

April 11, 2023

Deepak Industries Limited: Long-term rating upgraded and short-term rating reaffirmed; outlook on long-term rating revised to Stable

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based – Term Loans	22.45	12.00	[ICRA]AA; Upgraded from [ICRA]AA- and outlook revised to Stable from Positive
Fund-based – Working Capital Facilities*	78.00	83.00	[ICRA]AA; Upgraded from [ICRA]AA- and outlook revised to Stable from Positive
Non-fund based – Bank Guarantee/ Letter of Credit/ Forward Cover/ Standby Line of Credit	21.75	24.75	[ICRA]A1+; Reaffirmed
Fund-based – Standby Line of Credit	-	2.00	[ICRA]A1+; Reaffirmed
Unallocated Limit	12.62	13.07	[ICRA]AA; Upgraded from [ICRA]AA- and outlook revised to Stable from Positive / [ICRA]A1+; Reaffirmed
Total	134.82	134.82	

*Instrument details are provided in Annexure-I; *Can be availed as cash credit/WCDL

Rationale

The upgrade of the long-term rating considers Deepak Industries Limited's (DIL) healthy revenue growth since FY2022, which continued in 9M FY2023 and is likely to sustain in the near-to-medium term, driven by a strong demand from the end-user industries and an improvement in realisations. DIL's sustained revenue growth and stable operating margin are likely to result in a sharp growth in its absolute profits and cash accruals. The company's operating income in 9M FY2023 grew by 28% on a YoY basis, after a robust growth of 48% in FY2022. Its cash accrual has sequentially grown to Rs. 102.0 crore in 9M FY2023 from Rs. 84.1 crore in 9M FY2022 and Rs. 52.6 crore in 9M FY2021. Its core ROCE remained healthy at 35.0% in FY2022 vis-à-vis 26.7% in FY2021, and is likely to improve further in FY2023, aided by a rise in profits. The ratings continue to factor in the company's conservative capital structure, robust debt protection metrics and a strong liquidity position, given a large free cash balance. The ratings also draw comfort from DIL's established position in the automotive and industrial gears market with long relationships with leading commercial vehicle (CV) and tractor OEMs¹ and the company's ability to pass on the raw material cost increases, albeit with a lag of one month, to its customers in the automotive gear segment. The contracts in the industrial gear segment are firm price in nature, however, the segment's share in DIL's overall revenue remains low (around 11.5% in 9M FY2023). Moreover, a short time lag between the order receipt and the purchase is likely to shield DIL's profit margins to adverse fluctuation in the prices of steel, which is its main raw material. DIL's foray into the production of value-added ground gear, which command higher realisations, has supported its revenue and profitability. The revenue from ground gears increased sharply in the recent past and is likely to remain healthy, going forward on the back of an increasing demand from the customers and limited suppliers for the product in the domestic market. ICRA also notes that DIL's acquisition of Lotus Auto Engineering Limited (Lotus Auto), an automobile component manufacturing entity, in FY2022, is likely to provide operational synergies at the Group level through augmentation of the overall capacity and scopes for enhancement of product lines and backward integration.

The long-term rating is, however, constrained by the company's exposure to the cyclical nature associated with the CV and tractor industries and its high client concentration risks. However, incremental revenues from reputed CV OEMs added to its clientele

¹ Original Equipment Manufacturer

in the recent years are expected to reduce the client concentration risk to an extent. Besides, a balanced mix of revenues from the CV and tractor segments mitigates DIL's sectoral concentration risk. The performance of DIL's industrial gear segment remained muted historically, with stagnant revenues and depressed profitability. Nevertheless, the segment's revenue and profits at an absolute level have improved considerably from FY2022, which are likely to sustain in the near-to-medium term, led by an improvement in demand from the segment's clientele.

The Stable outlook on the long-term rating reflects ICRA's opinion that DIL's credit profile is likely to derive strength from its growing scale of operations, healthy business returns and limited needs for additional borrowings due to its sizeable cash accruals and free cash.

