Suzuki, who currently import a sizeable proportion of their critical fastener requirements. The company also collaborated with a Chinese company to expand its product portfolio into the electric vehicle (EV) space in FY2020 and has incorporated a joint venture (JV) for the same. The company is currently in prototype development stage with certain EV OEMs. Although incremental revenues from the new product segment would initially be negligible, the gradual scale up in the EV business would support both revenue growth as well as business diversification, going forward. Moreover, as operations would be restricted to assembly and testing, the quantum of investments is likely to be limited and would not impact credit metrics significantly over the medium term.

The ratings also continue to factor in the company's strong financial and liquidity profile, characterised by healthy profitability indicators, comfortable credit metrics and adequate amount of funds parked in liquid investments, in addition to unutilised working capital facilities. Due to drop in raw material (primarily steel) costs combined with cost rationalisation measures, the company improved its operating profit margin (OPM) by 50 bps to 17.5% in FY2020 from 17.0% in FY2019. Although Q1 FY2021 was expectedly weak on account of the production shutdowns, STL reported healthy revival subsequently, with OPM of 23.7% in Q2 FY2021. The company's average working capital utilisation also remained low at 23.4% over the past 15 months (July 2019–September 2020). As of March 31, 2020, the gearing was 0.2x and interest cover and debt service coverage ratio (DSCR) were 10x and 3x, respectively, during the year. Given that it has adequate installed capacity in place, ongoing capex requirements are also expected to be minimal and restricted to some product development, and are likely to be funded internally without taking additional term debt. Accordingly, STL is expected to maintain its healthy balance sheet going forward as well.

Nevertheless, the rating remains constrained by STL's limited product and geographic diversification, in addition to the modest scale of operations, relative to other auto-ancillaries in the AA rating category. With almost 93% of its revenues derived from supplies to domestic automotive OEMs, it remains exposed to the inherent cyclicality of the market. As a result, due to sharp slowdown in domestic auto industry, there was a significant revenue decline of 29% to Rs. 366 crore in FY2020 over Rs. 514 crore in FY2019. The subdued capacity utilisation at the existing plants, coupled with commercialisation of the greenfield facility in Bengaluru (that also remained underutilised), impacted the company's return on capital employed (ROCE), which declined from 23% in FY2019 to 11% in FY2020.

In the current fiscal, due to the Covid-19 induced temporary plant shutdowns in Q1 FY2021, the revenues declined by 80% and the company recorded operating losses during the quarter. However, STL has reported healthy recovery subsequently, with 370% growth on QoQ and 6.7% on YoY basis in Q2 FY2021. It was also able to report healthy profitability during the quarter, supported by lower steel prices and reduction of employee costs. Accordingly, despite the weak first quarter, the company was able to close H1 FY2021 at 15.3% OPM margin and 2.4% net profit margin. Although steel prices are on an uptrend currently, ICRA expects the company to be able to pass on the increase in raw material costs to its customers on a periodic basis and protect its margins to a large extent.

The Negative outlook on the rating reflects ICRA's opinion that the sustainability of the recent recovery in demand remains to be seen. While the sales and profitability recovery from Q2 FY2021 has been healthier than expected, the demand momentum may moderate now that the pent-up demand and festive-led demand is largely exhausted. Accordingly, ICRA would continue to monitor the demand trends in the industry, as the same would have an impact on the revenues and profitability of STL as well. Slower-than-expected recovery in the automobile demand and a resulting inability to achieve adequate capacity utilisation (especially for the greenfield facility set up recently in Karnataka), could lead to a moderation in its profitability and return indicators, and would remain a rating sensitivity. ICRA would also continue to monitor the movement in raw material prices, and STL's ability to pass on the recent sharp increase in steel prices to its customers, without impacting its profitability or credit metrics materially.

Key rating drivers and their description

Credit strengths

Positioned as the second largest player in the automotive fastener segment – STL is positioned as the second largest automotive fastener manufacturer in India, trailing behind only Sundaram Fasteners in terms of market share. Aided by regular investments in product development (with focus on specialised fasteners), consistent quality standards and competitive cost structure, the company has been able to enhance its SOB with leading automobile OEMs in India. Accordingly, despite stiff competition from both organised and numerous unorganised players in the fastener segment, the company has been able to maintain its market standing over the years.

