

August 10, 2020

Elgi Rubber Company Limited: Long-term rating downgraded to [ICRA]BB; short-term rating reaffirmed; outlook revised to Stable from Negative

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
LT-Foreign Currency Term Loan	USD 4.20 million	USD 3.40 million	
LT-Term Loan	Rs. 49.00 crore	Rs. 33.80 crore	
LT-Fund Based Facility	Rs. 50.00 crore	Rs. 46.50 crore	[ICRA]BB (Stable); revised from [ICRA]BB+ (Negative)
LT-Non-Fund Based Facility	USD 4.21 million	USD 3.70 million	
LT-Non-Fund Based Facility	Rs. 62.68 crore		
LT-Non-Fund Based Facility	EUR 5.90 million	EUR 12.20 million	
ST-Fund Based Facility	Rs. 15.00 crore	Rs. 15.00 crore	[ICRA]A4+; reaffirmed
ST-Fund Based sub limits	Rs. (15.00) crore	Rs. (15.00) crore	
ST-Non-Fund Based Facility	Rs. 18.00 crore	Rs. 18.00 crore	
ST-Non-Fund Based sub limits		Rs. (12.50) crore	
LT/ST- Unallocated Facilities	Rs.0.60 crore	Rs.0.60 crore	[ICRA]BB (Stable)/[ICRA]A4+; revised from [ICRA]BB+ (Negative) /[ICRA]A4+
Total	Rs. 195.28 Crore + USD 8.41 Mn + EUR 5.90 Mn	Rs. 113.90 Crore + USD 7.10 Mn + EUR 12.20 Mn	

*Instrument details are provided in Annexure-1

Rationale

The rating action considers the sustained concern in Elgi Rubber Company Limited's (ERCL) consolidated financial performance. Demand slowdown in the domestic/export automotive industry in 2019 had led to double digit decline in consolidated revenues in FY2020 (by -10.5%) and the subsequent moderation in debt and coverage metrics. ERCL's credit profile will continue to witness pressure in the near term due to the ongoing slowdown in the automotive industry across geographies including India, the USA, Brazil and Netherlands, aggravated by the impact of the pandemic.

At present, ICRA has a Negative outlook for multiple automotive segments including PV and CV segments. The novel coronavirus pandemic and the consequent nationwide lockdown significantly impacted economic activity and disrupted the supply chain. ICRA expects volume decline across most automotive segments in FY2021, with sharp double-digit reduction expected in domestic PV and M&HCV segments. The tractor industry is however expected to register a low single digit growth, supported by rural demand. The trajectory of demand recovery in CV and industrial segments will be a key monitorable for ERCL's credit profile.

The ratings consider ERCL's strong track record of operations and the promoters' vast experience in the tyre re-treading and rubber reclaim business. The company has a well-diversified clientele in the reclaim rubber segment which includes major tyre manufacturers like CEAT Limited, MRF Limited, TVS Sri Chakra Limited, etc. and also has a widespread franchisee network in the re-treading segment. While the ongoing automotive slowdown is likely to weaken the company's performance in FY2021, retreading demand could be supportive to an extent.

The performance of the company's subsidiaries remained subdued in FY2020, which coupled with the capital expenditure undertaken over the years had resulted in high debt levels and stretched debt coverage metrics as of March

2020. Ability of the company to correct the cost structure in key subsidiaries and timely monetisation of its non-core assets will be critical for improvement in its credit profile. Over the past several years, the company has closed/consolidated its overseas subsidiaries, paring down loss making operations. In FY2020, operations in Kenya has also been wound down to pure trading operations. The company continues to focus on exiting loss making overseas operations to return the company to net profits.

Consistent losses over the past six years have eroded the capital structure leading to deteriorating debt metrics. Total Debt/OPBDITA stood at 124.2 times as on March 31, 2020, as against 23.3 times as on March 31, 2019. The company has debt repayment obligations of Rs. 21.9 crore in FY2021, Rs. 33.4 crore in FY2022 and Rs. 30.5 crore FY2023.

Key rating drivers and their description

Credit strengths

Strong promoter profile and franchise network – Mr. Sudarsan Varadaraj, the Chairman and Managing Director of the company has vast experience in the tyre re-treading and rubber reclaim business. The Company operates its re-treading business through a well-established franchise model. ERCL operates over 170 active franchises and generates almost 50% of its domestic revenues and ~25% of its consolidated revenues from the same.

Established and well diversified clientele – The strong track record of the company and more than 35 years of experience in the re-treading business have aided in establishing a strong customer network. Some of the top customers include major tyre manufacturers such as CEAT, MRF and TVS. The company sells reclaim rubber to these companies; this segment accounts for around half of its revenues on the consolidated level.