Key rating drivers and their description

Credit strengths

Healthy revenue growth continuing since FY2022, supported by strong demand from the end-user industries and improved realisations – The demand from the automobile segment, particularly from CV OEMs, has improved significantly from FY2022. This along with an increase in realisations on the back of higher input prices led to a robust growth in DIL's operating income by 48% in FY2022 and by 28% in 9M FY2023 on a YoY basis. Around 60-65% of DIL's revenue from the CV gears comes from M&HCV (trucks) and the balance 35-40% from LCV (trucks). The M&HCV (trucks) market witnessed a sales volume growth by 49% in FY2022 and by 55% in 9M FY2023 on a YoY basis, while the LCV (trucks) sales volumes grew by 15% in FY2022 and by 34% in 9M FY2023. Healthy replacement demand, pick-up in mining, infrastructure and construction activities and increased allocation for capital spending in the Union Budget 2023-24 augur well for a significant growth in the CV (trucks) market in the near-to-medium term. The tractor sales volume contracted by 6% in FY2022 but has rebounded with a 12% growth in FY2023. Such a traction in demand from the key end-user segments along with DIL's planned capacity expansion by around 20% in FY2024 are likely to translate into a sustained growth in its revenues. The company's total order book (for the next three months) stood at around Rs. 250 crore as of mid-March 2023, providing healthy revenue visibility for Q1 FY2024.

Established presence in industrial and automotive gears markets; long relationships with leading CV and tractor OEMs provide competitive edge – DIL, incorporated in 1954, has an established presence in the domestic industrial and automotive gears markets with a long association with leading CVs and tractor OEMs. The company's product offerings include automotive transmission gears and shafts, couplings, gear boxes and engine gears, catering to the LCV, the MCV and the tractor segments in addition to the clients in other industries like power, steel, cement, sugar, etc. DIL caters to Tata Motors and Mahindra & Mahindra, which are the market leaders in the CV and tractor segments, respectively, in addition to other established OEMs in these industries including Ashok Leyland, TAFE, Escorts Group etc. The company, being the single/main supplier of various gears and shafts to some of these OEMs, has significant competitive advantage.

Increase in the share of value-added products and operational synergies with a newly acquired entity likely to strengthen operational profile – The company's sales of ground gears increased significantly in FY2022. The sales from its plant in Baghola, Haryana, which primarily manufactures high-precision ground gears, increased sharply to Rs. 99.2 crore in FY2022 from Rs. 46.5 crore in FY2021. An increasing demand for the relatively value-added products like ground gears is likely to support the company's revenues and operating margin. Besides, DIL's acquisition of Lotus Auto in FY2022 (entailing a cash outlay of Rs. 38 crore) is likely to provide operational synergies at the Group level through augmentation of the overall capacity and scopes for enhancement of product lines and backward integration, going forward.

Ability to pass on raw material price hike to customers in the automobile gear segment, albeit with a lag – The company can pass on the increase in raw material prices to the clients in the automobile gear segment with a lag of one month, protecting its operating margin from any adverse fluctuations in raw material prices. For the industrial segment, the prices remain firm during the contract tenure. However, a lower share of revenue from the industrial gear segment (around 11.5% in 9M FY2023) and the company's policy to purchase raw materials within a short interval from order receipt mitigate the impact of price

fluctuation on DIL's profitability. Its operating margin remained healthy at around 21% in FY2021 and FY2022 and is likely to remain at around 20% in FY2023.

Robust financial profile marked by healthy ROCE, conservative capital structure and strong debt coverage metrics – DIL's healthy profits at an absolute level kept its return indicators healthy. Its ROCE and core ROCE improved to 23.6% and 35.0%, respectively in FY2022 from 19.0% and 26.7% respectively in FY2021, driven by a significant improvement in profits. Going forward, with an expected improvement in profits at an absolute level due to a significant turnover growth and steady margins, DIL's ROCE and core ROCE are likely to remain healthy. The company's moderate debt levels compared to its sizeable net worth resulted in a comfortable capital structure, as reflected by a low gearing of 0.2-0.3 times since FY2020. DIL's overall leverage was negative on a net debt basis since March 31, 2020, supported by a sizeable free cash balance, which imparts a high degree of financial flexibility. Healthy profits and a conservative capital structure led to strong debt coverage indicators of DIL, as reflected by an interest coverage of 22.4 times (29.2 times in 9M FY2023), total debt relative to OPBDITA of 0.6 times and net cash accruals relative to the total debt of 128% in FY2022.

Credit challenges

Exposed to cyclicity associated with CV and tractor industries, though mitigated to an extent by a balanced exposure to these sectors – With around 88% of the company's revenue generated from sales to the CV and tractor segments in 9M FY2023, DIL is exposed to the cyclicity associated with the CV and the tractor industries, which keeps its profitability and cash flows volatile. However, a balanced mix of revenues from the CV and tractors industries, which accounted for 60% and 40% of the company's revenue from the CV gears segment in 9M FY2023, respectively, is likely to mitigate DIL's sectoral concentration risks.

