April 18, 2023

Virtuoso Optoelectronics Limited: [ICRA]BB+(Stable) assigned

Summary of rating action

Instrument*	Current Rated Amount (Rs. crore)	Rating Action
Long-term – Fund-based Facilities – Cash Credit	53.00	[ICRA]BB+(Stable); assigned
Long-term – Fund-based Facilities – Term Loan	56.22	[ICRA]BB+(Stable); assigned
Long-term – Unallocated	0.78	[ICRA]BB+(Stable); assigned
Total	**110.00**	

**Instrument details are provided in Annexure I*

Rationale

The assigned rating considers Virtuoso Optoelectronics Limited's (VOL) established track record spanning more than seven years in *Electronic Manufacturing Services (EMS)* business, its experienced management team with professional set-up, along with healthy relationship with its reputed client base, resulting in repeat business. The rating factors in the robust growth in the company's scale of operations, depicted by a CAGR of 42% over the last four years, on the back of its entry as a contract manufacturer for Voltas for its room air conditioners (RAC). ICRA notes that VOL has received approvals under the Production Linked Incentive (PLI) scheme announced for the white goods (air conditioners and LEDs), which is likely to support its earnings in the near to medium term, subject to meeting the requisite criteria and timely flow of incentives under the scheme.

The rating is, however, constrained by VOL's exposure to the inherent seasonality in the RAC business, leading to volatility in revenues and profitability. The company requires large working capital for its operations to manufacture and distribute its products due to the seasonality in the RAC industry. It needs to continually invest in building capacities, add new products in its portfolio and integrate backward to meet customer demands and sustain its competitive advantage. The rating is constrained by the company's high product and customer concentration, wherein a single customer/product accounted for ~75% of total revenues in FY2022. The rating factors in VOL's moderate capitalisation and coverage metrics, which are expected to remain range-bound in the near to medium term, given its regular debt-funded capex nature of business and high working capital requirements. Judicious funding of the capex and efficient working capital management are likely to keep the liquidity requirements at manageable levels and remain the key rating sensitivities on an ongoing basis.

The Stable outlook on the rating reflects ICRA's expectation that VOL will continue to benefit from its established relationships with its customers and healthy demand scenario in RAC industry.

Key rating drivers and their description

Credit strengths

Established track record in EMS business and strong management team – VOL has more than seven years of experience in the EMS business. The experienced management team with requisite professional set-up is led by Mr. Sukrit Bharti, its Managing Director. In FY2021, the company has started manufacturing indoor unit and outdoor unit of air conditioners for a customer, which has a leadership position in the AC segment.

Robust growth in scale of operations, coupled with reputed client base – The company's scale of operations witnessed a robust growth with CAGR of 42% over the last four years. Further, it is expected to witness revenue growth of ~60% in FY2023 owing to healthy demand from its key customer in the AC segment. The capacity expansion and healthy demand scenario are likely to drive the revenue growth in the near to medium term. Over the years, VOL has been able to maintain healthy relationship with its reputed client base, resulting in repeat business.

Favourable outlook for the Indian AC Industry supports long-term growth prospects – Increasing urbanisation, climate change and improving standards of living are expected to provide a huge opportunity for AC original equipment manufacturers (OEMs) in the domestic market. In addition, favourable regulatory developments in the recent past, i.e., the PLI scheme for the AC component sector, provide strong growth prospects for the industry over the medium to long term.

Credit challenges

Moderate coverage indicators due to capital-intensive nature of business necessitating regular debt-funded capex – The company has moderate coverage metrics as indicated by total Debt/ OPBDITA of 5.5 times (debt added for bill discounting) and interest coverage of 2.2 times in FY2023. These are likely to remain range-bound in the near to medium term, given its debt-funded expansion plans, which is mandated to support its growth plans. Though the capex is expected to aid in capacity enhancement, VOL's ability to scale up and garner commensurate returns from its planned capex will remain critical for improvement in its coverage metrics, going forward.

Working capital-intensive nature of business – The business remains working capital-intensive by nature, given the elongated receivable cycle. VOL has limited bargaining power with its customers and high inventory pile up during the peak season. The company's fund-based limit remain utilised to the extent of 75% of sanctioned limits for the last 12 months ending February 2023, necessitating working capital needs on a regular basis.

High product and customer concentration risks – The company derives ~75% of its top line from a single product/customer, which exposes it to high product and customer concentration risks. However, VOL plans to diversify its product profile and ultimately its customer concentration, which is expected to mitigate the risk to an extent over medium term.

Exposed to inherent seasonality in AC business – A dominant share of VOL's revenues are derived from the AC segment (~75%), which witnesses seasonal demand (January to June) and remains susceptible to changes in weather conditions.

Environmental and social risks

Environmental considerations – Air conditioner manufacturers remain exposed to tightening government regulations, because of the transition towards a low carbon economy and a consequent push towards energy-efficiency products. This could require increase in investments towards meeting the evolving and tighter regulatory standards. The company is actively working on energy efficiency. It is planning for solar roof top for all its plants to reduce energy consumption. Water recycling is also planned for all plants with zero wastage.