Credit challenges

Subdued financial profile – Weak financial performance of the foreign subsidiaries had resulted in net losses for the company in recent years (till FY2020). The consolidated losses stood at Rs. 15.2 crore (-4.1% NPM) in FY2020 as against net profit of Rs. 5.8 crore (3.1% NPM) by the standalone entity for FY2020. During FY2020, the company's operating margins for the consolidated entity declined sharply by 240 bps to 0.6% on account of increase in other overhead expenses.

The continuous funding to foreign subsidiaries via external borrowings coupled with debt funded capital expenditure over the years, resulted in high debt levels of Rs. 268.3 crore as on March 31, 2020. Although, the same had declined marginally from Rs. 284.9 crore as on March 31, 2019, it continues to remain high. This along with thin accruals has resulted in stretched coverage indicators with TD/OPBITDA of 124.2 times, interest coverage ratio of 0.1 times and DSCR of 0.6 times for FY2020. Although, interest coverage stood at 0.1 times during FY2020, funds generated from sale of non-core asset during FY2020 of Rs. 12.2 crore had partly supported cash flows. Ability of the company to monetise its non-core assets in a timely manner, reduce the debt levels and improve the profitability remains key rating monitorables.

Slowdown in the domestic/export automobile industry to impact the reclaim rubber division sales – Muted auto demand had impacted ERCL's revenues during FY2020, with consolidated revenues witnessing a de-growth of 10.5%. ERCL derived more than half of its revenues in FY2020 from the overseas markets, primarily from Europe and North America and the remaining from the Indian market (standalone operations). Hence, the company's revenues are vulnerable to the ongoing muted demand scenario in the domestic and global auto industry. However, since around half of the revenues are from the re-treading business, this exposure to replacement demand provides support to an extent.

Fragmented industry structure – The domestic re-treading industry is dominated by the unorganised sector. This is primarily due to the pricing disparity that exists between the organised and unorganised players because of relatively higher overheads of the organised players. However, with the introduction of GST and increasing radialisation of tyres, the organized share is expected to increase going forward.

Liquidity position: Stretched

ERCL has a consolidated debt repayment of Rs. 21.9 crore in FY2021, Rs. 33.4 crore in FY2022 and Rs. 30.5 crore FY2023. The company is focusing on reducing debt levels by monetizing its non-core assets (land) and has plans to monetize land worth ~Rs. 35 crore during FY2021. The company has Rs. 15 crore of undrawn term loans limits and further a buffer of Rs. 9.7 crore (with respect to sanctioned limits) on its working capital limits as on May 31, 2020. With thin cash accruals projected for the near-term, timely monetization of the non-core assets will be a key monitorable.

Rating sensitivities

Positive triggers – An upgrade is unlikely, given the weak global macroeconomic conditions and the negative outlook for the auto industry. However, significant improvement in scale, with sustained improvement in operating margins and debt metrics could lead to an upgrade over the medium term.

Negative triggers – Negative pressure on ERCL's ratings could arise from prolonged impact of the pandemic, leading to weak performance and deterioration in liquidity. Further negative pressure on the rating could emerge with sharp deterioration in the earnings or significant rise in debt beyond the estimates, resulting in moderation of debt coverage metrics.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Auto Component Suppliers
Parent/Group Support	Not Applicable
Consolidation/Standalone	The ratings are based on the consolidated financial profile of the company.

About the company

Elgi Rubber Company Limited (ERCL) is engaged in manufacturing of reclaimed rubber, retreading machinery and retread products. The Company had one domestic subsidiary – Titan Tyre care Products LLP, India and seven foreign subsidiaries in various countries including Netherlands, Brazil, Kenya, USA and Sri Lanka. The company is listed in National Stock Exchange (NSE).

The standalone entity is engaged in the manufacturing of reclaim rubber, tread rubber and bonding gum and other rubber products. ERCL has other rubber, machinery and accessories manufacturing facilities at Annur and Kovilpalayam; tread rubber and bonding gum manufacturing facility at Kuruchi, Coimbatore and Kottayi, Palakkad with a capacity of 1000 tpm. The reclaim rubber is manufactured at manufacturing facilities in Chengalpet and Kanjikode, Palakkad district with a total capacity of ~1000 tpm. Elgi's products are sold under the brands Jet, Pincott, Carbrasive, Midwest Rubber, CRS, Armonas, Westernweld and Ecorr. The Company also has captive windmills of 5MW capacity and an aircraft tyre re-treading facility in Coimbatore.

