December 21, 2022

Epack Components Private Limited: Ratings upgraded; outlook revised to Stable

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based – Working Capital	22.00	-	-
Fund-based – Term Loan	2.20	0.49	[ICRA]A- (Stable); upgraded with change in outlook from [ICRA]BBB+ (Positive)
Non-fund Based	8.00	-	-
Unallocated	12.80	-	-
Unallocated	-	44.51	[ICRA]A- (Stable)/ [ICRA]A2+; upgraded with change in outlook from [ICRA]BBB+ (Positive)/[ICRA]A2
Total	**45.00**	**45.00**	

**Instrument details are provided in Annexure-I*

Rationale

For arriving at the ratings, ICRA has taken a consolidated view of Epack Durable Private Limited (Epack Durable) and Epack Components Private Limited (Epack Components; a 100% subsidiary of Epack Durable), given their business and financial linkages as well as common management.

The ratings upgrade factors in ICRA's expectation that the company's operating profile will continue to improve aided by a healthy order book position, favourable outlook for the domestic room AC (RAC) industry and the company's efforts to improve cost competitiveness through backward integration. Aided by good summer season and recently commissioned capacity expansion (at Bhiwadi, Rajasthan) and an upcoming manufacturing unit (at Sricity, Andhra Pradesh), the company is likely to achieve healthy business growth over the medium term after experiencing ~24% and ~70% increase in its turnover in FY2022 and H1 FY2023, respectively. Further, the company's operating margins also improved on account of successful backward integration and economies of scale. In the current fiscal, the company has a healthy revenue visibility for the next season as reflected by its strong order book primarily in the RAC segment. ICRA continues to consider the extensive experience of the promoters and its established position in the consumer durables industry as one of the leading contract manufacturers in the RAC segment, having relationships with reputed Original Equipment Manufacturers (OEMs).

The ratings, however, are constrained by ICRA's estimates that the company's credit metrics will remain modestowing to considerable capacity expansion plans, which will be partly debt-funded. While the company has raised equity funding between FY2022 and H1 FY2023, the company's overall borrowings are likely to increase because of ongoing capacity expansion plans and higher working capital requirements, given the working-capital intensive nature of operations. ICRA also notes the contract manufacturing space for consumer durables is characterised by intense competition and moderate exposure to raw material price fluctuation risk.

The Stable outlook on the rating reflects ICRA's opinion that the company's operating profile will benefit from its capacity addition and increase in value addition through backward integration amid a healthy demand outlook for white goods particularly in RAC. The company's ability to ramp up its profitability metrics, especially RoCE from the expanded integrated capacities in a timely manner will be crucial for improvement in financial profile and coverage metrics and will be a key rating sensitivity.

Key rating drivers and their description

Credit strengths

Steady growth in revenue led by revival of RAC demand, expected to continue – The company has reported ~24% increase in operating income (OI) in FY2022 on account revival in demand for RACs in the domestic market, which had dampened during the pandemic in FY2021. In the current fiscal, demand continued to be strong in the summer, which enabled the company to achieve growth of more than ~70% in H1 FY2023 on a YoY basis. The current healthy order book poises the company well to continue its scale expansion for the current fiscal. The demand outlook is favourable for the consumer durable industry, driven by a growing urban population and rising disposable income. In the RAC segment, the penetration level is low in India and the industry is likely to witness healthy growth in the medium to long-term.

Long relationships with reputed clientele – The company has reputed clients, including Voltas, Haier Appliances, Philips India, Godrej, Whirlpool India, Havells India, Blue Star, with whom it has established strong relationships. Majority of the revenues come from the AC segment, mainly from Voltas and Blue Star. However, various customers have been added to its portfolio during the last two financial years. The company has also enhanced its finished goods capacity for the non-RAC segment such as induction cooktop and mixer grinder, which would gradually lead to product-wise revenue diversity.

Backward integration measures led to improvement in OPM in FY2022 – The company's OPM has increased to 7.7% in FY2022 from 6.5% in FY2021 mainly led by timely commencement of its backward integration project at Bhiwadi and Dehradun. In FY2022, the company started manufacturing in-house components like cross flow fans and entire plastic moulding components, increasing the manufacturing capacity for components such as heat exchangers, sheet metal components and copper tubing on a large scale. The company has spent ~Rs. 188 crore in FY2022 in capacity expansion and backward integration, which was largely funded by private equity investment from ICICI Ventures. It is implementing further backward integration at Bhiwadi in FY2023 to enable in-house manufacturing of critical RAC components such as printed circuit boards (PCBs), heat exchangers and motors of mixer grinders, thereby supporting cost competitiveness. ICRA also notes that the company's components manufacturing plan is selected for the Government's production linked incentive (PLI) scheme.

Experience of promoters in consumer durable industry – The promoters have been involved in manufacturing consumer durables for more than one-and-a-half decade with thorough knowledge of the market. Over the years, the company has become one of the leading players in the RAC contract manufacturing segment.

Credit challenges

Modest debt coverage ratios due to highly capital-intensive nature of operations – The company's operations are working capital intensive. Moreover, continued technology upgrades and expansion requires capex. Amid a growing scale, the company has remained dependent on external debt as evidenced by high utilisation of working capital facilities. The coverage indicators are likely to remain modest in the short-to-medium term mainly due to capital intensive nature of operations and realisation of returns from new capacities in due course of time. The company has planned substantial debt-funded capex for FY2023 and FY2024 mainly towards greenfield expansion in Sricity, Andhra Pradesh. Majority of the capex will be funded by recent private equity investment from Affirma Capital in September 2022, the company will also be availing additional term debt to part fund its capex, which will put its credit metrics under pressure in the short run (total debt/OPBIDTA of ~3.5-4.5 times and interest coverage of ~3-4 times estimated in FY2023). ICRA notes that the company will rely on more credit from vendors backed by letters of credit and limited bill discounting funding for its working capital requirements going forward. In addition, the company's ability to ramp up its returns from the expanded integrated capacities in a timely manner will be crucial for improvement in its coverage metrics and will be a key rating sensitivity.

