October 18, 2024

Shanthi Gears Limited: Ratings Reaffirmed and assigned for enhanced limits

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Fund-based – Cash Credit	1.00	0.00	-
Short-term Fund-based – Overdraft	0.00	0.01	[ICRA]A1+; assigned
Long-term Non-fund Based	26.00	28.99	[ICRA]AA (Stable); reaffirmed and assigned for enhanced limits
Long-term – Interchangeable	(36.00)	(38.99)	[ICRA]AA (Stable); reaffirmed and assigned for enhanced limits
Short-term – Interchangeable	(1.00)	(0.00)	-
Short-term Fund-based	10.00	10.00	[ICRA]A1+; reaffirmed
Total	**37.00**	**39.00**	

**Instrument details are provided in Annexure-I*

Rationale

The rating action takes into account Shanthi Gears Limited's (SGL/the company) strong business and financial profile and ICRA's expectation of a sustained financial performance in the near to medium term, supported by its established presence, diversified revenue base and healthy order book. Further, the company has a strong parentage by virtue of being a subsidiary of Tube Investments of India Limited (TIIL; rated [ICRA]AA+ (Stable)/[ICRA]A1+) and being part of the larger Murugappa Group. SGL has healthy financial profile marked by healthy profitability, debt free status and strong liquidity. While it does not require financial support from its parent (TIIL), SGL enjoys implicit financial and operational support from its parentage. With no major debt-funded capex plans in the medium term, ICRA expects the company's debt coverage metrics and liquidity to remain strong going forward as well.

The ratings are, however, constrained by SGL's moderate scale of operations, despite improvement in the same over the years. The company's operating income (OI) stood at Rs. 536.1 crore in FY2024 and Rs. 138.8 crore in Q1 FY2025, representing YoY growth of 20.3% and 14.3% respectively. While close linkage to capex cycles exposes revenues to cyclicality in end-user industries, considerable share of revenues from the replacement segment and presence across multiple segments with no segment contributing to more than 30% of the revenues in FY2024, mitigate the risk to an extent. SGL's operating margins (19.1% in FY2024 and 20.6% in Q1 FY2025) are exposed to volatility in raw material prices and competitive pressures. However, it would benefit from better absorption of costs as revenues scale up, and its periodic cost optimisation measures, going forward.

The stable outlook on the long-term rating reflects ICRA's expectation that the company will be able to maintain its credit profile, supported by its strong parentage, established presence/healthy order book and absence of debt-funded capex plans going forward.

Key rating drivers and their description

Credit strengths

Strong parentage – TIIL, the flagship company of the Murugappa Group, holds 70.46% stake in SGL. Ever since the acquisition, the company has benefitted from the strong management support and the operational synergies derived as a subsidiary of TIIL. SGL has healthy financial profile and is expected to remain net debt negative going forward as well. While it does not require financial support from its parent (TIIL), SGL enjoys implicit financial and operational support from its parentage.

Established presence in industrial gears; diversified clientele and end-user sectors support revenue stability – SGL has had extensive presence in the industrial gears segment for five decades and caters to a reputed clientele from diversified sectors such as general engineering, steel, lifts, railways, cement and power, among others. It has a diversified client base with its top 10 customers accounting for only one-third of its revenues in FY2024, thereby insulating its revenues from customer concentration risk.

Strong financial profile – The company's operating margins were healthy at 19.1% in FY2024 (FY2023: 20.2%) and 20.6% in Q1 FY2025 (Q1 FY2024: 19.0%), aided by relatively high value addition and favorable product mix. Further improvement in scale over the years has also aided expansion in operating margins from 14.3% in FY2020. Also, SGL has remained debt free since FY2013, primarily aided by healthy net cash accruals (Rs. 52.9 crore in FY2024) and moderate capex. Consequently, the company has strong capital structure and coverage metrics. Further, with no major debt-funded capex plans in the medium term, SGL's capital structure and debt coverage metrics are expected to remain strong going forward as well.

