

March 23, 2017

Elgi Rubber Company Limited

Instruments*	Amount rated	Rating Action
LT-Foreign Currency Term Loan	USD 4.50 Mio	[ICRA]BBB+ (Stable) / downgraded
LT- Fund Based Facility	Rs. 35.00 cr	[ICRA]BBB+ (Stable) / downgraded
LT- Non Fund Based Facility	Rs. 75.16 cr (enhanced from 76.13)	[ICRA]BBB+ (Stable) / downgraded
LT- Non Fund Based Facility	USD 5.85 Mio (revised from 8.35)	[ICRA]BBB+ (Stable) / downgraded
LT- Non Fund Based Facility	EUR 4.50 Mio	[ICRA]BBB+ (Stable) / downgraded
ST-Fund Based Facility	Rs. 15.00 cr	[ICRA]A2 / downgraded
ST-Fund Based sub limits	Rs. 10.00 cr	[ICRA]A2 / downgraded
ST-Non Fund Based Facility	Rs. 18.00 cr (revised from 13.00)	[ICRA]A2 / downgraded
LT/ST- Unallocated facilities	Rs. 0.60 cr	[ICRA]BBB+ (Stable) / [ICRA]A2; downgraded

*Instrument details are provided in Annexure-1

Rating Action

ICRA has downgraded the long term rating outstanding on the USD 4.50 Million foreign currency term loan facility, Rs. 35.00 crore long term fund based facility, Rs. 75.16 crore (revised from Rs. 76.13 crore) long term non fund based facility, USD 5.85 Million (revised from USD 8.35 Million) long term non fund based facility, Euro 4.50 Million long term non fund based facility of Elgi Rubber Company Limited (ERCL/the company)¹ to [ICRA]BBB+ (pronounced ICRA triple B plus) from [ICRA]A- (pronounced ICRA A minus). The outlook on the long term rating has been revised to 'stable' from 'negative'. ICRA has also downgraded the short term rating outstanding on the Rs. 15.00 crore short term fund based facility, Rs. 10.00 crore fund based facility (sub limits) and Rs. 18.00 crore (revised from Rs. 13.0 crore) non fund based facility of ERCL to [ICRA]A2 (pronounced ICRA A two) from [ICRA]A2+ (pronounced ICRA A two plus). For the unallocated facilities totaling Rs. 0.6 crore a rating of [ICRA]BBB+/Stable or [ICRA]A2 would apply contingent upon the tenor of the availed facility.

Rationale

The rating action takes into account the weaker than expected performance and sustained weakening of ERCL's consolidated financial profile on account of persistent losses in foreign operations (USA, Brazil and Netherlands) which together contributed to over ~51% of top line in December 31, 2016. With the commencement of plant operations at its Brazil arm and higher than anticipated revenues from its Netherlands plant with increase in off take from foreign markets has also aided in improved performance during January 2017.

The ratings take note of the fall in demand for reclaim rubber from tyre OEMs and loss of a key butyl rubber customer during FY2014; the company is in the process of renegotiating contracts with new

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

customers. Also, with price cuts in the reclaim and retread accessories, revenues for the consolidated entity marginally increased by 0.7% on YoY basis during 9M FY2017; volumes declined by 28% and tonnage fell by 4% during 9M FY2017 (consolidated). With re-negotiating of contracts and with improvement in foreign operations, the revenue outlook for consolidated entity remains stable.

Operating margins remained stable at Rs. 14.2 crore during 9M FY2017 with reduced power and employee costs on account of retrenchment at its Netherlands plant. While ERCL's standalone profits stood at Rs. 4.0 crore during 9M FY2017, the consolidated entity posted net loss of Rs. 7.7 crore which included Rs. 12.3 crore of non recurring expenses in the form of Voluntary Retirement Scheme (VRS) and one time maintenance of building and machinery amounting contributing to the losses in 9MFY2017. During FY2017 the management has implemented several strategic steps to rationalize costs in its core manufacturing (new global sourcing pattern) and franchisee business (shutting of non-profitable ventures); benefits of the same are expected to accrue over the next two to four quarters.