Exposure to raw material fluctuation risk – The margins are volatile owing to exposure to fluctuation in the raw material prices. However, the key raw materials, such as copper and compressor, are covered under price escalation clauses with most of its customers, which mitigates the risk to a large extent.

Intense competition in industry – The consumer durable industry is intensely competitive due to the presence of various organised and unorganised players. However, the company's strong position as a contract manufacturer acts as an entry barrier. About 80-85% of the company's revenues comes from the sale of RACs and its components, whose demand is seasonal and susceptible to changes in weather conditions.

Liquidity position: Adequate

The company's liquidity position is **adequate** with a comfortable buffer in cash credit limits, adequate sales invoice discounting and purchase-order-funding facilities, which are utilised against orders and receivables from its major customers, as and when required. The company also had free cash of ~Rs. 18 crore as on October 2022. The cash generation from its business, bill-discounting facility and the buffer in cash credit would be sufficient to meet its term loan repayment obligations and working capital requirement, if any. The company has a repayment liability of ~Rs. 25-27 crore for next year. The company also has planned capex of ~Rs. 210-215 crore for FY2023 and ~Rs. 70-75 crore for FY2024, which is being funded by private equity and a term debt that is tied-up with the banks.

Rating sensitivities

Positive factors – A ratings upgrade would be driven by the sustained improvement in scale while maintaining its profitability margin, coupled with improvement in liquidity position and debt coverage indicators.

Negative factors – The rating could be revised downwards if the company is unable to register the estimated revenue growth or there is any major delay in ramp-up of operations from the proposed manufacturing unit, which weakens its liquidity profile. A decline in the interest coverage less than 3 times on a sustained basis could be a negative trigger

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating Approach – Consolidation
Parent/Group support	Not applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has combined the business and financial risk profiles of Epack Durable and its wholly owned subsidiary Epack Components. The two entities share a common management and strong operational synergies.

About the company

Incorporated in 1999 and based out of Noida (Uttar Pradesh), Epack Durable (formally known as Epack Durables Solutions Private Limited) is a contract manufacturer of consumer durables, such as air conditioners (ACs), induction cooktops, juicer-mixer grinders and water dispensers for OEMs such as Voltas, Havells, Godrej, Whirlpool, Haier, Blue Star, Philips, Bajaj, etc. Epack Components (formally known as E-Durable Prefab Private Limited) has become a 100% subsidiary of Epack Durable since August 2021 and acts as a captive manufacturing unit for AC components. The company manufactured 1.4 million outdoor units (ODUs), indoor units (IDUs) and window ACs, 0.8 million induction cooktops, 0.5 million mixer grinders and 0.1 million water dispensers in FY2022. The company is setting up additional integrated capacities at Sricity, which is expected to become operational during H1 FY2024. The company is also adding further capacity in its existing Bhiwadi unit. Epack Durable has received private equity investment of ~$40 million from ICICI Ventures and Affirma Capital during FY2022 and FY2023.

The company's promoters, the Singhania and Bothra families, also have interests in E-Pack Polymers Private Limited and East India Technologies Private Limited, which are involved in manufacturing EPS products, prefabricated structures, and PCBs.

Key financial indicators (audited)

Epack Durable and Epack Components (consolidated)*	FY2021	FY2022
Operating income	746.8	929.0
PAT	7.9	24.6
OPBDIT/OI	6.5%	7.7%
PAT/OI	1.1%	2.6%
Total outside liabilities/Tangible net worth (times)	5.3x	2.8x
Total debt/OPBDIT (times)	6.0x	5.6x
Interest coverage (times)	1.7x	3.0x

*Source: Company, *consolidation done by ICRA*

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amounts in Rs. Crore

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 (Rs. crore) *	Date & rating in FY2023	Date & Rating in FY2022		Date & Rating in FY2021	Date & Rating in FY2020
					Dec 21, 2022	Jan 10, 2022	Nov 26, 2021	Sep 1, 2020	Mar 29, 2019
1	Cash Credit	Long Term	-	-	-	[ICRA]BBB+ (Positive)	[ICRA]BBB+ (Positive)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)
2	Term Loans	Long Term	0.49	0.49	[ICRA]A- (Stable)	[ICRA]BBB+ (Positive)	[ICRA]BBB+ (Positive)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)
3	Letter of Credit/BG	Short Term	-	-	-	[ICRA]A2	[ICRA]A2	[ICRA]A2	[ICRA]A2
4	Unallocated	Long term	-	-	-	[ICRA]BBB+ (Positive)	-	-	-
5	Unallocated	Long Term/ Short Term	44.51		[ICRA]A- (Stable)/ [ICRA]A2+				

*Source: Company, *outstanding as on October 31, 2022*

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long Term – Term Loan	Simple
Long Term and Short Term – 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 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: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loans	Mar 2017	NA	Mar 2023	0.49	[ICRA]A- (Stable)
NA	Unallocated	NA	NA	NA	44.51	[ICRA]A- (Stable)/ [ICRA]A2+

Source: Company

Annexure II: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Epack Durable Private Limited	NA*	Full consolidation
Epack Components Private Limited	100%	Full consolidation

*Source: Company; *parent company*

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About ICRA Limited:

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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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