November 30, 2021

Hi-Q Electronics (P) Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long Term – Fund Based/TL	13.20	13.20	[ICRA]BBB (Stable); reaffirmed
Long Term - Fund Based/ CC	5.50	5.50	[ICRA]BBB (Stable); reaffirmed
Short Term – Non-fund Based	3.00	3.00	[ICRA]A3+; reaffirmed
Long Term/Short Term - Unallocated	3.42	3.42	[ICRA]BBB (Stable)/[ICRA]A3+; reaffirmed
Total	**25.12**	**25.12**	

**Instrument details are provided in Annexure-1*

Rationale

The reaffirmation in the ratings continues to factor in Hi-Q Electronics (P) Limited's (Hi-Q) established track record in the printed circuit board (PCB) manufacturing business with focus on high-margin multi-layer PCBs used in research and development (R&D) in the information technology, defence and aerospace sectors. The ratings also factor in the company's reputed customer base and demonstrated technological capabilities, which enhance competitiveness and act as entry barriers for new players. The ratings further factor in the company's healthy financial risk profile characterised by a healthy operating margin, comfortable capital structure and healthy coverage indicators.

The ratings, however, remain constrained by the company's moderate scale of operations, given the niche nature of its business, and the sub-optimal return on capital employed owing to its sizeable investments in fixed assets. The ratings also consider the working capital intensive nature of operations owing to the high inventory holding as the company has to import electronic components having large procurement lead time and minimum order quantity. ICRA takes note of the company's presence in the electronics industry which demands constant innovation and adaption to latest technologies to restrict competitive pressures and the same necessitates regular capital investments. The company's ability to make prudent investments in fixed assets in line with its revenue growth expectations will remain a key factor from the credit perspective.

The Stable outlook on the long-term rating indicates that the company would continue to benefit from its established position in the PCB manufacturing business, which, along with the company's low leverage levels, would support a healthy financial performance going forward.

Key rating drivers and their description

Credit strengths

Established track record of operations in PCB manufacturing – The company started operations in 1978 and has an established track record of operations, spanning over four decades. Over the years, it ventured into the supply of complex PCBs that find application in the defence and aerospace segments. Such orders have low raw material component, need faster roll-out times and are technologically more sophisticated, thereby enabling the company to fetch relatively better margins over the industry average

Established and reputed customer base – Over the years, it has built relationships with reputed players in the IT, aerospace, and defence sectors. Hi-Q's customer base continues to be moderately diversified with more than 200 customers and consists of a large number of original equipment manufacturers (OEMs) and subcontractors for OEMs (engaged in assembly). The established relationship has aided Hi-Q to procure repeat orders and supports stability in revenues and earnings.

Large investments in technologies provide competitive advantage; capital-intensive operations act as an entry barrier - The company continues to focus on high-margin complex prototype PCB manufacturing to meet the R&D requirements of clients in the IT, aerospace, and defence sectors. It is capable of manufacturing up to 40-layer PCBs. Due to this, the operations require continuous capital expenditure for the acquisition and upgradation of technology, which acts as an effective entry barrier for new players. Additionally, the domestic demand growth for PCBs remains healthy, while the domestic manufacturing capacity remains limited.

Healthy financial risk profile – The company's operating profit margins remain healthy at 24.8% in FY2021 though declining somewhat from 30.2% in FY2020, led by under-absorption of fixed overhead expenses. The company's capital structure remained comfortable with gearing of 0.29 times as on March 31, 2021 on the back of repayment of long-term debt and modest accretion to reserves. Moreover, Hi-Q's debt coverage indicators remained healthy with an interest coverage of 9.17 times and DSCR[1] of 1.91 times in FY2021. Though the company has planned debt-funded capex in the near future, its financial risk profile is likely to remain comfortable, driven by healthy margins and net worth.

Credit challenges

Small scale of operations – The company's scale of operations has been small with an operating income of Rs. 48.02 crore in FY2021, declining from Rs. 57.04 crore in FY2020 owing to weak demand from its key end-user industries following the pandemic outbreak. The pick-up in activity in the IT and defence spaces in H1 FY2022 has helped the company book a revenue of Rs. 36.06 crore in 7M FY2022 and the revival in demand is expected to drive a modest year-on-year (YoY) revenue growth in FY2022.