Social considerations – VOL has healthy dependence on human capital with technological expertise needed to design appliances. Hence, retaining human capital, maintaining healthy employee relations and supplier ecosystem remain essential for disruption-free operations. The social risk pertaining to demographics and consumer trend remains generally low, given the increasing demand for air conditioners. The company's ability to execute orders and to obtain new clients also depends on their ability to attract, train, motivate and retain highly skilled professionals, particularly at managerial levels.

Liquidity position: Adequate

The overall liquidity position remains adequate with fund-based limits being utilised at 75% (excluding bill discounting) of the total sanctioned limits for last 12 months ending February 2023, reflecting a buffer of Rs. 9-10 crore. The liquidity position is supported by bill discounting facilities available with the company with average utilisation of 58% in the last 12 months ending February 2023. Further, some comfort can be drawn with enhancement in fund-based working capital limits in March 2023. It has repayment obligations of ~Rs. 11-12 crore in FY2024 and FY2025, which is expected to be covered adequately by the cash accruals. VOL raised Rs. 30 crore through initial public offering in September 2022 and Rs. 35 crore through allotment of preferential equity in January 2023 for capex and working capital requirements, which supports the liquidity profile.

Rating sensitivities

Positive factors – ICRA could upgrade VOL's rating if it demonstrates a significant increase in scale of operations and improvement in profitability leading to healthy cash accruals and improvement in liquidity profile as well as credit metrics. Specific credit metric that could lead to a rating upgrade will be interest coverage of more than 3.0 times on a sustained basis.

Negative factors – Negative pressure on VOL's rating could arise if there is considerable moderation in revenue and profitability, consistent increase in working capital intensity, any large debt-funded capex or decline in profitability resulting in material weakening of the company's liquidity and credit metrics. In addition, any loss of business from a key client, significant slowdown in its key product segments that materially affects its financial performance would be a negative trigger. Specific credit metrics could include interest coverage of less than 2.3 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology
Parent/Group support	NA
Consolidation/Standalone	Standalone

About the company

Incorporated on September 11, 2015 by the Bharati family, the company was originally incorporated as Virtuoso Optoelectronics Private Limited at Nashik, Maharashtra as a private limited entity. Subsequently, it was converted into a public limited company in March 2021 and consequent upon conversion, the name was changed to Virtuoso Optoelectronics Limited. The company started its operation with EMS manufacturing. In FY2021, it started manufacturing indoor and outdoor units for ACs with the help and support of its customers, team and partners. VOL serves under both original equipment manufacturer (OEM) and original design manufacturer (ODM) business models. Under the OEM model, the company manufactures and supplies indoor and outdoor units of AC based on designs developed by their customers. These customers further distribute these products under their own brands. Under the ODM model, in addition to manufacturing, they conceptualise and design the products, which are then marketed to their prospective clients under their brand. Under ODM model, the products includes electronic products and services, home appliances - water heaters and lighting products. However, from April 2023 onwards, the company has hived off water heater business.

In H1 FY2023, VOL had net profit of Rs. 5.2 crore on an OI of Rs. 112.5 crore, against net profits of Rs. 0.9 crore on an OI of Rs. 74.0 crore in H1 FY2022.

Key financial indicators (audited)

	FY2021*	FY2022*
Operating income	115.3	200.2
PAT	2.0	3.9
OPBDIT/OI	10.8%	10.1%
PAT/OI	1.7%	2.0%
Total outside liabilities/Tangible net worth (times)	5.2	6.9
Total debt/OPBDIT (times)	5.8	5.5
Interest coverage (times)	1.7	2.2

*PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs. crore, *Numbers adjusted wherever necessary*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2024)				Chronology of rating history for the past 3 years		
		Type	Amount rated (Rs. crore)	Amount outstanding as of Dec 31, 2022 (Rs. crore)	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021
					April 18, 2023	-	-	-
1	**Long-term – Fund-based Facilities – Cash Credit**	Long term	53.00	-	**[ICRA]BB+(Stable)**	-	-	-
2	**Long-term – Fund-based Facilities – Term Loan**	Long term	56.22	47.17	**[ICRA]BB+(Stable)**	-	-	-
3	**Long-term-Unallocated**	Long term	0.78	-	**[ICRA]BB+(Stable)**	-	-	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term – Fund-based Facilities – Cash Credit	Simple
Long-term – Fund-based Facilities – Term Loan	Simple
Long-term – Unallocated	Not applicable

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	**Long-term – Fund-based Facilities – Cash Credit**	NA	NA	NA	53.00	[ICRA]BB+(Stable)
NA	**Long-term – Fund-based Facilities – Term Loan**	FY2018-FY2023	NA	FY2023-FY2030	56.22	[ICRA]BB+(Stable)
NA	**Long-term – Unallocated**	NA	NA	NA	0.78	[ICRA]BB+(Stable)

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.

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