

September 24, 2019

## Sterling Tools Limited: Rating reaffirmed; Rated amount enhanced

### Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term Loan	69.24	76.58	[ICRA]AA-(Stable); Reaffirmed
Long Term Fund Based facilities	65.00	95.00	[ICRA]AA-(Stable); Reaffirmed
Non-Fund based limits	32.75	34.09	[ICRA]A1+; Reaffirmed
<b>Total</b>	<b>166.99</b>	<b>205.67</b>	

\*Instrument details are provided in Annexure-1

### Rationale

The rating reaffirmation factors in the healthy business profile of Sterling Tools Limited (STL) as a leading manufacturer of automotive fasteners in India, with presence across automotive segments and original equipment manufacturers (OEMs). Although the domestic automotive market is undergoing a sharp demand slowdown, ICRA does not expect STL's financial risk profile to weaken significantly over the medium term, considering its comfortable capital structure and strong liquidity position.

The company is positioned as the second largest manufacturer of automotive fasteners in India, trailing behind only Sundaram Fasteners in terms of market share. The company enjoys a healthy share of business (SOB) with leading automotive original equipment manufacturers (OEMs) in India, including Maruti Suzuki India Limited (MSIL), Honda Motorcycles and Scooters India Limited (HMSI), Tata Motors Limited (TML) and Ashok Leyland Limited (ALL). With STL's expertise in developing value-added critical fasteners for the automotive segment, including those used in engine and transmission systems, the company has become a key development partner for OEMs for their fastener requirement. Accordingly, the company has been able to improve its SOB with these OEMs over the years.

STL's product development capabilities and business prospects over the medium term are also likely to benefit from its recent business collaboration arrangement. In FY2018, the company collaborated with Meidoh, a leading fastener manufacturer in Japan, to develop and manufacture specialised fasteners in India. The collaboration, which also entailed purchase of 5% stake in STL by Meidoh, augurs well for the company's business prospects, especially with Indian subsidiaries of leading Japanese OEMs like Toyota, Honda and Suzuki, which currently import a large proportion of their critical fastener requirement. However, the same is yet to materialise in a meaningful way.

The rating also draws comfort from the company's strong financial and liquidity profile, characterised by healthy profitability and return indicators, comfortable credit metrics and adequate amount of funds parked in liquid investments, in addition to unutilised working capital facilities. Although profitability and return indicators moderated in FY2019 due to increase in raw material prices being passed on with a lag to customers, it continues to remain healthy with operating profit margin (OPM) of 17.1% and core ROCE of 28.9%. Similarly, despite debt-funded capex undertaken during the year for a greenfield facility in Karnataka and capacity expansion at existing plants, the credit metrics continue

to remain at comfortable levels, with interest cover of 24.0x and DSCR of 5.3x. Additionally, the company maintains adequate liquidity cushion in the form of cash and liquid investments (Rs. 58 crore as on June 30, 2019) and unutilised working capital facilities (Rs. 65 crore on an average during the 15-month period ended June 2019), which would support it in tiding over the existing downcycle in the automotive industry.

Nevertheless, the rating remains constrained by STL's limited product and geographic diversification, in addition to the modest scale of operations, relative to other auto-ancillaries in the AA rating category. With more than 86% of its revenues derived from supplies to domestic automotive OEMs, it remains exposed to the inherent cyclicity of the market. Despite enjoying a well-diversified revenue profile in terms of automotive segments and client OEMs, the company's revenues and earnings have come under pressure during recent quarters in line with the broad-based slowdown in the domestic automotive market. Accordingly, STL's revenues are likely to moderate during the current fiscal, given the sharp slowdown during the first half of the year.

Furthermore, ramp up at the greenfield facility in Karnataka, which was commercialised in September 2019, is likely to be slow, considering the current subdued demand environment. Accordingly, weaker-than-expected asset utilisation and additional overheads from the new plant are likely to exert some pressure on profitability and return indicators in the current fiscal, despite some easing on the raw material front. Nevertheless, confirmed orders for its additional capacity and STL's healthy market position with OEMs, offer comfort regarding business visibility for the plant.

The Stable outlook on the long-term rating reflects ICRA's opinion that STL will continue to maintain its healthy business and financial risk profile, with comfortable credit metrics and adequate liquidity cushion. Although the current year's performance is likely to be subdued in line with the weak demand environment, STL is expected to maintain comfortable coverage indicators, in line with its commitment to conservative financial policies.