Exposed to client concentration risk – DIL remains exposed to the high client concentration risk as the top two and top five customers accounted for nearly 49% and 66% of its total revenues in FY2022, respectively. This will keep DIL's business operations vulnerable to the performance of its key clientele. However, a reputed client base, coupled with DIL's long-term relationships with its clients, mitigate such risk to an extent. ICRA notes that DIL's client concentration has declined over the last five years and is likely to decline further going forward with the addition of new OEMs to its clientele.

Weak performance of the industrial gear division historically, notwithstanding an improvement since FY2022 – The company's industrial gear segment, which caters to the clients in the sectors like power, steel, cement, sugar etc., accounted for 11.5% of DIL's overall sales in 9M FY2023. The segment's revenue contracted by around 23% in FY2021 to around Rs. 54 crore amid the pandemic, after remaining stagnant in the range of Rs. 69-72 crore in the preceding five years from FY2016 to FY2020. The profitability of the industrial gear segment also remained muted historically, as reflected by consecutive losses at the PBIT level from FY2016 to FY2019 and modest profits in the subsequent two fiscals. However, in FY2022, the revenue from the industrial gear segment grew by 44% to around Rs. 78 crore and registered a YoY growth of 29% in 9M FY2023 led by strong demand from the industrial clients, which is likely to sustain in the near to medium term. The segment's PBIT also improved to Rs. 5.4 crore in FY2022 from Rs. 1.0 crore in FY2021 and stood at Rs. 3.5 crore in 9M FY2023 vis-à-vis Rs. 1.8 crore in 9M FY2022.

Environmental and Social Risks

Environmental considerations: Even as DIL is not directly exposed to climate-transition risks from the likelihood of tightening emission-control requirements, with its products used in automobile OEMs, its customers remain exposed to the same. Accordingly, the company's prospects are linked to the ability of its customers to meet tightening emission requirements. Any major disruption to the businesses of DIL's key clients due to stiff competition from the emerging players in the clean-fuel based automobile segment (mainly EV) or stricter regulatory intervention may also indirectly affect the credit profile of the company. The company may need to invest incrementally, going forward, to develop products to cater to electric vehicles, even as a transition towards the same in the segments catered to by DIL is likely to be only gradual. The company's exposure to litigation/ penalties from issues related to waste and water management remains relatively lower.

Social considerations: DIL, like most automotive-component suppliers, has a healthy dependence on human capital. Retaining human capital, maintaining healthy relations with employees and supplier ecosystem remain essential for disruption-free operations for the entity. Another social risk that DIL faces pertains to product safety and quality, wherein instances of product recalls and high-warranty costs may not only lead to a financial implication but could also harm the reputation and create a more long-lasting adverse impact. In this regard, DIL's strong track record of catering to leading automotive manufacturers underscore its ability to mitigate these risks to an extent. The company's strong technological capabilities are likely to help it align its products with any change in customer preferences.

Liquidity position: Strong

DIL's liquidity is likely to remain **strong**. The company had free cash (fixed deposits) of Rs. 216 crore as on December 31, 2022. Its cash flow from operations remained healthy at Rs. 81 crore in FY2022 and is likely to remain at a similar level in FY2023, despite an increase in the working capital requirement owing to a significant revenue growth. This along with limited and diminishing debt repayment obligations (around Rs. 10 crore, Rs. 6 crore and Rs. 4 crore respectively, in FY2023, FY2024 and FY2025) and a sizeable undrawn working capital limit (Rs. 22 crore as on February 2023) would support DIL's overall liquidity profile. ICRA expects the company to be able to comfortably meet its capex plans in the near term (around Rs. 30-35 crore) through internal accruals and yet be left with a sizeable surplus cash.

Rating sensitivities

Positive factors – An upgrade of the long-term rating will remain contingent upon a significant scaling up of operations coupled with product and geographical diversification and maintenance of healthy profit margins and liquidity position.

Negative factors – ICRA may downgrade DIL's ratings if there is a significant decline in the company's revenue or profit margins or any major debt-funded capital expenditure, acquisition or incremental investments in Group entities, which may lead to a significant weakening of its credit profile. A deterioration in its total debt/OPBDITA to above 1.0 times on a sustained basis may also be a trigger for ratings downgrade.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Auto Components
Parent/Group support	Not applicable
Consolidation/Standalone	The ratings are based on the standalone financial profile of the company

About the company

Deepak Industries Limited (DIL), incorporated in 1954, is promoted by Mr. Pradip Kumar Daga. DIL began its operations in 1957, after acquiring a company named New Allenberry Works (NAW), with a factory on Hazra Road, Kolkata. DIL has three other units in Faridabad, Rudrapur and Baghola. The Faridabad unit was set up in 1971, the Rudrapur unit began operations in December 2007, while the Baghola plant commenced commercial operations in FY2018. DIL had another plant in Dharwad, Karnataka which commenced operation in January 2016, but has been closed as the unit's sales volume remained low. The company manufactures gears, shafts, gearboxes and couplings used in the automobile (tractors and CVs) and various other industries like power, steel, cement, sugar etc. DIL also has a 5-MW solar power plant in Agar, Shajapur, Madhya Pradesh, which sells power to the Group company, Deepak Spinners Limited.

