

HI-Q Electronics (P) Limited

February 14, 2019

Summary of rating action

Instrument*	Previous Rated Amount(Rs. crore)	Current Rated Amount(Rs. crore)	Rating Action
Long-term – Fund-based – Cash Credit	5.50	5.50	[ICRA]BBB- Reaffirmed; Outlook revised from Stable to Positive
Long-term – Fund-based – Term Loan	17.90	13.20	[ICRA]BBB- Reaffirmed; Outlook revised from Stable to Positive
Short-term - Non-fund based-Working Capital Facilities	1.00	3.00	[ICRA]A3; Reaffirmed
Unallocated	0.72	3.42	[ICRA]BBB-/A3 Reaffirmed; Outlook revised from Stable to Positive
Total	25.12	25.12	

*Instrument details are provided in Annexure-1

Rationale

The revision in the outlook is driven by the expected growth in revenues in FY2019, supported by increased orders from defence customers and healthy margins, aided by economies of scale from increased absorption of fixed expenses. The outlook revision also reflects the likely improvement in the company's financial profile with an improvement in capital structure and coverage indicators, aided by better operating margins and decline in debt levels. The outlook revision also considers the comfortable liquidity position with undrawn cash credit facilities of Rs. 5.50 crore.

The ratings reaffirmation continues to consider HI-Q Electronics (P) Limited's (Hi-Q) established track record in the printed circuit board (PCB) manufacturing business with focus on high-margin multi-layer PCBs used in research and development (R&D) in IT sector, and in the defence and aerospace sectors. The offset clause in the Defence Procurement Policy, which mandates foreign players to source a part of their purchases from India, has benefited Hi-Q to secure complex PCB manufacturing orders in this sector. The ratings also factor in the company's reputed customer base and strong technological capabilities, which provides it with adequate competitive strength and acts as an entry barrier for new players.

The ratings, however, remain constrained by the company's modest scale of operations and low return on capital employed owing to high investments in fixed assets. The growth in its scale of operations has remained constrained over the past years due to its focus on low-volume, high-margin orders. Therefore, increasing the scale of operations in proportion to the investments undertaken, while maintaining profitability levels, will be critical for improving the return indicators. Further, the profitability continues to remain vulnerable to fluctuations in the imported raw material prices and adverse foreign exchange fluctuations with limited natural hedge through exports. This apart, Hi-Q's working capital intensity remains high with high inventory and debtor levels.

Outlook: Positive

The Positive outlook reflects ICRA's expectation that Hi-Q's scale of operations and cash accruals will improve going forward. The ratings may be upgraded if the company is able to achieve strong growth in revenues and healthy margins while efficiently managing its working capital cycle. The outlook may be revised to Stable if revenue growth and profitability are lower than expected or if there is any weakening of the financial risk profile due to any debt-funded capital expenditure.

Key rating drivers

Credit strengths

Strong track record of operations in PCB manufacturing and established relationships with customers - The company started operations in 1978 and has an established track record of operations, spanning over four decades. Over the years, it has built relationships with reputed players in IT and the defence sectors, which include customers like Vinyas Innovative Technologies, Honeywell Technology Solutions Lab Private Limited, Elbit Systems Limited and PSUs like Bharat Electronics Ltd. (BEL), Electronics Corporation of India Ltd. (ECIL) and Bharat Heavy Electricals Limited (BHEL), The Indian Space Research Organisation Space (ISRO). The established relationship has aided Hi-Q to procure repeat orders from these clients.

Offset clause in the Defence Equipment Procurement Policy supports revenue visibility - The company stands to benefit from the offset clause in the Defence Equipment Procurement Policy, which mandates foreign players to source a part of their purchases from India. This has aided the revenue growth from the defence and aerospace segments for the past three years. The defence sector orders are relatively long term with supplies spanning up to a period of six months. This arrangement also results in optimum capacity utilisation for the company.

Large investments in technologies provide competitive advantage and capital-intensive operations act as an entry barrier - The company continues to focus on high-margin complex prototype PCB manufacturing for defence sector clients and to meet R&D requirements of clients in the IT sector. It is capable of manufacturing up to 40-layers PCBs. Due to this, the operations require continuous capital expenditure towards acquisition and up-gradation of technology installed, which acts as an entry barrier for new and existing players. Additionally, the domestic demand growth for PCBs remains healthy, while domestic manufacturing capacity remains limited.

Healthy financial risk profile characterised by low gearing and increased profitability - The company's operating profitability increased to 23.47% in FY2018 from 22.99% in FY2017 with increased sales of high-margin PCBs. The healthy net profit and its accretion also strengthened the capital structure of the company. No utilisation of working capital borrowings, post receipt of subsidy from the government towards capital expenditure incurred, resulted in lower debt levels and better debt coverage indicators, characterised by a gearing of 0.53 times and interest coverage of 3.70 times in FY2018 against a gearing of 0.80 times and interest coverage of 3.11 times in FY2017.

