August 12, 2022

# Duncan Engineering Limited: Ratings placed under watch with negative implications

## Summary of rating action

| Instrument* | Previous Rated Amount (Rs. crore) | Current Rated Amount (Rs. crore) | Rating Action |
|---|---|---|---|
| Fund Based-Working Capital Facility | 10.00 | 10.00 | [ICRA]A- @; rating placed under watch with negative implications |
| Short Term-Non fund Based Limits | 1.10 | 1.10 | [ICRA]A2+ @; rating placed under watch with negative implications |
| **Total** | **11.10** | **11.10** | |

**Instrument details are provided in Annexure-1*

## Rationale

The existing parent company of Duncan Engineering Limited - Oriental Carbon and Chemicals Limited - has proposed a demerger wherein the company will be demerged into two companies with the manufacturing business shifted to a new entity and the existing entity having the investments. The company with the investment business will be the parent company of DEL post demerger. As the investment company is likely to have a weaker credit profile vis-à-vis the existing company, the ratings of Duncan Engineering Limited have been put on watch with negative implications. ICRA will continue to monitor the developments in this regard and will take a suitable rating action as more clarity emerges on the demerger.

The assigned ratings factor in the existing strong parentage of Oriental Carbon & Chemicals Limited (OCCL, rated [ICRA]AA-@/[ICRA]A1+ @; rating on watch with developing implications) till the time the demerger is complete, the extensive experience of DEL in the pneumatic products industry and its established relationships with various customers and suppliers. Further, the ratings factor in the comfortable debt protection metrics, supported by the company's adequate liquidity position. The ratings are, however, constrained by the small scale of operations, coupled with limited bargaining power and stiff competition from large players. The ratings are further constrained by the vulnerability of profitability to the volatility in key raw material (steel and special alloys) prices.

OCCL currently holds a 50.01% ownership in DEL. It has supported the company in the past by extending corporate guarantees to its bank lines, although the current bank limits are not backed by corporate guarantees from the parent. Currently, DEL's cash generation remains stable and ICRA does not expect the company to have any funding requirements. However, in case of a distress situation, ICRA expects OCCL to pitch in for DEL. With a stable cash generation amid limited capex plans or debt repayments, DEL's credit profile is expected to remain healthy, going forward. With low levels of debt, the financial leverage (gross debt/OPBDITA) was 0.1 times by the end of FY2022 and is expected to continue to be comfortable, going forward. The interest coverage ratio was 46.8 times in FY2022 and is expected to improve further on expectations of stable operating profits and declining interest costs.

## Key rating drivers and their description

### Credit strengths

**Established track record of company in pneumatics products industry** - DEL, incorporated in 1962, was promoted as a joint venture (JV) between Schrader Bridgeport International (SB International, a wholly-owned subsidiary of Tomkins Plc), and the Duncan Group (managed by the Goenka family, the promoter of OCCL). OCCL currently holds a 50.01% stake in DEL. The company manufactures pneumatic products such as air cylinders, valves and accessories. Over the decades, the company has established relationships with its key clients, which positively get reflected in the repeat orders and, thus, provide revenue visibility for DEL.

**Moderate customer concentration with clients from diversified industries** - DEL caters to a diversified clientele from diverse industries, such as power, cement, machine building, steel, automotive and material handling, among others. DEL is exposed to a moderate level of customer concentration risk as its top five clients drove about 20-30% of its operating income in the last three years. Given the diversified background of its clients across sectors, DEL exhibits moderate sector-specific and client concentration risks.

**Strong parentage of OCCL** - DEL is a subsidiary of OCCL, and the latter holds a 50.01% stake in the company. OCCL produces insoluble sulphur. While it has dominant position in the domestic market, it has been able to position itself as the preferred/second preferred supplier to most of the global tyre makers. OCCL had provided corporate guarantees for the bank lines of DEL earlier although the current bank limits are not backed by a corporate guarantee from the parent. Additionally, OCCL would be ready to support DEL in case of any need, as per the stated intent of the management of the former. However, with the proposed demerger, this is likely to change, resulting in the investment entity holding this stake in DEL.

**Comfortable debt protection metrics**- With stable cash generation amid no major capex plans or debt repayments, DEL's credit profile is expected to remain healthy, going forward. With low levels of debt, the financial leverage (gross debt/OPBDITA) was 0.1 times by the end of FY2022. The interest coverage ratio was 46.8 times in FY2022 and is expected to improve further on expectations of stable operating profits and declining interest costs.

## Credit challenges

**Small scale of operations with limited bargaining power** - DEL deals only in pneumatic products used to control air pressure in various machines. The scale of operations is very limited and, hence, it does not have much bargaining power with suppliers and customers.

**Competition from large established players** - The company faces stiff competition from domestic and international players such as Rotork, Janatics, FMC, Parker etc. However, competitive pricing and good product quality enable DEL to attract repeat orders from its customers.