## Key rating drivers and their description

### Credit strengths

**Positioned as the second-largest player in the automotive fastener segment** – STL is positioned as the second largest automotive fastener manufacturer in India, trailing behind only Sundaram Fasteners in terms of market share. Aided by regular investments in product development (with focus on specialised fasteners), consistent quality standards and competitive cost structure, the company has been able to enhance its share of business with leading automobile OEMs in India. Accordingly, despite stiff competition from both organised and numerous unorganised players in the fastener segment, the company has been able to maintain a stable operational profile.

**Presence across all major automotive segments and non-automotive business renders diversity to revenue profile** – STL's revenue profile is well-diversified, catering to all major automotive segments, as well as some non-automotive segments. Furthermore, its dependence on each segment is limited, with the largest contributor, viz. commercial vehicles (CVs), accounting for only 32% of its OE revenues followed by two-wheelers (30%) and passenger vehicles (PVs; 24%). STL's diversified presence protects its revenues and earnings to some extent from demand downturns that impact only certain segments.

**Diversified customer portfolio with healthy share of business** – The company caters to multiple OEMs across the automotive spectrum, with healthy share of business with most leading OEMs and limited dependence on a single customer. Its largest customer accounted for 22% of its FY2019 revenues, while its top five customers contributed approximately 60%. STL's well-diversified revenue profile, coupled with healthy market position with major automotive OEMs augurs well for its business prospects over the medium term.

**Product development and business expansion capabilities to benefit from recent collaborations** – During FY2018, STL entered into a business collaboration agreement with Meidoh Co. Ltd., Japan, to develop and sell high tensile fasteners in India. With Meidoh being one of the leading fastener developers in Japan, the collaboration is likely to enable STL to have access to product development in the fastener space and improve its business prospects with Japanese OEMs. Additionally, the company is exploring opportunities to expand its product portfolio and collaborations for the same, scale-up in which would further strengthen the business profile.

**Strong liquidity position with unutilised working capital facilities and healthy quantum of funds parked in liquid investments** – The company's liquidity position is comfortable, characterised by healthy quantum of cash and liquid investments (Rs. 58 crore as on June 2019), as well as adequate buffer available in the form of unutilised working capital facilities.

**Healthy financial risk profile with robust profitability, return indicators and comfortable credit metrics** – Despite slight contraction in operating profit margins and debt-funded capex undertaken to set-up a new manufacturing unit during FY2019, STL's financial risk profile continues to be healthy with OPM of 17.1%, core ROCE of 28.9% and comfortable credit metrics (interest cover of 24.0x and DSCR of 5.3x in FY2019).

## Credit challenges

**Exposed to inherent cyclicality of domestic automotive industry; earnings likely to moderate during current fiscal given sharp slowdown across segments** – With 86% of STL's revenues derived from supplies to domestic automotive OEMs, it remains exposed to cyclicality in the domestic automobile market. With the market currently witnessing sharp slowdown in automobile sales, the company's financial performance has been adversely impacted over the past 2-3 quarters. Accordingly, the company's earnings are likely to moderate during the near-term in line with the sharp slowdown across automotive segments and OEMs.

**Sizeable capex with respect to greenfield facility to constrain return indicators in near term** – STL has set up a greenfield facility in Karnataka, which commenced operations from September 2019 with an initial capacity of 500 MT per month. Given the current subdued demand environment, ramp-up at the plant is expected to be slower than envisaged, which is likely to exert some pressure on return indicators over the near-term till operations scale up to optimal levels.

**Limited product diversification with presence restricted to fasteners segment** – Currently, STL operates in a single product category of fasteners, thereby limiting its product diversification and offerings. Nevertheless, the versatility of the product segment, along with STL's strong market position as the second largest player and its healthy presence with its key OEMs, offers comfort regarding the stability of the business. Additionally, the company is exploring opportunities to enter new product segments, which augurs well for business prospects as well as diversification, if it materialises.

## Liquidity position: Strong

STL's liquidity is **strong** supported by expectation of healthy cash flow generation, although likely to be lower than the previous year. Its liquidity is also supported by surplus cash balances (Rs. 58 crore parked in liquid mutual funds) and availability of adequate unutilised working capital limits (Rs. 65 crore on an average during the 15-month period ended June 2019). The company's capex commitment of Rs. 56 crore for FY2020 has already been met from internal accruals and long-term borrowings tied up. Further, the capex over the medium-term is likely to moderate. STL's debt repayments at Rs. 14 crore in FY2020 also remain moderate vis-à-vis internal accruals and are expected to be serviced comfortably.