High working capital intensity from high inventory holding - The company's working capital intensity remains high and stood at 45% in FY2021, owing to the high receivable days and inventory levels. It maintains high levels of inventory to successfully fulfil customer orders which require a fast turnaround time. Additionally, the company is required to order above a minimum order quantity for most of its raw materials, resulting in high inventory levels. The receivables position has also been high in the past with extended credit period provided to public sector undertakings (PSUs) and a few of its key customers. Nonetheless, the renowned clientele reduces counterparty risks to an extent.

Exposure to foreign-currency risks due to significant proportion of imports - The company imports a major part of its raw material requirements. On the other hand, the export revenues are limited. Although Hi-Q gets a natural hedge to some extent through forex receivables, it remains exposed to forex fluctuations.

Liquidity position: Adequate

Hi-Q's liquidity remains adequate with healthy net cash accruals and modest cash and bank balance. The free cashflow from operations has been positive in the past five fiscals, aided by healthy profit margins coupled with a marginal increase in the working capital intensity. The company has a cash credit facility of Rs. 5.50 crore, with the average utilisation level standing at a modest of 59% for the July 2020 to September 2021 period.

Going forward, the company has expansion plans in the pipeline, which might necessitate a debt-funded capital expenditure in FY2023. Nonetheless, ICRA expects the cashflows to be sufficient to meet the scheduled repayment obligations on the company's proposed borrowings.

[1] Debt service coverage ratio

Rating sensitivities

Positive factors – ICRA could upgrade Hi-Q's rating if the company demonstrates a sustained improvement in its operating income and profitability. The ratings can also be upgraded if the company demonstrates an improvement in its capital structure and liquidity position on a sustained basis.

Negative factors – Negative pressure on Hi-Q's rating could arise if there is a significant decline in the operating income and profitability or a higher-than-anticipated debt-funded capital expenditure, weakening the capital structure and debt protection metrics. Specific credit metrics that might trigger a rating downgrade include a total debt/OPBITDA of more than 2.0 times on a sustained basis.

Analytical approach

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

About the company

Hi-Q was initially founded as a partnership firm in 1978 by Dr. S. Venkatachalam and was converted into a private limited company in 1983. The company manufactures prototypes of printed circuit boards (PCBs) that are mainly used by IT hardware companies for their research and development requirements. It has also forayed into the manufacturing of complex multi-layer PCBs with specific design and testing requirements for the players in the defence and aerospace sectors. Hi-Q's manufacturing facility is located at Hosur, Tamil Nadu.

Key financial indicators

Hi-Q (Standalone)	FY2020 (Audited)	FY2021 (Audited)
Operating Income (Rs. crore)	57.04	48.02
PAT (Rs. crore)	7.97	3.05
OPBDIT/OI (%)	30.20%	24.78%
PAT/OI (%)	13.97%	6.35%
Total Outside Liabilities/Tangible Net Worth (times)	0.77	0.55
Total Debt/OPBDIT (times)	0.95	0.95
Interest Coverage (times)	12.02	9.17

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation

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 on	Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2019
					30-Nov-2021	**31-August-2020**		**14-Feb-2019**
1	Cash Credit	Long Term	5.50	3.95	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)		[ICRA]BBB- (Positive)
2	Term Loan	Long Term	13.20	7.40	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)		[ICRA]BBB- (Positive)
3	Bank Guarantee	Short Term	3.00	2.92	[ICRA]A3+	[ICRA]A3+		[ICRA]A3
4	Unallocated	Long Term/ Short Term	3.42	-	[ICRA]BBB (Stable)/[ICRA]A3+	[ICRA]BBB (Stable)/[ICRA] A3+		[ICRA]BBB- (Positive); [ICRA]A3

Complexity level of the rated instruments

Instrument	Complexity Indicator
Cash Credit	Simple
Term Loan	Simple
Bank Guarantee	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 analyzing 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: www.icra.in

Annexure-1: Instrument details

ISIN No/Banker Name	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (RS Crore)	Current Rating and Outlook
Axis Bank	Cash Credit	NA	NA	NA	5.50	[ICRA]BBB (Stable)
Axis Bank	Term Loan	December 2018	NA	April 2022	13.20	[ICRA]BBB (Stable)
Axis Bank	Bank Guarantee	NA	NA	NA	3.00	[ICRA]A3+
NA	Unallocated	NA	NA	NA	3.42	[ICRA]BBB (Stable)/[ICRA]A3+

Source: *Company*

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
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.

For more information, visit www.icra.in

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