ERCL's standalone financial profile is characterised by stable cash flows, healthy capital structure of 0.3x as on Mar 31, 2016 and comfortable debt metrics with TD/ OPBTDA at 3.7x and interest coverage of 4.0x during Mar 31, 2016. These strengths are however offset by the group's exposure to loss making entities across geographies; and exposure of margins to fluctuations in currency / natural rubber and butyl rubber price movements. ERCL's consolidated financial profile is relatively weak with capital structure of 0.9x as on Mar 31, 2016 and debt metrics with TD/ OPBTDA at 12.7x and coverage at 1.3x during Mar 31, 2016. The high competitive intensity in a fragmented / unorganized domestic industry has led to considerable uncertainty in the performance of few global subsidiaries. Given large debt repayment obligations of ~Rs. 20.0 crore p.a. (on a consolidated basis in FY2017), and the weak performance of the global subsidiaries, onus of repayment of these loans could fall on the Indian entity which has extended guarantees to several of the loss making subsidiaries.

The ratings continue to factor in the strong track record of the company and its promoters in the retreading and rubber products business, the company's well diversified clientele for reclaim rubber which includes major tyre manufacturers (CEAT, MRF, TVS, JSR, etc) and ERCL's wide spread franchisee network (192 franchisees as on November 30, 2016) in the retreading segment. Further, the prospects for the retreading industry in India are expected to improve going forward driven by increase in radialization in the commercial vehicle tyres segment.

Ability of the group to correct its over-seas cost structure, address supply side issues, expand scale of operations and focus on profitable products / geographies will be critical for improvement in its credit profile.

Key rating drivers

Credit Strengths

- Track record of promoters with extensive experience in the rubber retreading business.
- Strong franchisee network in the Indian retreading segment and brand name in reclaim rubber business
- Established and well diversified clientele which includes major tyre manufacturers in the country (domestic operations) and global tyre majors (through foreign subsidiaries) for reclaimed rubber products and other retreading accessories
- Healthy growth prospects for retreading business in India owing to enabling factors like increase in penetration of radial tyres in Commercial Vehicle segment and expansion of highway network

Credit Weakness

- Several loss making foreign subsidiaries
- Sizable debt repayment obligations for the global subsidiaries exerting stress on the Indian arm which has guaranteed these loans.
- Margins are susceptible to volatility in raw material prices, with the group having limited ability to pass on the costs to customers, especially in the reclaim rubber business
- The industry is fragmented with nearly 70-75% of production in the unorganized sector, where cash and carry nature of competitor operations allows them to aggressively compete on prices
- Environment related regulatory risks which could hamper operations / nudge up operating expenses

Description of key rating drivers highlighted above:

ERCL's Indian operations contributed to over 49% of the top line of the company during 9M FY2017; foreign subsidiaries located in Netherlands, USA and Brazil contributed to the balance 51% of revenues during the same period. Revenues for the consolidated entity marginally increased by 0.7% on YoY basis during 9MFY2017; volumes declined by 28% and tonnage fell by 4% during 9M FY2017 (consolidated). Persistent losses in foreign operation coupled with weak overall demand have impacted the financial profile of the consolidated entity. With re-negotiating of contracts with customers and with improvement in foreign operations, the revenue outlook for consolidated entity remains stable.

Price cut taken by the management due to lower input costs and competitive pressures impacted margins during FY2017; OPM fell to 5.2% in 9m FY2017 from 5.3% in FY2016 (consolidated). The Netherlands entity (40.5% of revenues and 10.4% of losses during 9M FY2017) is expected to become self-sustaining by March 2017; although Brazil and USA would continue to require funding support from Indian operations.

The management has invested in several strategies to rationalize costs during FY2017; benefits of the same are likely to accrue in the medium term. Ability of the group to turnaround its foreign subsidiaries remain critical to improvement in the credit profile of the company.

Ability of the group to correct its over-seas cost structure, address supply side issues, expand scale of operations and focus on profitable products / geographies will be critical for improvement in its credit profile.

Analytical approach:

While arriving at the ratings, ICRA has taken a consolidated view of Elgi Rubber Company Limited along with all its subsidiaries (domestic and global) to arrive at the ratings owing to common management and strong operational and financial linkages between the entities.