In June 2021, DIL acquired Lotus Auto Engineering Limited (Lotus Auto) through liquidation process under IBC, 2016 on a going concern basis. Lotus Auto, an erstwhile Amtek Group company, has its plant at Bhiwadi, Rajasthan and was a vendor for reputed automobile OEMs. It has facilities like casting, vertical machining, turning etc.

Key financial indicators (audited)

DIL (Standalone)	FY2021	FY2022	9M FY2023^
Operating income	428.2	634.8	581.9
PAT	55.1	83.1	83.5
OPBDIT/OI	21.2%	20.7%	21.2%
PAT/OI	12.9%	13.1%	14.3%
Total outside liabilities/Tangible net worth (times)	0.6	0.5	-
Total debt/OPBDIT (times)	1.0	0.6	-
Interest coverage (times)	12.2	22.4	29.2

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; ^Unaudited; Amount in Rs crore

Source: Company, ICRA Research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument	Type	Current rating (FY2024)		Chronology of rating history for the past 3 years			
		Amount rated (Rs. crore)	Amount outstanding as of Mar 31, 2023 (Rs. crore)	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021
				Apr 11, 2023	Apr 18, 2022	-	Feb 19, 2021
1 Fund-based – Term Loans	Long Term	12.00	10.67	[ICRA]AA (Stable)	[ICRA]AA- (Positive)	-	[ICRA]AA- (Stable)
2 Fund-based – Working Capital Facilities*	Long Term	83.00	-	[ICRA]AA (Stable)	[ICRA]AA- (Positive)	-	[ICRA]AA- (Stable)
3 Non-fund based – Bank Guarantee/ Letter of Credit/ Forward Cover/ Standby Line of Credit	Short Term	24.75	-	[ICRA]A1+	[ICRA]A1+	-	[ICRA]A1+
4 Fund-based – Standby Line of Credit	Short Term	2.00		[ICRA]A1+	-	-	-
5 Unallocated Limit	Long/ Short Term	13.07		[ICRA]AA (Stable)/ [ICRA]A1+	[ICRA]AA- (Positive)/ [ICRA]A1+	-	-

*Can be availed as cash credit/WCDL

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long term - Fund-based – Term Loans	Simple
Long term - Fund-based – Working Capital Facilities*	Simple
Short term - Non-fund based – Bank Guarantee/ Letter of Credit/ Forward Cover/ Standby Line of Credit	Very simple
Short term - Fund-based – Standby Line of Credit	Simple
Long term / Short term - Unallocated Limit	Not applicable

*Can be availed as cash credit/WCDL

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 Loan- 1 (Corporate Loan)	May-2015	-	Sep-2023	3.00	[ICRA]AA (Stable)
NA	Term Loan- 2 (GECL 2.0 Loan)	Jun-2021	-	Mar-2025	9.00	[ICRA]AA (Stable)
NA	Fund-based – Working Capital Facilities*	-	-	-	83.00	[ICRA]AA (Stable)
NA	Non-fund based – Bank Guarantee/ Letter of Credit/ Forward Cover/ Standby Line of Credit	-	-	-	24.75	[ICRA]A1+
NA	Fund-based – Standby Line of Credit	-	-	-	2.00	[ICRA]A1+
NA	Unallocated Limit	-	-	-	13.07	[ICRA]AA (Stable)/ [ICRA]A1+

Source: Company; *Can be availed as cash credit/WCDL

[Please click here to view details of lender-wise facilities rated by ICRA](#)

Annexure II: List of entities considered for consolidated analysis: Not applicable

ANALYST CONTACTS

Jayanta Roy

+91 33 7150 1120

jayanta@icraindia.com

Kaushik Das

+91 33 7150 1104

kaushikd@icraindia.com

Sujoy Saha

+91 33 7150 1184

sujoy.saha@icraindia.com

Sovanlal Biswas

+91 33 7150 1181

sovanlal.biswas@icraindia.com

RELATIONSHIP CONTACT

Jayanta Chatterjee

+91 80 4332 6401

jayantac@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani

Tel: +91 124 4545 860

communications@icraindia.com

Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

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For more information, visit www.icra.in

ICRA Limited



Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001
Tel: +91 11 23357940-45



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