

January 11, 2017

D&H Secheron Electrodes Pvt. Ltd.

Instrument*	Rated Amount (in crore)	Rating Action
Non-Fund Based Limits	4.00 (reduced from 5.00)	[ICRA]A3; reaffirmed
Fund Based Limits	12.50	[ICRA]BBB- (Stable); reaffirmed
Unallocated Limits	3.50 (enhanced from 2.50)	[ICRA]BBB- (Stable)/A3; reaffirmed
Total	20.00	

*Instrument Details are provided in Annexure-1

Rating Action

ICRA reaffirms the long-term rating at [ICRA]BBB- (pronounced ICRA Triple B Minus)¹ for the Rs. 12.50-crore fund-based facility of D&H Secheron Electrodes Private Limited (DSEPL). ICRA also reaffirms the short-term rating of [ICRA]A3 (pronounced ICRA A Three) for the Rs. 4.00-crore² (reduced from 5 crore) non-fund based bank facilities. ICRA has also reaffirmed the long-term/short-term rating of [ICRA]BBB-/A3 for the Rs. 3.50 crore³ (Enhanced from 2.50 crore) unallocated limits. The outlook on the long-term rating is 'Stable'.

Rationale

The rating action takes into consideration the decline in operating income and net profits, in FY2016, which were, however, accompanied by improvement in operating margins. The working capital intensity also increased in FY2016, which led to almost full utilisation of working capital limits.

ICRA's ratings continue to take into account the long track record of DSEPL in its core business of manufacturing welding consumables and the strong brand image of its products, which resulted in its well-established position in the industry. The ratings also factor in DSEPL's extensive sales distribution network, strong customer base and diversified product portfolio. Further, ratings continue to factor in the company's comfortable capital structure, backed by its healthy net worth.

However, ratings continue to be constrained by the continued deterioration in DSEPL's operational performance, owing to the weakness in the manufacturing sector, which has led to a year-on-year decline in sales. A combination of weak demand and competition from low-cost Chinese products has limited the pricing flexibility of the company, impacting its overall profitability, resulting in a deterioration in its DSCR⁴. ICRA also notes that of the weak return on capital indicators due to modest profitability of core operations and sizeable investments in low return-yielding equity investments; from which significant losses in FY2016 have pulled down the net profitability and cash accruals.

Going forward, DSEPL's ability to grow its scale of operations while improving its margins and retaining its market share in the face of increased competition will remain the key rating sensitivities.

Key rating drivers

Credit Strengths

¹ For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications

² 100 lakh = 1 crore = 10 million

³ 100 lakh = 1 crore = 10 million

⁴ DSCR-Debt Service Coverage Ratio

- Experienced promoters with more than three decades of track record in the welding consumables industry
- Well diversified product portfolio with more than 200 product variants, largely approved by internationally accepted inspection agencies
- Diversified customer profile comprising reputed companies like Larsen & Toubro Ltd, Bharat Heavy Electricals Ltd, Jindal Steel & Power Ltd, Bajaj Auto Ltd, Indian Oil Corp. Ltd, etc. supported by an established distribution network
- Comfortable capital structure with low gearing levels of 0.54 times in FY2016

Credit Weaknesses

- Slowdown in the industry and lack of new projects has affected the operating income of the company adversely in the past two years
- Weak return on capital indicators due to modest profitability of core operations and sizeable investments in low return yielding equity investments
- The company operates in an industry which is highly fragmented in nature, exposing it to stiff competition from both organised as well as unorganised players
- Exposed to fluctuations in the raw material prices such as steel wires, ferro alloys etc, given the highly volatile nature of these products
- Threat from cheaper imports largely from China, which constitute approximately 10-15% of the total industry turnover

Description of key rating drivers highlighted above:

The company mainly focuses on the domestic market due to its strong presence in the industry and dealings with reputed customer base. It consistently derives more than 95% of its total revenue from the domestic markets. Further, the margins improved significantly in FY2016 on account of certain cost reduction measures taken by the company such as procurement of raw material at reduced rates and setting-up of a backward integration unit for crushing of core raw materials, prompt payment to suppliers to receive discounts on purchases etc.

The operating income of the company depicted a declining trend over the past few years due to the economic slowdown and on account of tough market conditions and lack of new projects. The company is exposed to raw material price risk, given the high volatility witnessed in the prices of ferro alloys and steel wires in the past. Since DSEPL particularly caters to a highly competitive and price sensitive market, at times the company is unable to pass on the increased raw material cost to the end users; leading to pressures on its profitability margins. The net profit margin is reduced due to non-operating loss reported to the tune of Rs. 5.38 crore, arising out of a loss on sale of shares, future and options. Significant investment of the company's net worth in equity investments has made the company's profitability vulnerable to any gain/loss arising on such investments.

Analytical approach: Not Applicable

Links to applicable Criteria

Corporate Credit Ratings: A Note on Methodology

About the Company:

DSEPL was incorporated in 1966 as a joint venture between the Switzerland-based 'Secheron' Group and Mr. Dalamal and Mr. Hiranandani. The business was taken over by Mr. Ashok Maheshwari in 1986 after the expiry of the technical collaboration. The promoters and their family members control the entire shareholding. DSEPL manufactures welding consumables such as manual metal arc welding (MMAW) electrodes, submerged arc welding (SAW) wires and flux, flux cored arc welding wires and CO₂ welding wires, at its manufacturing facility in Indore, Madhya Pradesh.

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable
Rating History for last three years:

Table: Rating History

S.No	Name of Instrument	Current Rating			Chronology of Rating History for the past 3 years			
		Type	Rated amount (Rs. Crores)	Month-year & Rating	Month- year & Rating in FY2016	Month- year & Rating in FY2016	Month- year & Rating in FY2014	
				January 2017	December 2015	July 2015	October 2013	
1	Cash Credit	Long Term	12.50	[ICRA]BBB-(Stable)	[ICRA]BBB-(Stable)	[ICRA]BBB-(Stable)	[ICRA]BBB (Stable)	
2	Letter of Credit/ Bank Guarantee	Short Term	4.00	[ICRA]A3	[ICRA]A3	[ICRA]A3	[ICRA]A3+	
3	Unallocated	Long Term/Short Term	3.50	[ICRA]BBB-(Stable)/A3	[ICRA]BBB-(Stable)/A3	-	-	

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

Annexure-1
Details of Instrument

Name of the instrument	Date of issuance	Coupon rate	Maturity Date	Size of the issue (Rs. Cr)	Current Rating and Outlook
Cash Credit	-	-	-	12.50	[ICRA]BBB- (Stable)
Letter of Credit/ Bank Guarantee	-	-	-	4.00	[ICRA]A3
Long Term/ Short Term Unallocated	-	-	-	3.50	[ICRA]BBB- (Stable)/A3

Source: DSEPL's sanction letter

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About ICRA Limited:

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