

August 25, 2021

## Sterling Tools Limited: Ratings reaffirmed; outlook revised to Stable from Negative

### Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term Loans	58.88	78.88	[ICRA]AA-(Stable); Reaffirmed and outlook revised to Stable from Negative
Long-term Fund-based Facilities (Cash Credit and Packing Credit)	90.00	120.00	[ICRA]AA-(Stable); Reaffirmed and outlook revised to Stable from Negative
Non-fund Based Limits	29.09	2.09	[ICRA]A1+; Reaffirmed
Unallocated	27.70	4.70	[ICRA]A1+; Reaffirmed
<b>Total Bank Lines</b>	<b>205.67</b>	<b>205.67</b>	

\*Instrument details are provided in Annexure-1

### Rationale

The revision in outlook of Sterling Tools Limited (STL) factors in the stabilisation in its operating performance over the past few quarters, post the disruptions brought about by the pandemic and the nationwide lockdown in Q1 FY2021. As the restrictions were lifted gradually over the course of the year, the company reported a significant revival in revenues and profitability, even outpacing the industry growth, and was able to close FY2021 with only a marginal YoY revenue contraction of 3%, despite the sharp 81% contraction reported in Q1 FY2021. The company was also able to improve upon its operating profit margins (OPM) to 17.1% in FY2021 from 16.9% in FY2020, despite the operating losses reported in Q1 FY2021, and commodity headwinds in the latter half of the fiscal. Although the performance weakened sequentially in Q1 FY2022 on account of the second wave of the pandemic, and associated regional lockdowns, the impact has been much less pronounced vis-à-vis the previous year, and recovery is already under way as the infections have abated. Additionally, the new orders gained in the Electric Vehicle (EV) component space for supply of Motor Control Units (MCUs) offers comfort regarding revenue visibility and diversification, going forward.

The ratings continue to factor in STL's established market position as the second largest automotive fastener manufacturer in India, trailing behind only Sundram Fasteners (in terms of revenues). 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). Benefitting from its expertise in developing value-added specialised and critical fasteners for the automotive segment, including those used in engine and transmission systems, the company has become a key development partner for auto OEMs for their fastener requirements. Accordingly, it has been able to improve its SOB with these OEMs, and secure orders from new OEMs over the years.

In addition to its healthy market position, STL's business profile also draws strength from diversified revenue streams, with presence across the automotive segments. In FY2021, the passenger vehicle (PV) segment accounted for 28% of the revenues, followed by commercial vehicles (CV) with 27% share, two-wheelers (2W) with 26% share and tractors with 17%. In terms of geographic exposure, although exports are currently a marginal segment, accounting for 7% of sales in FY2021, the addition of international OEMs such as John Deere and Piaggio over the past year, augurs well for exports over the long term. The customer portfolio is well diversified with its largest customer accounting for only 19% of the total sales and its top five customers contributing less than 55% to its revenues in FY2021.

STL has also, over the years, entered into business collaborations to strengthen its business profile. Its collaboration with the leading Japanese fastener manufacturer, Meidoh (acquired 5% stake in the company in FY2018), has helped the company

improve its product development capabilities for specialised fasteners and foster confidence with its Japanese OEM customers, who currently import a sizeable proportion of their critical fastener requirements.

The company also collaborated with a Chinese company to expand its product portfolio into the EV space in FY2020 and has incorporated a subsidiary, Sterling Gtake E-Mobility Limited (Sterling Gtake) for the same. The entity has already secured its first order for the supply of MCUs to an electric two-wheeler (e2W) OEM in the current fiscal, amounting to Rs. 60 crore and is undertaking discussions with other EV OEMs for further expansion of its presence in the segment. Although incremental revenues from the new product segment are not expected to be sizeable initially, the gradual scale up in the EV business would support both revenue growth as well as diversification, going forward. Moreover, as operations would be restricted to assembly and testing, the quantum of investments is likely to be limited and would not impact credit metrics significantly over the medium term.

Nevertheless, the long-term rating remains constrained by STL's limited product and geographic diversification, in addition to the modest scale of operations. With 93% of its revenues derived from supplies to the domestic markets, it remains exposed to the inherent cyclicity of the market. Additionally, the steep rise in steel prices over recent quarters are likely to emerge as margin headwinds over the near term, if the company is not able to pass on the price increases completely to the OEMs; nevertheless, the company's history of maintaining strong profitability metrics through commodity cycles (albeit with a lag in some cases) offers comfort.