Healthy order book – SGL's pending order book position was over Rs. 340 crore as on June 30, 2024, supported by demand from both original equipment manufacturers (OEM) and replacement segments. The healthy order book provides revenue visibility for the next few quarters.

Credit challenges

Moderate scale of operations – The company reported a moderate operating income (OI) of Rs. 536.1 crore in FY2024 and Rs. 138.8 crore in Q1 FY2025, despite YoY growth of 20.3% and 14.3% respectively in FY2024 and Q1 FY2025, and healthy improvement over the years. A higher scale would enhance resilience to volatility in demand and enable better cost absorption. Nevertheless, the company's healthy pending order book position and demand prospects are likely to support revenue growth, going forward.

Close linkage to capex cycle exposes revenues to cyclicality in end-user industries – SGL's revenues are exposed to the cyclicality in the domestic capex cycles and any economic slowdown could impact its revenues as witnessed in the past. However, considerable share of revenues from the replacement segment and presence across multiple segments, with no segment generating more than 30% of its revenues in FY2024**,** mitigate the risk to an extent.

Margins susceptible to fluctuations in raw material prices – SGL's major raw materials include steel and steel components. The company's margins are susceptible to fluctuations in raw material prices, given its limited pricing flexibility for procured orders. Nonetheless, SGL's ability to pass through the increase in raw material prices in new orders and advance procurement of raw material for the existing orders mitigates the risk to an extent. Further, the company's margins are also likely to benefit from the operating leverage and periodic cost-optimisation initiatives, although competitive pressures remain.

Liquidity position: Strong

SGL's liquidity position remains strong supported by healthy anticipated cash flows from operations. Besides, it has unencumbered cash and liquid investments of Rs. 31.9 crore and non-current investments of Rs. 104.9 crore in total in tax-free bonds and fixed deposits as on March 31, 2024. The company has remained debt free, and the fund-based working capital utilisation has been nil over the last 10 years. In relation to these sources of cash, SGL has moderate capex plans over the medium term, to be funded by internal accruals. Overall, the company's liquidity position is expected to remain strong over the medium term, supported by its strong operational and financial profile.

Rating sensitivities

Positive factors – ICRA could upgrade SGL's ratings if it demonstrates significant growth in its scale of operations and earnings, while sustaining its healthy debt protection metrics and liquidity profile.

Negative factors – Negative pressure on the company's ratings could arise if it witnesses a sharp deterioration in its earnings or significant rise in net debt; or weakening in the parent's credit profile or SGL's operational/financial linkages with the parent, TIIL.

Environmental and Social Risks

Environmental considerations: The company remains exposed to any tightening of environmental regulations, which can lead to an increase in operating costs. SGL has been taking steps to minimise the impact of environmental risks on its operations through adopting practices like reducing overall energy consumption (8% reduction in FY2024), renewable energy generation for captive consumption (45% of energy requirements met through renewable sources), monitoring and tracking greenhouse gases in operations to reduce the carbon footprint, ensuring supplier evaluation on environment aspects, and reducing waste and water consumption in operations on a continuous improvement basis.

Social considerations: Social considerations for SGL relate primarily to maintaining healthy industrial relations and occupational safety. Attracting and nurturing skilled manpower is critical as it seeks to keep pace with innovation and technological changes. The company would need to adapt to evolving social fabric, including changing consumer preferences, from time to time. SGL is also vulnerable to data security and data privacy risks and has reasonable reliance on human capital. However, its ability to mitigate risks arising from human capital issues in the past, provides comfort.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology
Parent/Group support	Tube Investments of India Limited (TIIL, rated [ICRA]AA+ (Stable)/[ICRA]A1+) holds 70.46% in SGL.
Consolidation/Standalone	The ratings are based on the standalone financial profile of the company.