## Rating sensitivities

**Positive triggers:** Sustained improvement in business risk profile, characterised by expansion in product portfolio and significant scale up in operations, while maintaining profitability indicators, credit metrics and liquidity profile at current healthy levels would be critical for an upward rating revision.

**Negative triggers:** Slower than expected ramp up at the greenfield facility or increased reliance on external borrowings, leading to sustained deterioration in profitability and credit metrics with Total Debt/OPBITDA above 1.5x could, could cause a downward rating movement.

## Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	<a href="#">Corporate Credit Rating Methodology</a> <a href="#">Rating Methodology for Auto Component Manufacturers</a>
Parent/Group Support	Not applicable
Consolidation/Standalone	The rating is based on STL's standalone financial statements

## About the company

Established in 1979, STL is engaged in the manufacturing and marketing of high tensile cold forged fasteners, primarily for the automobile industry. Currently, it is positioned as the second largest fastener manufacturer in India, after Sundaram Fasteners. The company's business profile is characterised by high segment as well as customer diversification. In FY2019, the CV segment was the largest driver of its turnover (32%), followed by two-wheelers (30%) and PVs (24%). The company caters to leading automotive companies in India and tier-I auto component manufacturers in Europe. STL's product portfolio includes fasteners, which find application in both automotive and non-automotive segments.

STL has three manufacturing plants at Faridabad, Ballabgarh and Palwal in Haryana and has set up its fourth manufacturing plant near Bengaluru, Karnataka. The company has a total installed capacity of approximately 50,000 MT per annum at its existing plants, and an additional 6,000 MTPA capacity installed at the new facility in Karnataka.

STL was founded by the first generation entrepreneur, Mr. Manohar Lal Aggarwal, and has thereafter been managed by his two sons, Mr. Anil Aggarwal and Mr. Atul Aggarwal. The company is listed on the Bombay Stock Exchange and National Stock Exchange. Other group companies operated by the promoters are engaged in automobile dealerships of Honda Cars India Limited (HCIL), Harley Davidson and Audi across Delhi, Haryana and Punjab.

During FY2018, STL entered into a business collaboration with the Japan-based fastener manufacturer, Meidoh Co. Ltd, which would enhance its design and development capabilities in the automotive fastener segment and strengthen business prospects with Indian subsidiaries of Japanese OEMs. The Japanese company acquired 5% stake in STL at a consideration of Rs. 44.3 crore as part of the business collaboration agreement.

### Key financial indicators (audited)

	FY2018	FY2019
Operating Income (Rs. crore)	454.9	514.1
PAT (Rs. crore)	48.7	44.9
OPBDIT/OI (%)	20.5%	17.1%
RoCE (%)	31.4%	23.4%
Total Outside Liabilities/Tangible Net Worth (times)	0.4	0.6
Total Debt/OPBDIT (times)	0.4	1.1
Interest Coverage (times)	24.7	24.0
DSCR	4.4	5.3

**Status of non-cooperation with previous CRA: Not applicable**

**Any other information: None**

### Rating history for past three years

	Instrument	Current Rating (FY2020)				Rating History for the Past 3 Years		
		Type	Amount Rated	Amount Outstanding*	Rating	FY2019	FY2018	FY2017
					24-Sep-2019	26-Jul-2018	6-Oct-2017	20-Oct-2016
1	Term Loan	Long Term	76.58	67.27	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]A+ (Positive)	[ICRA]A+ (Stable)
2	Long Term Fund Based facilities	Long Term	95.00	32.30	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]A+ (Positive)	[ICRA]A+ (Stable)
3	Non Fund based limits	Short Term	34.09	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
4	Unallocated	Long Term	-	-	-	-	[ICRA]A+ (Positive)	[ICRA]A+ (Stable)

Amount in Rs. crore

\*As on March 31, 2019

### 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](http://www.icra.in)

### Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loan I	FY2014	MCLR linked rate	FY2025	11.90	[ICRA]AA- (Stable)
NA	Term Loan II	FY2015	MCLR linked rate	FY2025	19.68	[ICRA]AA- (Stable)
NA	Term Loan III	FY2018	MCLR linked rate	FY2025	45.00	[ICRA]AA- (Stable)
NA	Fund Based facilities	NA	NA	NA	95.00	[ICRA]AA- (Stable)
NA	Non Fund Based facilities	NA	NA	NA	34.09	[ICRA]A1+

Source: Sterling Tools Limited

### Annexure-2: List of entities considered for consolidated analysis – Not Applicable

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