Over the past couple of quarters, the company's reliance on working capital borrowings also increased to some extent on account of the raw material stocking done to counter the volatilities in steel prices and supply. Accordingly, gross debt levels increased to Rs. 105.4 crore as on March 31, 2021 (PY: Rs. 75.0 crore) and have remained elevated at Rs. 88.8 crore as on June 30, 2021. Nevertheless, the company continues to maintain adequate cash and liquid investments (Rs. 31.0 crore as on June 30, 2021), resulting in net debt levels of Rs. 57-60 crore; coupled with healthy operating profitability, credit metrics remain comfortable with gearing of 0.3x, interest cover of 8.0x and TOL/TNW of 0.6x in FY2021. STL's liquidity position is further supported by significant quantum of unutilised working capital facilities (Rs. 50.2 crore as on June 30, 2021) and undrawn term loan of Rs. 30 crore, which remains comfortable vis-à-vis its debt repayment and capex outflow requirements.

The Stable outlook on the long-term rating reflects ICRA's opinion that STL would continue to maintain healthy credit metrics going forward as well, despite some temporary headwinds that may arise from the commodity upcycle and semi-conductor shortage issues. The company is also expected to maintain its healthy liquidity profile, which would support it in navigating any temporary disruptions from further waves of the pandemic, if any.

## Key rating drivers and their description

### Credit strengths

**Positioned as the second largest fastener manufacturer 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), the company has been able to enhance its SOB 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 its market standing over the years.

**Diversified revenue profile across automotive segments; diversified customer profile with healthy share of business with key customers** – 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. PV, accounting for only 28% of its OEM revenues, followed by CV (27%) and 2W (26%). Additionally, the company has been increasing its presence in the tractor segment as well (currently 17% of sales). STL's diversified presence protects its revenues and earnings to some extent from demand downturns that impact only certain segments.

The company caters to multiple OEMs across the automotive spectrum, with healthy SOB with most leading OEMs and limited dependence on a single customer. Its largest customer accounted for 19% of its FY2021 revenues, while its top five customers

contributed less than 55%. 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 prospects 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 expected to improve STL's product development in the fastener space and improve its business prospects with Japanese OEMs. In January 2020, the company also set up a JV with a Chinese company for manufacturing Motor Control Units (MCUs) for EVs, for which it has already started gaining orders, with a Rs. 60-crore order for MCUs won from a leading e2W OEM in July 2021, supporting its entry into the EV component space and diversifying its revenue streams, going forward.

**Healthy financial risk profile with robust profitability and comfortable credit metrics** – Over the years, STL has maintained healthy profitability indicators, with OPM in the range of 16-21%, supported by high share of specialised fasteners, steady realisations and strict control on cost overheads. Additionally, STL maintains a conservative capital structure with low gearing levels and comfortable coverage indicators. Its average working capital utilisation also remains low, with an average buffer of Rs. 46 crore as unutilised limits in the January to June 2021 period. As of March 31, 2021, the gearing ratio was 0.3x and interest cover and DSCR were 8x and 2x, respectively, during the year, despite the pandemic-induced impact on earnings in the first half of the year. Going forward as well, ICRA expects the funding of future capex to be undertaken through internal accruals, minimising the dependence on external borrowings, and helping the entity maintain comfortable credit metrics.

## Credit challenges

**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, some of which have started to materialise, and would augur well for business prospects as well as diversification, going forward.

**Exposed to inherent cyclicity of domestic automotive industry** – With ~80% of STL's revenues derived from supplies to domestic automotive OEMs, it remains exposed to cyclicity in the domestic automobile market. As the domestic auto industry underwent a sharp downturn in FY2020, and the pandemic impacted operations in H1 FY2021, it had significant impact on STL as well, with revenues contracting by 29% and 40% YoY during the periods respectively. However, the situation progressively improved in H2 FY2021 as the domestic automotive market recovered, and the company was able to close FY2021 with only a marginal 3% contraction in revenues.

**Slow ramp up at the Bengaluru 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 production capacity of 500 MT per month. Given the slowdown in the domestic automotive market over the past two years, ramp-up at the plant has been slower than envisaged, which has exerted some pressure on return indicators (ROCE reduced to 9% in FY2021 from 23% in FY2019). With further capacity expansion planned at this plant in the current fiscal, and some continued headwinds from the pandemic, RoCE is expected to remain pressurised over the near term but is expected to improve going forward as operations scale up to optimal levels.

## Liquidity position: Strong

The company has a strong liquidity position, with sufficient amount of funds parked in liquid investments (Rs. 31 crore as on Jun 30, 2021) and sufficient buffer from undrawn working capital limits (Rs. 50 crore as on Jun 30, 2021). Repayment obligations are moderate at Rs. 14-18 crore annually and are expected to be comfortably serviced from internal accruals.

## Rating sensitivities

**Positive factors** – For a rating upgrade, 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.

**Negative factors** – Sustained pressure on revenues and earnings is likely to exert pressure on the ratings. Slower-than-expected ramp up at the greenfield facility with increased reliance on external borrowings, leading to sustained deterioration in profitability and credit metrics with Total Debt/OPBITDA above 1.5 times, could also 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 Suppliers</a>
Parent/Group Support	Not applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of STL. As on March 31, 2021, the company had two subsidiaries and one JV, which are enlisted in Annexure-2.