About the company

SGL manufactures standard and customised gears and caters to a reputed clientele from diversified sectors such as general engineering, steel, cement, railways, power and material handling, among others. Its product portfolio encompasses a range of customised gear boxes, loose gears, worm gear boxes and helical gear boxes. It has manufacturing facilities (including a foundry) in and around Coimbatore, Tamil Nadu. The company was founded in 1969 by Mr. P Subramanian, a first-generation entrepreneur from Coimbatore. In 2012, the Murugappa Group's Tube Investments of India Limited acquired the promoter's entire 44.12% stake in SGL. Subsequently, TIIL increased its stake in the company to 70.12% by tendering an open offer in 2012. In April 2019, the company bought back shares, increasing TIIL's shareholding to 70.46%. SGL is currently a subsidiary of TIIL, with minority shareholding by public and financial institutions.

Key financial indicators (audited)

	FY2023	FY2024
Operating income	445.7	536.1
PAT	67.1	82.2
OPBDIT/OI	20.2%	19.1%
PAT/OI	15.0%	15.3%
Total outside liabilities/Tangible net worth (times)	0.2	0.3
Total debt/OPBDIT (times)	0.0	0.0
Interest coverage (times)	243.8	197.2

Source: Company, ICRA Research; Note: Amount in Rs. crore; PAT: Profit after Tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Financial ratios in the report are ICRA adjusted figures and may not be directly comparable with results reported by the company in some instances.

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

			Current (FY2025)	Chronology of rating history for the past 3 years							
				FY2025		FY2024		FY2023		FY2022	
Instrument	Type	Amount Rated(Rs crore)	Oct 18, 2024	Date	Rating	Date	Rating	Date	Rating	Date	Rating
Long term-others-interchangeable	Long Term	38.99	[ICRA]AA (Stable)	03-OCT-2024	[ICRA]AA (Stable)	05-OCT-2023	[ICRA]AA (Stable)	-	-	-	-
Long term-cash credit-fund based	Long Term	0.00	-	03-OCT-2024	[ICRA]AA (Stable)	24-JUL-2023	[ICRA]AA (Stable)	04-AUG-2022	[ICRA]AA (Stable)	05-JUL-2021	[ICRA]AA (Stable)
				-	-	05-OCT-2023	[ICRA]AA (Stable)	-	-	-	-
Short term-overdraft-fund based	Short Term	0.01	[ICRA]A1+	-	-	-	-	-	-	-	-
Short term-others-interchangeable	Short Term	0.00	-	03-OCT-2024	[ICRA]A1+	24-JUL-2023	[ICRA]A1+	04-AUG-2022	[ICRA]A1+	05-JUL-2021	[ICRA]A1+
				-	-	05-OCT-2023	[ICRA]A1+	-	-	-	-
Long term-others-non fund based	Long Term	28.99	[ICRA]AA (Stable)	03-OCT-2024	[ICRA]AA (Stable)	24-JUL-2023	[ICRA]AA (Stable)	04-AUG-2022	[ICRA]AA (Stable)	05-JUL-2021	[ICRA]AA (Stable)
				-	-	05-OCT-2023	[ICRA]AA (Stable)	-	-	-	-
Short term-others-fund based	Short Term	10.00	[ICRA]A1+	03-OCT-2024	[ICRA]A1+	24-JUL-2023	[ICRA]A1+	04-AUG-2022	[ICRA]A1+	-	-
				-	-	05-OCT-2023	[ICRA]A1+	-	-	-	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Short-term Fund-based – Over draft	Simple
Long term non-fund based	Very Simple
Long-term interchangeable	Very Simple
Short term fund based	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: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	**Overdraft**	NA	NA	NA	0.01	[ICRA]A1+
NA	**Long term Non-fund based limits**	NA	NA	NA	28.99	[ICRA]AA (Stable)
NA	**Long term interchangeable**	NA	NA	NA	(38.99)	[ICRA]AA (Stable)
NA	**Short term fund based**	NA	NA	NA	10.00	[ICRA]A1+

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:

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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