August 01, 2023

Veljan Denison Limited: Ratings reaffirmed and outlook revised to Stable

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund based – Cash credit	20.25	32.00	[ICRA]BBB+ (Stable) reaffirmed; outlook changed to Stable from Positive
Bank guarantee	3.00	3.00	[ICRA]BBB+ (Stable) reaffirmed; outlook changed to Stable from Positive
Letter of credit	10.00	10.00	[ICRA]A2; reaffirmed
Unallocated	23.75	12.00	[ICRA]BBB+ (Stable) reaffirmed; outlook changed to Stable from Positive
Total	**57.00**	**57.00**	

**Instrument details are provided in Annexure-I*

Rationale

The change in the outlook to Stable represents the moderation in Veljan Denison Limited's (VDL) operating profitability in FY2023 compared to the previous fiscal and ICRA's expectation of the profitability remaining at similar levels. While the company has maintained steady revenue growth and healthy debt protection metrics and liquidity position, its overall scale of operations remains moderate.

The ratings positively factor in the established track record of VDL as a manufacturer of hydraulic pumps, valves and power pack systems, and its comfortable capital structure and healthy debt coverage indicators with negligible debt levels. ICRA takes note of VDL's diversified customer base comprising both domestic and overseas customers.

The ratings are, however, constrained by the company's moderate scale of operations owing to intense competition from cheaper imports and the demand linked to capital expenditure across industries. The ratings also take into account the high working capital intensity owing to the high debtor and inventory days, though there has been a gradual improvement in the last few years. Also, the profitability is susceptible to the volatility in raw material prices.

Key rating drivers and their description

Credit strengths

Long track record in manufacturing hydraulic pumps and valves – VDL has more than five decades of experience in manufacturing vane-based hydraulic pumps, valves and power pack systems. The company's customer base is geographically diversified as VDL caters to around 250 customers, domestically and internationally. The company's recent acquisition of Adan Holdings Limited, England and Wales, is expected to support revenue growth and expand its market reach.

Healthy financial risk profile – The operating profit margins had remained healthy (20%+) in the last five years (except for FY2021) because of VDL's presence in the niche hydraulic pump manufacturing segment. The company's operating profit margins have moderated to 21.12% in FY2023 from 26.2% in FY2022 mainly on account of higher raw material cost along with an increase in the fixed overheads. Going forward, the margins are expected to remain at FY2023 levels. VDL's capital structure remains strong. The coverage indicators also continued to be robust owing to the healthy profitability levels coupled with low dependence on debt as seen in an interest coverage of 30.06 times and TD/OPBDITA of 0.40 times in FY2023. In the absence of any debt-funded capex/acquisition, the financial risk profile should continue to be comfortable over the medium term.

Credit challenges

High working capital intensity – VDL's working capital intensity remained elevated, indicated in NWC/OI of 62% in FY2023; though it has gradually improved over the last few years. The elevated working capital intensity is primarily driven by the high inventory holdings (~246 days in FY2023) and debtor days (~93 days in FY2023). The company keeps an inventory of major raw materials like castings and steel owing to the long lead time in procurement. Notwithstanding this, the liquidity position is comfortable with free cash and bank balance of Rs. 37.85 crore as on March 31, 2023 and buffer available in the working capital limits. The high working capital intensity of operations kept the RoCE at modest levels of around 12.44% in FY2023.

Modest scale of operations – VDL's scale of operations has remained modest, with an operating income of Rs. 120.58 crore in FY2023 on a consolidated basis. Going forward, VDL's ability to scale up its operations by ensuring a healthy inflow of orders while sustaining robust profitability levels would remain a key rating monitorable.

Vulnerability of profitability to adverse fluctuations in input and steel prices – The company keeps an inventory of major raw materials like castings and steel owing to the long lead time in procurement. Hence, its margins are exposed to the adverse fluctuations in the prices of key inputs used to manufacture the end products. Though the company revises the prices periodically, the minor fluctuations cannot be passed on immediately to remain competitive in the market.

Environmental and Social Risks

Environmental concerns – VDL remains dependent on the consumption of power and fuel to run its operations which results in greenhouse emission. Also, hydraulic products operate on hydraulic fluids and various factors lead to oil leakage in hydraulic products and is a concern for the environment. Thus, in the long term, the replacement of hydraulic equipment with electromechanical systems may restrain the growth of the hydraulic equipment market. Nevertheless, the company's exposure to litigation/penalties from issues related to waste and water management remains relatively low.

