March 15, 2024

Incap Contract Manufacturing Services Private Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term fund-based – Cash credit	5.00	5.00	[ICRA]BBB+ (Stable); reaffirmed
Long-term fund-based – Term loan	3.45	3.45	[ICRA]BBB+ (Stable); reaffirmed
Short-term – Fund based limits	38.00	38.00	[ICRA]A2; reaffirmed
Short-term – Non-fund based – Letter of credit	5.00	5.00	[ICRA]A2; reaffirmed
Short-term – Non-fund based – Bank guarantee^	(5.00)	(5.00)	[ICRA]A2; reaffirmed
Short-term – Non-fund based – Forward cover	1.55	1.55	[ICRA]A2; reaffirmed
Total	**53.00**	**53.00**	

**Instrument details are provided in Annexure-1; ^sublimit of letter of credit facility*

Rationale

The ratings reaffirmation continues to factor in Incap Contract Manufacturing Services Private Limited's (ICPL) established track record in the electronics manufacturing services (EMS) industry, along with the technical and marketing support provided by the parent company, Incap Corporation, Finland, which has played a critical role in getting new business/customers and expanding footprint in new markets. The ratings also factor in the company's comfortable financial risk profile characterised by healthy profitability and strong debt coverage metrics. The ratings also factor in the company's ability to report profitable operations across business cycles and, thus, remains a credit positive for the company. Moreover, the outlook for the EMS industry over the medium remains favourable, given the Government policies to strengthen the domestic electronics ecosystem.

The ratings, however, remain constrained by competitive nature of the EMS industry, which limits the pricing flexibility and the sector's exposure to the risk of technological obsolescence and regulatory changes. ICPL also remains exposed to foreign currency fluctuations owing to sizeable net exports, which remain unhedged and can exert pressure on margins in case of an appreciation of the rupee. The ratings also consider the company's exposure to sizeable imports of critical input materials like integrated chips and transformers primarily from China, which may result in challenges in their timely availability and exposes ICPL to fluctuations in input materials prices. This can affect the company's margins as well as block the working capital due to the long lead time of delivery, adversely impacting the liquidity. The ratings are also tempered by ICPL's high dependence on a single customer in the power electronics sector, which accounted for ~91% of its revenue in FY2023, exposing it to high sectoral and customer concentration risks. However, the long track record of repeat orders from its largest customer mitigates the customer concentration risk to an extent. Supported by a strong order pipeline from its largest customer, ICPL's top line increased at a compounded annual growth rate (CAGR) of ~46% between FY2018 and FY2023. After reporting an all-time high top line and earnings in FY2023, ICRA notes that a temporary slowdown in order inflows from its largest customer in the current fiscal year has not been adequately compensated by new orders from other customers. This will lead to a significant reduction in the scale of business for ICPL, which will result in a steep sequential contraction in earnings in FY2024. However, the company's earnings will remain healthy on an absolute basis.

The Stable outlook on the [ICRA]BBB+ rating reflects ICRA's opinion that the company's established track record in the EMS business, the favourable industry outlook, along with the company's prudent capital deployment plans are expected to keep its credit risk profile at a comfortable level, going forward.

Key rating drivers and their description

Credit strengths

Established track record in EMS business – ICPL, along with its parent entity, Incap Oyj, Finland has a long track record in the EMS business. The parent has been involved in contract equipment manufacturing for the power electronics sector for over three decades. The company receives technical and marketing support from Incap Oyj, Finalnd and in return pays ~5% of the export revenues and 1% of the total sales as commission to the parent. The key managerial personnel have more than two decades of experience in the electronics contract manufacturing industry. Over the years, ICPL has augmented its manufacturing capacities and increased the share of value-added products, which support its margin.

Comfortable financial risk profile characterised by healthy profitability and strong debt coverage metrics – ICPL's financial risk profile remains comfortable, characterised by healthy profitability as reflected in its core return on capital employed (RoCE) of 44-63% during FY2019-FY2023. The debt coverage indicators remained healthy with an interest coverage of 67.5 times in FY2023 (42.9 times in FY2022). ICRA expects the profitability and debt coverage indicators of the company to remain healthy, going forward.

Ability to report profitable operations across business cycles; favourable industry outlook following Government's thrust on increasing indigenisation in the electronics industry – ICPL has been able to report profitable operations across business cycles, and thus remains a credit positive for the company. The industry outlook for the EMS industry over the medium term remains favourable, given the Government policies to strengthen the domestic electronics ecosystem.

Credit challenges

High customer and sector concentration risks; significant decline in earnings in FY2024 due to slowdown in business from a key customer – Most of ICPL's customers are in the power electronics segment, thereby exposing the company to sector concentration risk. In FY2023, the company derived ~91% of its revenues from a single customer, exposing it to high customer concentration risk as well. However, the long track record of repeat orders from its largest customer mitigates the customer concentration risk to an extent. Supported by a strong order pipeline from its largest customer, ICPL's top line increased at a compounded annual growth rate (CAGR) of ~46% between FY2018 and FY2023. After reporting an all-time high top line and earnings in FY2023, ICRA notes that a temporary slowdown in order inflows from its largest customer in the current fiscal year has not been adequately compensated by new orders from other customers. This will lead to a significant reduction in the scale of business for ICPL, which will result in a steep sequential contraction in earnings in FY2024. However, the company's earnings will remain healthy on an absolute basis.