Key financial indicators

Consolidated	FY2019 (audited)	FY2020 (audited)
Operating Income (Rs. crore)	409.9	366.8
PAT (Rs. crore)	(16.1)	(15.2)
OPBDIT/OI (%)	3.0%	0.6%
PAT/OI (%)	-3.9%	-4.1%
Total Outside Liabilities/Tangible Net Worth (times)	1.4	1.7
Total Debt/OPBDIT (times)	23.3	124.2
Interest Coverage (times)	0.7	0.1

Source: Annual reports; ICRA research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Rating (FY2021)				Rating History for the Past 3 Years					
		Type	Amount Rated	Amount Outstanding (as of June 30, 2020)	Current Rating	FY2020	FY2019		FY2018		
					10-Aug-2020	13-Sep-2019	26-Feb-2019	18-Feb-2019	23 Feb 2018	24 Oct 2017	05 Sep 2017
1	Term Loan Foreign Currency	Long term	USD 3.40 Million	USD 3.40 Million	[ICRA]BB (Stable)	[ICRA]BB+ (Negative)	[ICRA]BBB- (Negative)	[ICRA]BBB- (Negative)	[ICRA]BBB (Negative)	[ICRA]BBB+ (Negative)	[ICRA]BBB+ (Negative)
2	Term Loan	Long term	Rs.33.80 crore	Rs. 33.80 crore	[ICRA]BB (Stable)	[ICRA]BB+ (Negative)	[ICRA]BBB- (Negative)	[ICRA]BBB- (Negative)	-	-	-
3	Cash Credit/ WCDL	Long term	Rs. 46.50 crore	-	[ICRA]BB (Stable)	[ICRA]BB+ (Negative)	[ICRA]BBB- (Negative)	[ICRA]BBB- (Negative)	[ICRA]BBB (Negative)	[ICRA]BBB+ (Negative)	[ICRA]BBB+ (Negative)
4	Bank Guarantee	Long term	USD 3.70 Million	-	[ICRA]BB (Stable)	[ICRA]BB+ (Negative)	[ICRA]BBB- (Negative)	[ICRA]BBB- (Negative)	[ICRA]BBB (Negative)	[ICRA]BBB+ (Negative)	[ICRA]BBB+ (Negative)
5	Bank Guarantee	Long term	Euro 12.20 Million	-	[ICRA]BB (Stable)	[ICRA]BB+ (Negative)	[ICRA]BBB- (Negative)	[ICRA]BBB- (Negative)	[ICRA]BBB (Negative)	[ICRA]BBB+ (Negative)	[ICRA]BBB+ (Negative)
6	Export Packing Credit	Short term	Rs. 15.00 crore	-	[ICRA]A4+	[ICRA]A4+	[ICRA]A3	[ICRA]A3	[ICRA]A3	[ICRA]A2	[ICRA]A2
7	Letter of Credit/BG	Short term	Rs. 18.00 crore	-	[ICRA]A4+	[ICRA]A4+	[ICRA]A3	[ICRA]A3	[ICRA]A3	[ICRA]A2	[ICRA]A2
8	Sublimit	Short term	Rs. 27.50 crore	-	[ICRA]A4+	[ICRA]A4+	[ICRA]A3	[ICRA]A3	[ICRA]A3	[ICRA]A2	[ICRA]A2
9	Unallocated	Long / Short term	Rs. 0.60 crore	-	[ICRA]BB (Stable)/ [ICRA]A4+	[ICRA]BB+ (Negative)/ [ICRA]A4+	[ICRA]BBB- (Negative)/ [ICRA]A3	[ICRA]BBB- (Negative)/ [ICRA]A3	[ICRA]BBB (Negative)/ [ICRA]A3	[ICRA]BBB+ (Negative)/ [ICRA]A2	[ICRA]BBB+ (Negative)/ [ICRA]A2

Amount in Rs. Crore

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 [click here](#)

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	Feb 2016	-	Apr 2023	USD 3.40 Million	[ICRA]BB (Stable)
NA	Term Loan	Apr 2018	-	Jul 2025	Rs. 33.80 crore	[ICRA]BB (Stable)
NA	Cash Credit	-	-	-	Rs. 46.50 crore	[ICRA]BB (Stable)
NA	Bank Guarantee	-	-	-	USD 3.70 Million	[ICRA]BB (Stable)
NA	Bank Guarantee	-	-	-	Euro 12.20 Million	[ICRA]BB (Stable)
NA	Export Packing Credit	-	-	-	Rs. 15.00 crore	[ICRA]A4+
NA	Letter of Credit/BG	-	-	-	Rs. 18.00 crore	[ICRA]A4+
NA	Sub-limit	-	-	-	Rs. 27.50 crore	[ICRA]A4+
NA	Unallocated	-	-	-	Rs. 0.60 crore	[ICRA]BB (Stable)/ [ICRA]A4+

Source: Elgi Rubber Company Limited

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Elgi Rubber Company LLC, USA	100.00%	Full Consolidation
Elgi Rubber Company Limited, Kenya	99.99%	Full Consolidation
Elgi Rubber Company Limited, Sri Lanka	99.99%	Full Consolidation
Treadsdirect Limited, Bangladesh	100.00%	Full Consolidation
Borrachas e Equipamentos Elgi Ltda, Brasil	99.99%	Full Consolidation
Pincott International Pty Limited, Australia	100.00%	Full Consolidation
Titan Tyrecare Products LLP, India	99.99%	Full Consolidation
Elgi Rubber Company Holding BV, Netherlands	100.00%	Full Consolidation

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