April 19, 2022

Sigma Electric Manufacturing Corporation Private Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term / short-term – fund-based/non-fund based	157.50	157.50	[ICRA]A-(Positive)/[ICRA]A2+; reaffirmed
Total	**157.50**	**157.50**	

**Instrument details are provided in Annexure-1*

Rationale

The rating action favourably factors in Sigma Electric Manufacturing Corporation Private Limited's (Sigma) healthy revenue growth estimated in FY2022 on back of sustained demand from the end users in the US. The operating profitability is also expected to remain stable at around 13% as the company has been able to pass on the increase in raw materials cost to the customers.

ICRA continues to derive comfort from the established operations of Sigma in the electrical castings industry for over 20 years, with the company using a wide range of raw materials such as aluminium, copper, zinc, steel and iron. It has a diversified product portfolio, servicing the electrical fittings segment, power transmission and distribution, as well as customised products for residential and commercial usages, instrumentation and home appliance industries. The company derived the major portion of its revenues from exports to Sigma Electric Manufacturing Corporation, its Group company in the US, which manages its marketing and distribution in the country. Sigma optimises cost and production by maintaining an efficient supply chain and investing in technology, inventory management software and implementing lean manufacturing across its units. The ratings are also supported by its reputed client profile (mostly in the US), which includes large home improvement companies, appliance manufacturers, engineering and power transmission and distribution companies.

The ratings, however, remain constrained on account of the leveraged capital structure on account of interest-bearing CCDs (14% interest), which were infused subsequent to the acquisition by Argand Partners (New York-based private equity fund). Significant interest outflow in CCDs impacts the net margins and fund flow from operations, leading to moderate interest coverage ratios. The leveraged interest coverage stood at 2.1 times as on March 31, 2021 and 2.7 times post equity adjustments to the CCD instrument.[1] ICRA draws comfort from the option of deferment of interest payment on CCDs to the parent entity and subordination of such outflows to domestic bank repayments. The working capital cycle also remained stretched with the net working capital to the operating income (NWC/OI) ratio of 44% in FY2021 compared to 33.7% in FY2020 primarily owing to an increase in the receivable cycle. However, the same has moderated to an extent in 9M FY2022, which if sustained, will support the company's liquidity position. The company is vulnerable to commodity prices, although it can pass on the increase in raw material costs with a lag. Sigma is also vulnerable to forex movements as 90% of its revenues are in the form of exports to the parent entity that are impacted by significant mark-to-market gains or losses.

The Positive outlook on [ICRA]A- rating reflects the benefits that the company is expected to derive from the established relationships with big customers in US and healthy revenue growth in all the major segments. Besides, healthy operating margins will result in a sustained improvement in debt coverage indicators.

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[1] *Internal adjustments have been made by ICRA based on the equity content of the CCD instrument*

Key rating drivers and their description

Credit strengths

Healthy revenue growth likely in FY2022 on the back of improved order flow – The company is expected to report healthy growth in revenues in FY2022 on the back of improved performance from all the major segments including electrical and industrial equipment. The company is expected to report over Rs. 1,400 crore of revenues in FY2022 against ~Rs. 1,100 crore in the previous fiscal.

Established position in the castings industry spanning over 20 years with a strong market position – Incorporated in 1996, the company manufactures castings for electrical components and fittings used in commercial and residential projects as well as for power transmission and distribution. It also caters to custom business requirements for industrial equipment, home appliances and instrumentation. It is a market leader in the US across low voltage electrical product segments, including weatherproof boxes (estimated 75% shares of die-cast weatherproof boxes), power transmission and distribution cut-outs, and connectors (estimated ~80% share in cutouts).

Diversified product portfolio – The company is a large integrated player in the US, with a range of castings in all non-ferrous metals in addition to iron and steel. The core electrical segment comprises ~80% of the consolidated revenues of the entity and supplies products such as fitting, connectors, couplings, weatherproof box, flip covers, lamp holders, lamp holder covers and lighting kits, connectors and fittings, among others, to the retail electrical segment, private labels and the power transmission and distribution sector. The custom products cater to the indigenous requirements of the industrial segment, instrumentation and appliance manufacturing segments.

Reputed client base – The Indian entity derives ~90% of its revenues from exports to its US entity, which carries out end-customer sales. Sigma has a reputed customer base that comprises large engineering companies, home improvement stores, home appliance companies and power transmission companies. Its top three customers generated 24% of its consolidated revenue portfolio for FY2021 and 7M FY2022. The concentration risk is mitigated by Sigma's established relationships with them and the large size of these corporations.

Consistent track record of operating profitability – The operating margins of the entity have been largely stable at ~ 12-14% over the past few years. ICRA expects the operating margins to remain at similar levels in FY2022. However, the net margins remain low owing to a significant interest outgo towards CCDs.