Social concerns – The social risk for capital goods manufacturers manifest itself in the health and safety of employees involved in the manufacturing activity. Casualties/accidents at operating units due to gaps in safety practices may not only lead to production outages, but also invite penal actions from regulatory bodies. The sector is exposed to labour-related risks and risks of protests/social issues with local communities, which might impact the expansion/modernisation plans.

Liquidity position: Strong

VDL's liquidity position is **strong** with healthy cash flow from operations against debt obligations. It had a liquid cash surplus of Rs. 37.42 crore as on March 31, 2023 and a buffer of ~Rs. 21.46 crore in working capital borrowings with no fixed debt repayment obligations. The average working capital utilisation has remained low at 27% during the last 6 months ended May 2023.

Rating sensitivities

Positive factors – The ratings could be upgraded if there is an improvement in the scale of operations amid healthy profit margins along with an improvement in the working capital cycle on a sustained basis.

Negative factors – The ratings could be downgraded if there is a significant decline in revenues or margins, or further deterioration in the working capital cycle, adversely impacting the key credit metrics and liquidity position.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology
Parent/Group support	Not applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has consolidated the financials of VDL and its subsidiary Adan Holdings Limited

About the company

Veljan Denison Limited (VDL), incorporated in 1973, is a listed company on the BSE. It manufactures hydraulic vane pumps, motors, valves and power pack systems. The company has its manufacturing unit at Patancheru, Hyderabad. The company is promoted by Mr. V C Janardan Rao, a qualified engineer with specialisation in fluid power. The company indigenously manufactures precision engineering components and has its own research and development (R&D) wing.

Key financial indicators

VDL	Standalone			Consolidated
	FY2021	FY2022	FY2023*	FY2023*
Operating income	73.6	97.9	110.6	120.6
PAT	6.9	16.9	14.6	16.0
OPBDIT/OI	18.3%	26.2%	21.1%	21.3%
PAT/OI	9.3%	17.3%	13.2%	13.3%
Total outside liabilities/Tangible net worth (times)	0.2	0.2	0.2	0.2
Total debt/OPBDIT (times)	0.7	0.3	0.4	0.4
Interest coverage (times)	32.0	111.4	30.1	32.8

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

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2024)				Chronology of rating history for the past 3 years		
		Type	Amount rated (Rs. crore)	Amount outstanding as on Mar 31, 2022 (Rs. crore)	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021
					August 01, 2023	Dec 06, 2022	Dec 03, 2021	Feb 16, 2021
1	**Fund based – Cash credit**	Long-term	32.00	-	**[ICRA]BBB+ (Stable)**	**[ICRA]BBB+ (Positive)**	**[ICRA]BBB+ (Stable)**	**[ICRA]BBB+ (Stable)**
2	**Bank guarantee**	Long-term	3.00	-	**[ICRA]BBB+ (Stable)**	**[ICRA]BBB+ (Positive)**	**[ICRA]BBB+ (Stable)**	**[ICRA]BBB+ (Stable)**
3	**Letter of credit**	Short-term	10.00	-	**[ICRA]A2**	**[ICRA]A2**	**[ICRA]A2**	**[ICRA]A2**
4	**Unallocated**	Long-term	12.00	-	**[ICRA]BBB+ (Stable)**	**[ICRA]BBB+ (Positive)**	**[ICRA]BBB+ (Stable)**	**[ICRA]BBB+ (Stable)**

Complexity level of the rated instruments

Instrument	Complexity Indicator
Cash credit	Simple
Bank guarantee	Very Simple
Letter of credit	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 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	Cash credit	NA	NA	NA	32.00	[ICRA]BBB+ (Stable)
NA	Bank guarantee	NA	NA	NA	3.00	[ICRA]BBB+ (Stable)
NA	Letter of credit	NA	NA	NA	10.00	[ICRA]A2
NA	Unallocated	NA	NA	NA	12.00	[ICRA]BBB+ (Stable)

Source: Company

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

Annexure II: List of entities considered for consolidated analysis- Not Applicable

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About ICRA Limited:

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