**Profitability vulnerable to volatility in key raw material prices** - The key raw materials for the company are aluminium tubes and steel rods, whose prices are volatile. The company has limited ability to pass on any adverse fluctuation in raw material prices due to the intense competition in the industry. However, there are several suppliers of these raw materials, which mitigates the supplier concentration risk.

## Liquidity position: Adequate

DEL's liquidity position is expected to remain adequate, going forward, in light of the stable cash generation, healthy unencumbered cash balances (Rs. 10.2 crore at the end of FY2022) and unutilised bank limits. The company does not have any significant capex plans apart from Rs. 4-5-crore capex in FY2023 which is expected to be funded using internal accruals. The company does not have any major repayments as well. Thus, the liquidity profile is expected to remain adequate, going forward.

## Rating sensitivities

**Positive factors –** The ratings may be upgraded if there is a significant increase in the company's revenue and operating profits on a sustained basis.

**Negative factors –** The ratings may be downgraded if DEL's linkage with the parent weakens and/or there is any significant deterioration in DEL's standalone financial profile. The rating mays also be impacted if the credit profile of the parent entity weakens.

## Analytical approach

| Analytical Approach | Comments |
|---|---|
| **Applicable Rating Methodologies** | [Corporate Credit Rating Methodology](#)<br>[Impact of Parent or Group Support on an Issuer's Credit Rating](#) |
| **Parent/Group Support** | ICRA factors in the parentage of Oriental Carbon & Chemicals Limited while assigning the ratings for DEL. There is a track record of support from OCCL in the form of corporate guarantees backing the bank lines of DEL in the past. ICRA expects OCCL to support DEL in a situation of distress albeit currently DEL's performance remains stable with no major funding requirements. |
| **Consolidation/Standalone** | For arriving at the ratings, ICRA has considered the standalone financials of DEL. |

## About the company

Duncan Engineering Limited, incorporated as Schrader Duncan Limited in 1962, was promoted as a JV between Schrader Bridgeport International (a wholly-owned subsidiary of Tomkins Plc) and the Duncan Group (managed by the JP Goenka family). DEL manufactures automotive tyre valves and pneumatic products, such as air cylinders, valves, and accessories. Its plant is at Ranjangaon, Pune.

### Key financial indicators (audited)

| DEL Standalone | FY2021 | FY2022 |
|---|---|---|
| **Operating income (Rs. crore)** | 41.5 | 55.8 |
| **PAT (Rs. crore)** | 8.0 | 6.2 |
| **OPBDIT/OI (%)** | 10.9% | 16.6% |
| **PAT/OI (%)** | 19.3% | 11.2% |
| **Total outside liabilities/Tangible net worth (times)** | 0.2 | 0.3 |
| **Total debt/OPBDIT (times)** | 0.1 | 0.1 |
| **Interest coverage (times)** | 22.9 | 46.8 |

*Source: DEL's Annual Report for FY2021; ICRA estimates; 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 (FY2023) | | | | Chronology of Rating History for the past 3 years | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Type | Amount Rated (Rs. crore) | Amount Outstanding as on March 31, 2022 (Rs. crore) | Date & Rating in | Date & Rating in FY2022 | Date & Rating in FY2021 | | Date & Rating in FY2020 |
| | | | | | August 12, 2022 | October 5, 2021 | February 19, 2021 | July 20, 2020 | July 25, 2019 |
| 1 | Fund Based-Working Capital Facility | Long-term | 10.0 | - | [ICRA]A- @ | [ICRA]A- (Stable) | [ICRA]A+(CE) (Stable) rating withdrawn; [ICRA]A- (Stable) assigned | [ICRA]A+ (CE) (Stable) | [ICRA]AA- (SO) (Stable) |
| 2 | Short Term-Non fund Based Limits | Short Term | 1.10 | - | [ICRA]A2+ @ | [ICRA]A2+ | [ICRA]A1(CE) rating withdrawn; [ICRA]A2+ assigned | [ICRA]A1 (CE) | [ICRA]A1+ (SO) |

*@ - Rating placed under watch with negative implications*

## Complexity level of the rated instruments

| Instrument | Complexity Indicator |
|---|---|
| Fund Based-Working Capital Facility | Simple |
| Short Term-Non fund Based Limits | 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 are available on ICRA's website: www.icra.in

### Annexure-1: Instrument details

| ISIN | Instrument Name | Date of Issuance | Coupon Rate | Maturity | Amount Rated (RS Crore) | Current Rating and Outlook |
|---|---|---|---|---|---|---|
| | **Fund Based-Working Capital Facility** | NA | NA | NA | 10.00 | [ICRA]A- @ |
| | **Short Term-Non fund Based Limits** | NA | NA | NA | 1.10 | [ICRA]A2+ @ |

***Source:*** *Company; @- Rating placed under watch with negative implications*

*Please click here to view details of lender-wise facilities rated by ICRA*

### Annexure-2: List of entities considered for consolidated analysis-NA

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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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### Branches




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