Credit challenges

Leveraged capital structure due to interest bearing CCDs; mitigated by interest payment subordination – The major portion of Sigma's total debt (85% of the FY2021 debt) pertains to CCDs and ECBs from its parent entity. The principal amount of the CCD infused in the Indian entity in FY2017 was Rs. 390.4 crore at an annual interest rate of 14%. The outstanding debt component of CCDs is Rs. 420.3 crore as on March 31, 2021. ICRA draws comfort from the option of deferment of interest payment on CCDs to the parent entity by agreement between the two entities and subordination of such outflows to domestic bank repayments.

High working capital cycle – The working capital cycle deteriorated to 44% in FY2021 compared to 33.7% in FY2020 because of an increase in the receivable cycle. The company exports ~90% of its products to its sister concern in the US at an extended credit period of 120-130 days. The creditors consist of raw material imports and domestic suppliers that are paid in 90-150 days, depending on the supplier and country of import. The inventory primarily constitues die castings manufactured by Sigma, as per client specifications.

Vulnerable to changes in raw material prices and forex movement – The entity derives ~90% of its revenues from exports to its Group entity in the US, which exposes Sigma to forex movements and significant mark-to-market gains or losses that impact its net profitability. The company is vulnerable to commodity prices, although it can pass on the same with a lag of one quarter.

Liquidity position: Adequate

The liquidity profile is adequate, supported by Sigma's comfortable margins and healthy fund flow from operations of Rs. 65-70 crore in FY2022. The cash and liquid investment balance stood at around Rs. 54 crore as on December 31, 2021. The company has modest capex plans, which will be funded through internal accruals. ICRA also draws comfort from the option of deferment of interest payment on CCDs to its parent entity by agreement and subordination of the same to bank repayments. The ECB payment of Rs. 81 crore is due in October 2022, however, the company has stated that the funds would be infused at the PE level for repayment of the same.

Rating sensitivities

Positive factors – ICRA could upgrade Sigma's ratings if the company continues to benefit from its established market position in the core electric business in the US, its established product portfolio, reputed customer profile and efficient supply chain. Specific credit metrics that could lead to an upgrade of Sigma's ratings include an adjusted interest coverage ratio greater than 4 times on a sustained basis and early conversion of CCDs into equity.

Negative factors – Pressure on Sigma's ratings could arise if its working capital deteriorates or the capex outlay is higher without the desired level of accruals weakening the cash flows. Weakening in the adjusted interest coverage below 2.8 times on a sustained basis could lead to ratings downgrade.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	None
Consolidation/Standalone	Standalone

About the company

Sigma Electric Manufacturing Corporation Private Limited is a Pune-based company established in 1996 by Mr. Sajjan Kumar Agarwal. During FY2007-FY2008, Goldman Sachs Capital Partner Fund, a private equity (PE) fund, acquired the majority equity stake (80.11%) in Sigma. In October 2016, Argand Partners LLP, a New York-based PE firm bought out Goldman Sachs' 80% stake and Mr. Sajjan Agarwal's equity of 20% to acquire 100% ownership of the company.

Sigma manufactures castings for the electrical and fittings industry, connectors and cut-outs for the power transmission and distribution sector, and customised products for the industrial, instrumentation and appliances segments. It uses a wide range of material grades such as aluminium, zinc, copper, iron and steel. Sigma has 11 manufacturing units across India, with six in Pune (Maharashtra) and five in Jaipur, with a total installed production capacity of 35,702 metric tonnes per annum as on March 31, 2021. It is an export-oriented company with nearly 90% of its exports made to Sigma Electric Manufacturing Corporation, a Group entity in Garner, the US. The company services its North American customer base from a 1,80,000-square-feet warehouse and distribution centre in Garner, North Carolina, the US.

Key financial indicators

Sigma- Standalone	FY2020(A)	FY2021(A)	9MFY2022(P)
Operating Income (Rs. crore)	1103.9	1090.8	1075.2
PAT (Rs. crore)	37.6	-27.0	0.6
OPBDIT/OI (%)	14.7%	13.2%	10.6%
PAT/OI (%)	3.4%	-2.5%	0.1%
Total Outside Liabilities/Tangible Net Worth (times)	1.8	2.0	2.1
Total Debt/OPBDIT (times)	3.4	4.5	3.8
Interest Coverage (times)	2.7	2.1	2.3

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; A-Audited; P-Provisional

Status of non-cooperation with previous CRA: Not Applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2023)				Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of Mar 31,2021 (Rs. crore)	Date & Rating in	Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2019
					April 19,2022	February 22,2021	February 07,2020	January 16,2019
1	Fund based/non-fund based	Long-term/ short term	157.50	-	[ICRA]A-(Positive)/ [ICRA]A2+	[ICRA]A-(Positive)/ [ICRA]A2+	[ICRA]A-(Stable)/ [ICRA]A2+	[ICRA]A-(Stable)/ [ICRA]A2+

Complexity level of the rated instruments

Instrument	Complexity Indicator
Fund based/non-fund based	Simple/Very simple

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 analysing 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

Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
Fund based/non-fund based	NA	NA	NA	157.50	[ICRA]A- (Positive)/ [ICRA]A2+

Source: *Company*

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.

For more information, visit www.icra.in

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