Stiff competition from other contract manufacturers limits pricing flexibility – ICPL remains a mid-sized player, which faces intense competition in the electronic contract manufacturing services industry. The company is not involved in designing of the PCBs, but only assembles components based on the designs provided by its customers, hence value addition in its operations remains limited. This restricts its pricing flexibility and bargaining power with customers.

Risk of technological obsolescence necessitates continuous upgrade to sustain competitive advantage – The electronic products industry is characterised by continuous product and process innovations, along with rapid adoption of new technology. Given the risk of technological obsolescence, the industry players are required to undertake regular upgrades to sustain the competitive advantage. However, the technical and marketing support provided by the parent company, Incap Corporation, Finland, has played a critical role in new business/ customer acquisition and expanding footprint in new markets. ICRA notes that the royalty/commission paid by ICPL to the parent constrains its profit margins to an extent.

Exposure to foreign currency fluctuation risk – ICPL remains exposed to foreign currency fluctuations owing to sizeable net exports, which remain unhedged and can exert pressure on margins in case of an appreciation of the rupee. The ratings also consider the company's exposure to sizeable imports of critical input materials like integrated chips and transformers, primarily from China, which accounted for approximately 72% of ICPL's raw material requirement in FY2023. This results in challenges in their timely availability and exposes ICPL to fluctuations in input material prices. Further, the company's margins can be affected and working capital blocked due to the long lead time of delivery, adversely impacting the liquidity.

Liquidity position: Adequate

ICPL's liquidity profile remains **adequate**, as reflected in the large free cash/bank balance of ~Rs. 165 crore as of January end 2024. The liquidity is also supported by the company's debt-free status as of end-December 2023 and absence of any major capex/investment plan in the near term.

Rating sensitivities

Positive factors – ICRA may upgrade ICPL's ratings if the company is able to significantly increase its scale of operations and earnings, while maintaining comfortable liquidity and credit metrics.

Negative factors – Pressure on ICPL's ratings may arise if there is an increase in the working capital intensity that results in tightening of the liquidity position. The ratings could also be downgraded if there is a significant decline in the scale of operations, leading to a fall in earnings and consequent deterioration in the leverage position. A specific trigger for a downgrade is if Total Outside Liabilities/Tangible Net Worth (TOL/TNW) is more than 1.5 times, on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	Not Applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the standalone financials of ICPL

About the company

Incorporated in 2007, Incap Contract Manufacturing Services Private Limited (ICPL) provides electronics manufacturing services mainly to companies operating in the power electronics segment. The company, which started its operations by taking over TVS Electronic Limited's contract manufacturing services division, is a 100% subsidiary of Incap OYJ, Finland. It manufactures products based on design specifications given by its customers at its manufacturing facility in Tumkur (near Bengaluru). Its major products are inverters, printed circuit board assemblies (PCBA), uninterruptible power-supply systems (UPS) and emergency rescue devices (ERD). ICPL derives a predominant share of its income through exports to companies based in the Netherlands and Switzerland.

Key financial indicators

ICPL standalone	FY2022 (Audited)	FY2023 (Audited)
Operating income (Rs. crore)	1116.8	1682.4
PAT (Rs. crore)	117.1	188.1
OPBDIT/OI (%)	15.1%	16.0%
PAT/OI (%)	10.5%	11.2%
Total outside liabilities/tangible net worth (times)	1.0	0.7
Total debt/OPBDIT (times)	0.2	0.1
Interest coverage (times)	42.9	67.5

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

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 March 31, 2023 (Rs. crore)	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021
				Mar 15, 2024	Dec 26, 2022	Sep 13, 2021	Jul 16, 2020
1 Cash credit	Long-term	5.00	-	**[ICRA]BBB+ (Stable)**	**[ICRA]BBB+ (Stable)**	**[ICRA]A (Stable)**	**[ICRA]A- (Stable)**
2 Term loan	Long-term	3.45	1.80	**[ICRA]BBB+ (Stable)**	**[ICRA]BBB+ (Stable)**	-	-
3 Fund based	Short-term	38.00	-	**[ICRA]A2**	**[ICRA]A2**	**[ICRA]A2+**	**[ICRA]A2+**
4 Letter of credit	Short-term	5.00	-	**[ICRA]A2**	**[ICRA]A2**	-	-
5 Bank guarantee^	Short-term	(5.00)	-	**[ICRA]A2**	**[ICRA]A2**	-	-
6 Forward cover	Short-term	1.55	-	**[ICRA]A2**	**[ICRA]A2**	-	-

Amount in Rs. Crore; ^sublimit of letter of credit facility

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term fund-based – Cash credit	Simple
Long-term fund-based – Term loan	Simple
Short-term – Fund based	Very Simple
Short-term – Non-fund based – Letter of credit	Very Simple
Short-term – Non-fund based – Bank guarantee^	Very Simple
Short Term – Non-fund based – Forward cover	Very Simple

^sublimit of letter of credit facility

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-1: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	**Cash credit**	NA	NA	NA	5.00	[ICRA]BBB+ (Stable)
NA	**Term Loan**	FY2019	NA	FY2025	3.45	[ICRA]BBB+ (Stable)
NA	**Fund Based Limits**	NA	NA	NA	38.00	[ICRA]A2
NA	**Letter of Credit**	NA	NA	NA	5.00	[ICRA]A2
NA	**Bank Guarantee^**	NA	NA	NA	(5.00)	[ICRA]A2
NA	**Forward Cover**	NA	NA	NA	1.55	[ICRA]A2

Source: Company; ^sublimit of letter of credit facility

Please Click here to view details of lender-wise facilities rated by ICRA

Annexure-2: 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.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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