Presence across all major automotive segments and non-automotive business renders diversity to revenue profile – STL's revenue profile is well-diversified, catering to all major automotive segments, as well as some non-automotive segments. Furthermore, its dependence on each segment is limited, with the largest contributor, viz. two-wheelers, accounting for only 34% of its OEM revenues, followed by passenger vehicles (PVs; 24%) and commercial vehicles (CVs; 22%). The company also plans to enter the three-wheeler segment going forward. STL's diversified presence protects its revenues and earnings to some extent from demand downturns that impact only certain segments.

Diversified customer portfolio with healthy share of business with key customers – The company caters to multiple OEMs across the automotive spectrum, with healthy SOB with most leading OEMs and limited dependence on a single customer. Its largest customer accounted for 24% of its FY2020 revenues, while its top five customers contributed approximately 60%. STL's well-diversified revenue profile, coupled with healthy market position with major automotive OEMs, augurs well for its business prospects over the medium term.

Product development and business expansion capabilities to benefit from recent collaborations – During FY2018, STL entered into a business collaboration agreement with Meidoh Co. Ltd., Japan, to develop and sell high tensile fasteners in India. With Meidoh being one of the leading fastener developers in Japan, the collaboration is likely to enable STL to have access to product development in the fastener space and improve its business prospects with Japanese OEMs. In January 2020, the company also set up a JV with a Chinese company for the purpose of manufacturing Motor Control Units (MCUs) for EVs, which would support its entry into the EV component space and also help diversify its revenue streams, going forward.

Healthy financial risk profile with robust profitability, return indicators and comfortable credit metrics – Over the years, STL has maintained healthy profitability indicators, with OPM in the range of 16-21%, supported by high share of specialised fasteners, steady realisations and strict control on cost overheads. Additionally, STL maintains a conservative capital structure with low gearing levels and comfortable coverage indicators. During FY2020, although the company availed incremental term loans to fund its capex, the impact was not material as the equivalent amount was repaid during that period. Its average working capital utilization also remains low, averaging 23.4% in the past 15 months (July 2019–September 2020). As a result, the capital structure and credit metrics remain comfortable. As of March 31, 2020, the gearing ratio was 0.2x and interest cover and DSCR were 10x and 3x, respectively, during the year. Going forward as well, ICRA expects the funding of future capex to be undertaken through internal accruals, minimising the dependence on external borrowings, and helping to maintain comfortable credit metrics.

Credit challenges

Exposed to inherent cyclicality of domestic automotive industry; revenues likely to moderate during current fiscal given pandemic situation – With 80% of STL's revenues derived from supplies to domestic automotive OEMs, it remains exposed to cyclicality in the domestic automobile market. As the domestic auto industry underwent a sharp downturn in FY2020, it had significant impact on STL, which reported revenue degrowth of 29% during the same period.

The onset of pandemic induced lockdowns resulted in the temporary shutdown of the manufacturing facilities, which led to a revenue loss of 81% in Q1 FY2021. However, there was a 370% increase in quarterly sales during Q2 FY2021 over that in Q1 FY2021 and 6.7% increase on a YoY basis. The recovery continued in early Q3 FY2021 with monthly sales growth of 43% and 28% in October and November 2020 on a YoY basis. Going forward, sustaining this pace of recovery in subsequent months remain critical.

Slow ramp up at the Bengaluru facility to constrain return indicators in near term – STL has set up a greenfield facility in Karnataka, which commenced operations from September 2019 with an initial production capacity of 500 MT per month. Given the current subdued demand environment, ramp-up at the plant is expected to be slower than envisaged, which is likely to exert some pressure on return indicators over the near term till operations scale up to optimal levels.

Limited product diversification with presence restricted to fasteners segment – Currently, STL operates in a single product category of fasteners, thereby limiting its product diversification and offerings. Nevertheless, the versatility of the product segment, along with STL's strong market position as the second largest player and its healthy presence with its key OEMs, offers comfort regarding the stability of the business. Additionally, the company is exploring opportunities to enter new product segments, which augurs well for business prospects as well as diversification, if they materialise.

Liquidity position: Strong

The company has a healthy liquidity position with ample amount of funds parked in liquid investments (Rs. 55 crore as on Sep 30, 2020) and sufficient buffer from undrawn working capital limits (Rs. 47 crore on an average during the 15-month period ended September 2020). Repayment obligations are moderate at Rs. 15-20 crore annually and are expected to be comfortably serviced from internal accruals.