Credit challenges

Modest scale of operations with weak return indicators - The scale of operations continues to remain modest with an operating income (OI) of Rs. 35.05 crore in FY2018 against Rs. 32.48 crore in FY2017. There was a substantial amount of investment undertaken in FY2017. However, the growth in revenues has not been to the same proportion, resulting in low OI/GB of 35% and consequently a low return on capital employed of 7.76% in FY2018. Further, Hi-Q focuses on complex PCB manufacturing. Though this strategy results in high profit margins and limited competition, it also limits the growth in its scale of operations as a major part of the PCB market consists of volume-driven manufacturing.

High working capital intensity, resulting from high inventory holding - The company's working capital intensity stood at 37% in FY2018 owing to high receivable days and high inventory level. The raw material procurement by Hi-Q is forecast based. It is required to maintain high levels of inventory to take up orders which require a fast turnaround time.

Additionally, there were higher purchases towards the year end. Further, it extends a credit period of 60 to 90 days to its customers, resulting in high receivables.

Exposure to foreign currency risks due to significant proportion of imports - The company imports a major part of its raw material requirements, but its exports revenues are limited. Although Hi-Q gets a natural hedge to some extent through forex receivables, it remains exposed to forex fluctuations.

Intense competition from established players in the global market - Hi-Q faces competition from other established players in the industry. In complex PCB manufacturing, competition from domestic players is limited, but the company faces strong competition from imports. However, focus on high quality and stringent approval norms keep the fragmented low-quality players away from the niche segment, in which the company operates.

Liquidity position

The company's liquidity position is comfortable with healthy cash flows on account of healthy operating margins. The company has external term loans of Rs. 14.13 crore on its books as on March 31, 2018, of which Rs. 1.20 crore is scheduled to be repaid in FY2019. It received a capital subsidy of Rs. 6.41 crore in October 2017, which has eased the liquidity position. It has not been utilising the cash-credit facilities post receipt of the subsidy. The undrawn working-capital facilities of Rs. 5.50 crore and cash and bank balance of Rs. 2.80 crore as of January 2019 provide healthy liquidity cushion.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	Not applicable
Consolidation / Standalone	Standalone financial statements of the issuer.

About the company

Hi-Q was initially founded as a partnership firm in 1978 by Dr. S. Venkatachalam and was converted into a private limited company in 1983. The company manufactures prototypes/small quantities of complex printed circuit boards (PCBs) that are mainly used by IT hardware companies for their R&D requirements. It has also forayed into manufacturing complex multi-layer PCBs with specific design and testing requirements for players in the defence and aerospace sector. Hi-Q's manufacturing facility is located at Hosur, Tamil Nadu.

In FY2018, the company reported a net profit of Rs. 1.66 crore on an OI of Rs. 35.05 crore compared to a net loss of Rs. 0.46 crore on an OI of Rs. 32.48 crore in the previous year.

Key financial indicators (audited)

	FY2017	FY2018
Operating Income (Rs. crore)	32.48	35.05
PAT (Rs. crore)	-0.46	1.66
OPBDITA/OI (%)	22.99%	23.47%
RoCE (%)	7.03%	7.76%
Total Debt/TNW (times)	0.80	0.53
Total Debt/OPBDITA (times)	2.93	1.72
Interest Coverage (times)	3.11	3.70

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

Instrument	Current Rating (FY2019)				Chronology of Rating History for the past 3 years			
	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore) as on Dec 12, 2018	Date & Rating February 2019	Date & Rating in FY2018 January 2018	Date & Rating in FY2017 October 2016	Date & Rating in FY2016 June 2015	
1 Term Loan	Long Term	13.20	13.20	[ICRA]BBB- (Positive)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Negative)	[ICRA]BBB- (Stable)	
2 Cash Credit	Long Term	5.50	-	[ICRA]BBB- (Positive)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Negative)	[ICRA]BBB- (Stable)	
3 Bank Guarantee	Short Term	3.00	-	[ICRA]A3	[ICRA]A3	[ICRA]A3	[ICRA]A3	
4 Unallocated	Long/Short Term	3.42	-	[ICRA]BBB- (Positive)/[ICRA]A3	[ICRA]BBB- (Stable)/[ICRA]A3	[ICRA]BBB- (Negative)/[ICRA]A3	[ICRA]BBB- (Stable)/[ICRA]A3	

Complexity level of the rated instrument:

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument Details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loan	September 2015	-	FY2023	13.20	[ICRA]BBB- (Positive)
NA	Cash Credit	-	-	-	5.50	[ICRA]BBB- (Positive)
NA	Bank Guarantee	-	-	-	3.00	[ICRA]A3
NA	Unallocated	-	-	-	3.42	[ICRA]BBB- (Positive)/ [ICRA]A3

Source: HI-Q Electronics (P) Limited

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