## About the company

Established in 1979, STL manufactures and markets high tensile cold forged fasteners, primarily for the automobile industry. At present, 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 FY2021, the PV segment was the largest revenue driver with 28% share, followed by the CV (27%) and two-wheeler (26%) segments. 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 (all in Haryana and) has set up its fourth manufacturing plant near Bengaluru (Karnataka) and has a total installed manufacturing capacity of approximately 50,000 MT per annum at its existing plants, with an additional 6,000-MTPA capacity installed at the new facility in Karnataka. The latter is proposed to be increased further by 6,000-MTPA capacity this fiscal.

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 involved in automobile dealerships of Honda Cars India Limited (HCIL) and Harley Davidson.

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

## Key financial indicators (audited)

STL Consolidated	FY2020	FY2021	Q1 FY2022
Operating Income (Rs. crore)	364.2	353.1	89.3
PAT (Rs. crore)	31.1	24.0	3.3
OPBDIT/OI (%)	16.9%	17.1%	13.0%
PAT/OI (%)	8.5%	6.8%	3.7%
Total Outside Liabilities/Tangible Net Worth (times)	0.4	0.6	NA*
Total Debt/OPBDIT (times)	1.2	1.7	NA*
Interest Coverage (times)	9.8	8.0	6.3

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation

\*Balance sheet figures not available for Q1 FY2022

Note: Amount in Rs. crore; All calculations are as per ICRA research

Source: Company Annual Reports, ICRA research

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

## Any other information: None

## Rating history for past three years

	Instrument	Current Rating (FY2022)				Chronology of Rating History for the past 3 years				
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of Jun 30, 2021 (Rs. crore)	Date & Rating in	Date & Rating in FY2021		Date & Rating in FY2020	Date & Rating in FY2019	
						Aug 25, 2021	Jan 7, 2021			May 21, 2020
1	Term Loan	Long Term	78.88	48.97	[ICRA]AA-(Stable)	[ICRA]AA-(Negative)	[ICRA]AA-(Negative)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	
2	Cash Credit	Long Term	120.00	39.81	[ICRA]AA-(Stable)	[ICRA]AA-(Negative)	[ICRA]AA-(Negative)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	
3	Non-fund Based Limits	Short Term	2.09	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	
4	Unallocated	Short Term	4.70	-	[ICRA]A1+	[ICRA]A1+	-	-	-	

## Complexity level of the rated instruments

Instrument	Complexity Indicator
Term Loan	Simple
Cash Credit	Simple
Unallocated	Not Applicable
Non-fund Based Limits	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 analyzing 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, is available on ICRA's website: [www.icra.in](http://www.icra.in)

**Annexure-1: Instrument details**

ISIN No/Banker Name	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. Crore)	Current Rating and Outlook
SBI	Term Loan	FY2022*	MCLR linked	FY2025	6.26	[ICRA]AA- (Stable)
PNB	Term Loan	FY2022*	MCLR linked	FY2024	7.20	[ICRA]AA- (Stable)
HDFC	Term Loan – I	FY2019	MCLR linked	FY2025	30.00	[ICRA]AA- (Stable)
HDFC	Term Loan – II	FY2021	MCLR linked	FY2026	5.42	[ICRA]AA- (Stable)
HDFC	Term Loan – III	FY2022	MCLR linked	FY2027	30.00	[ICRA]AA- (Stable)
SBI	Cash Credit	FY2022*	NA	NA	30.00	[ICRA]AA- (Stable)
HDFC	Cash Credit	FY2021*	NA	NA	30.00	[ICRA]AA- (Stable)
PNB	Cash Credit	FY2022*	NA	NA	30.00	[ICRA]AA- (Stable)
Kotak Mahindra	Cash Credit	FY2022	NA	NA	30.00	[ICRA]AA- (Stable)
SBI	Non-fund Based Limits – Forward Contract	FY2022*	NA	NA	0.14	[ICRA]A1+
PNB	Non-fund Based Limits – BG	FY2022*	NA	NA	0.75	[ICRA]A1+
PNB	Non-fund Based Limits – Forward Contract	FY2022*	NA	NA	1.20	[ICRA]A1+
NA	Unallocated	NA	NA	NA	4.70	[ICRA]A1+

Source: Company \*As per latest renewal date

**Annexure-2: List of entities considered for consolidated analysis**

Company Name	Ownership	Consolidation Approach
Haryana Ispat Private Limited	100.00%	Full Consolidation
Sterling Gtake E-Mobility Limited	99.88%	Full Consolidation
Sterling Fabory India Private Limited	50.00%	Equity Method

Source: Sterling Tools Limited

Note: ICRA has taken a consolidated view of the parent (STL), its subsidiaries and associates while assigning the ratings.

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