Links to applicable Criteria

Corporate Credit Rating - A Note on Methodology

<http://www.icra.in/Files/Articles/2009-October-Rating-Corp-Rating-Methodology.pdf>

Rating Methodology for Auto Component Manufacturers

<http://www.icra.in/Files/Articles/Auto%20Component-June%202016.pdf>

About the Company:

Elgi Rubber Company Limited (ERCL) is engaged in manufacturing of reclaim rubber, retreading products and providing retreading services through its franchisee network. Until FY2015, the company had two domestic subsidiaries – Treadsdirect Limited and Titan Tyrecare Private Limited and eleven foreign subsidiaries in various countries including Netherlands, Australia, Brazil, Kenya, USA, Sri Lanka,

Bangladesh and Mauritius. In FY2015, in order to draw operational benefits, the company via court order dated April 1, 2015 has merged back its domestic operations into ERCL. 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 accessories manufacturing facilities at Annur, Vellalore and Karur; tread rubber and bonding gum manufacturing facility at Kuruchi, Coimbatore with a capacity of 500 tpm. The reclaim rubber is manufactured at manufacturing facilities in Chengalpet, Chennai and Kanjikode, Palakkad district with a total capacity of ~1000 tpm. Elgi's products are sold under the brands Jet, Pincott, Carbrasive, Midwest Rubber and Ecorr. The retread rubber facility operates at over ~99% capacity utilisation and reclaim rubber operates at 100% capacity utilisation. The company also has captive windmills of 5MW capacity and an aircraft tyre retreading facility in Coimbatore.

At the consolidated level, the company reported net loss of Rs. 7.7 crore on an operating income of Rs. 274.9 crore during the nine month period ending December 31, 2016 as against a net loss of Rs. 11.5 crore on an operating income of Rs. 367.1 crore for the financial year ending March 31, 2016, as opposed to a net loss of Rs. 22.4 crore on an operating income of Rs. 439.8 crore for the financial year ending March 31, 2015.

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	Type	Current Rating		Chronology of Rating History for the past 3 years		
			Rated amount	Month - year & rating	Month - year & Rating in FY2016	Month - year & Rating in FY2015	Month - year & Rating in FY2014
1	Term Loan	Long term	USD 4.50 Mio	March 2017 [ICRA]BBB+ (Stable)	June 2016 [ICRA]A- (Negative)	June 2015 [ICRA]A (Stable)	March 2014 [ICRA]A (Stable)
2	Cash Credit	Long term	Rs. 35.0 cr	[ICRA]BBB+ (Stable)	[ICRA]A- (Negative)	[ICRA]A (Stable)	[ICRA]A (Stable)
3	Bank Guarantee	Long term	Rs. 75.16 cr	[ICRA]BBB+ (Stable)	[ICRA]A- (Negative)	[ICRA]A (Stable)	[ICRA]A (Stable)
4	Bank Guarantee	Long term	USD 5.85 Mio	[ICRA]BBB+ (Stable)	[ICRA]A- (Negative)	[ICRA]A (Stable)	[ICRA]A (Stable)
5	Bank Guarantee	Long term	Euro 4.50 Mio	[ICRA]BBB+ (Stable)	[ICRA]A- (Negative)	[ICRA]A (Stable)	[ICRA]A (Stable)
6	Export Packing Credit	Short term	Rs. 15.0 cr	[ICRA]A2	[ICRA]A2+	[ICRA]A1	[ICRA]A1
7	Letter of Credit	Short term	Rs. 18.0 cr	[ICRA]A2	[ICRA]A2+	[ICRA]A1	[ICRA]A1
8	Unallocated	Long/ Short term	Rs. 0.6 cr	[ICRA]BBB+ (Stable)/ [ICRA]A2	[ICRA]A- (Negative)/ [ICRA]A2+	[ICRA]A1	[ICRA]A1

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 Instruments

Name of the instrument	Date of issuance	Coupon rate	Maturity Date	Size of the issue(Rs. Cr)	Current Rating and Outlook
Term Loan	FY2016		FY2022	USD 4.50 Mio	[ICRA]BBB+ (Stable)
Cash Credit				Rs. 35.0 cr	[ICRA]BBB+ (Stable)
Bank Guarantee				Rs. 75.16 cr	[ICRA]BBB+ (Stable)
Bank Guarantee				USD 5.85 Mio	[ICRA]BBB+ (Stable)
Bank Guarantee				Euro 4.50 Mio	[ICRA]BBB+ (Stable)
Export Packing Credit				Rs. 15.0 cr	[ICRA]A2
Inland Letter of Credit/ Bank Guarantee				Rs. 18.0 cr	[ICRA]A2
Unallocated				Rs. 0.6 cr	[ICRA]BBB+ (Stable)/ [ICRA]A2

Source: Company

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