Rating sensitivities

Positive triggers – Given the negative outlook, an immediate upgrade in ratings is unlikely. ICRA would consider revising the outlook to Stable once the business environment stablises. For a rating upgrade, sustained improvement in business risk profile, characterised by expansion in product portfolio and significant scale up in operations, while maintaining profitability indicators, credit metrics and liquidity profile at current healthy levels would be critical.

Negative triggers – Sustained pressure on revenues and earnings is likely to exert pressure on the ratings. Slower-than-expected ramp up at the greenfield facility with increased reliance on external borrowings, leading to sustained deterioration in profitability and credit metrics with Total Debt/OPBITDA above 1.5 times, could also cause a downward rating movement.

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	The rating is based on STL's standalone financial statements

About the company

Established in 1979, STL manufactures and markets high tensile cold forged fasteners, primarily for the automobile industry. At present, it is positioned as the second largest fastener manufacturer in India, after Sundaram Fasteners. The company's business profile is characterised by high segment as well as customer diversification. In FY2020, the two-wheeler segment was the largest revenue driver with 34% turnover, followed by the PV (29%) and CV (22%) segments. The company caters to leading automotive companies in India and tier-I auto component manufacturers in Europe. STL's product portfolio includes fasteners, which find application in both automotive and non-automotive segments.

STL has three manufacturing plants at Faridabad, Ballabhgarh and Palwal in Haryana and has set up its fourth manufacturing plant near Bengaluru, Karnataka. The company has a total installed manufacturing capacity of approximately 50,000 MT per annum at its existing plants, with an additional 6,000-MTPA capacity installed at the new facility in Karnataka.

STL was founded by the first generation entrepreneur, Mr. Manohar Lal Aggarwal, and has thereafter been managed by his two sons, Mr. Anil Aggarwal and Mr. Atul Aggarwal. The company is listed on the Bombay Stock Exchange and National Stock Exchange. Other group companies operated by the promoters are involved in automobile dealerships of Honda Cars India Limited (HCIL), Harley Davidson and Audi across Delhi, Haryana and Punjab.

In FY2018, STL entered into business collaboration with the Japanese fastener manufacturer, Meidoh Co. Ltd, which will enhance its design and development capabilities in the automotive fastener segment and strengthen its business prospects with the Indian subsidiaries of Japanese OEMs. The Japanese company acquired 5% stake in STL at a consideration of Rs. 44.3 crore, as a part of the business collaboration agreement.

Key financial indicators (audited)

	FY2019	FY2020
Operating Income (Rs. crore)	513.8	366.3
PAT (Rs. crore)	44.9	29.0
OPBDIT/OI (%)	17.0%	17.5%
PAT/OI (%)	8.7%	7.9%
Total Outside Liabilities/Tangible Net Worth (times)	0.6	0.4
Total Debt/OPBDIT (times)	1.1	1.2
Interest Coverage (times)	23.9	10.2

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2021)					Rating History for the Past 3 Years		
		Type	Amount Rated	Amount Outstanding*	Current Rating	Earlier Rating	FY2020	FY2019	FY2018
					7-Jan-2021	21-May-2020	24-Sep-2019	26-Jul-2018	6-Oct-2017
1	Term Loan	Long Term	58.88	57.47	[ICRA]AA- (Negative)	[ICRA]AA- (Negative)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]A+ (Positive)
2	Long-term Fund-based Facilities (Cash Credit and Packing Credit)	Long Term	90.00	40.04	[ICRA]AA- (Negative)	[ICRA]AA- (Negative)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]A+ (Positive)
3	Non-fund Based Limits	Short Term	29.09	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
4	Unallocated	Long Term	0.00	-	-	-	-	-	[ICRA]A+ (Positive)
5	Unallocated	Short Term	27.70	-	[ICRA]A1+	-	-	-	-

*Amount in Rs. crore *As on September 30, 2020*

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	Term Loan I	FY2014	MCLR linked rate	FY2025	7.08	[ICRA]AA- (Negative)
NA	Term Loan II	FY2015	MCLR linked rate	FY2025	10.35	[ICRA]AA- (Negative)
NA	Term Loan III	FY2018	MCLR linked rate	FY2025	41.45	[ICRA]AA- (Negative)
NA	Fund-based facilities (Cash Credit and Packing Credit)	NA	NA	NA	90.00	[ICRA]AA- (Negative)
NA	Non-fund Based facilities	NA	NA	NA	29.09	[ICRA]A1+
NA	Unallocated	NA	NA	NA	27.70	[ICRA]A1+

Source: Sterling Tools Limited

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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