

November 29, 2019

Varun Enterprises: Rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund Based facility (CC/BD)	15.50	15.50	[ICRA]BB- (Stable); reaffirmed
Total	15.50	15.50	

*Instrument details are provided in Annexure-1

Rationale

The rating reaffirmation of Varun Enterprises (VE) takes into account the extensive experience of the promoter and established track record of the firm in wires and cables trading business. The rating factors in VE's long association with reputed electrical product manufacturers like KEI Industries Limited (KEI) and Indo Asian Switchgear Private Limited and benefit derived from being the authorised distributor in Karnataka. The rating also factors in the established relationship with its key customers, which provides stability to revenues, however, the receivables period remains quite stretched. The rating also considers firm's healthy revenue growth in FY2019.

The rating, however, is constrained by the firm's modest scale of operations and low net worth, restricting operational and financial flexibility to some extent. The rating is also constrained by its moderate financial profile, characterised by thin margins (which is inherent to the trading nature of operations), weak capital structure and moderate coverage indicators. The margins of the firm remain exposed to raw material price fluctuations. The rating also factors in the intensely competitive and fragmented nature of the business, which limits the firm's bargaining power as well as pricing flexibility. The rating is also constrained by the inherent risks associated with the proprietorship nature of business, including the risk of capital withdrawal, among others.

The Stable outlook on the [ICRA]BB- rating reflects ICRA's opinion that VE will continue to benefit from the extensive experience of its promoter in the wires and cables trading business and established relationship with its suppliers.

Key rating drivers and their description

Credit strengths

Extensive experience of the promoter in the wires and cables industry – VE's promoter, Mr. Karthik K., has experience of over a decade and the firm has an established presence in the wires and cables trading business. The operations of the firm are mainly concentrated in and around Bengaluru. VE primarily trades in various grades of low-tension cables, control cables and house wires.

Long-term association with suppliers – VE is an authorised distributor of KEI, Hager Electro Private Limited, Jaquar & Company Private Limited and Indo Asian Switchgear Private Limited in Karnataka and has established healthy relationship with its suppliers over the years. The firm is a leading distributor of wires and cables for KEI during the last seven years and accounted for 3.8% of the company's total retail sales in FY2018.

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Established relationship with key customers – The firm has healthy relationship with over 300 customers, resulting in repeat orders, which provide stability to revenues. The major customers of the firm include reputed property developers and electrical contractors based out of Bengaluru. With a stretched receivables period in the last four years, timely realisation of payment from its customers that undertake transmission/distribution projects for state utilities remains critical, going forward. With a diversified customer profile, the concentration remains moderate with the top-five customers accounting for ~43% of revenue in FY2019.

Improved scale of operations – The company registered a healthy revenue growth in the last three fiscals including FY2019. The operating income grew by 29.4% in FY2019 and 17.3% in FY2018 on account of an increase in demand from end user industry.

Credit challenges

Modest scale of operations – The firm's existing scale of operations is modest with an operating income of Rs. 60.0 crore in FY2020, restricting operational and financial flexibility to some extent. The firm's net worth base has remained modest owing to thin accruals over the years.

Leverage capital structure and moderate coverage indicators – The firm's total debt stood at 13.9 crore as on March 31, 2019, comprising working capital borrowings, vehicle loan and channel finance. Owing to high debt levels, STPL's gearing was high at 2.9 times and other coverage indicators remained weak as depicted by interest coverage of 1.8 times, DSCR of 1.5 times and TD/OPBITDA of 6.5 times as on March 31, 2019.

Margins remain thin and exposed to fluctuation in raw material prices – The operating profit margin of the firm has been inherently low due to low value additive nature of the business. In the absence of any fixed price agreements with its suppliers or customers, the firm's profitability remains vulnerable to fluctuation in raw-material prices which in turn is dependent on copper and aluminum prices. However, low inventory holding of the company mitigates the commodity price fluctuation risk to a large extent.

Intense competition in a highly fragmented industry limits bargaining power – The wire and cable industry remain intensely competitive and commoditised, restricting the pricing flexibility of players operating in the industry. The industry is also highly fragmented with several established players, thereby limiting the firm's bargaining power.

Inherent risks associated with the proprietorship nature of the business – The firm is exposed to risks associated with a proprietorship concern including limited ability to raise capital, capital withdrawal risks besides others, that could adversely impact the capital structure.

Liquidity position: Adequate

VE's liquidity is **adequate** with low term loan repayment obligation is Rs. 0.17 crore for next two fiscals. The firm has also availed Rs. 3.00 crore SODH facility from Syndicate Bank and the firm has a high average utilisation of 80% for the period covering April 2018 to March 2019. The company has also availed channel finance facility from Corporation Bank of Rs. 12.50 crore and they are utilizing 88% of the limit as March 31, 2019. The firm's unencumbered cash is low at Rs. 0.33 lakhs as on March 31, 2019.

Rating sensitivities

Positive triggers – ICRA could upgrade Varun’s rating if the firm demonstrates a sustained improvement in its scale and profitability margin while maintaining a comfortable liquidity position. Specific credit metrics that could lead to an upgrade of Varun’s rating include (1) Total Debt/ OPBITDA below 5 times on a sustained basis and (2) Interest coverage of more than 2.5 times on a sustained basis.

Negative triggers – Negative pressure on Varun’s rating could arise if, for reasons there is a decline in revenue and margins and deterioration in liquidity. A weakening in interest coverage to below 1.5 times could also exert negative pressure on the company's rating.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	NA
Consolidation/Standalone	The rating is based on standalone financial statements

About the company

Incorporated in 2009, Varun Enterprises is a proprietorship concern, managed by Mr. Karthik K, who has experience of more than a decade in the trading business. The firm trades in cables, wires and other electrical products and is an authorised distributor of KEI Industries Limited, Hager Electro Private Limited, Jaquar & Company Private Limited and Indo Asian Switchgear Private Limited in Karnataka. Its customers primarily include electrical contractors and property developers based in Bengaluru.

In FY2019, the firm reported a net profit of Rs. 0.5 crore on an operating income of Rs. 60.0 crore compared to a net profit of Rs. 0.7 crore on an operating income of Rs. 46.4 crore in the previous year.

Key financial indicators (audited)

	FY2018	FY2019
Operating Income (Rs. crore)	46.4	60.0
PAT (Rs. crore)	0.7	0.5
OPBDIT/OI (%)	4.4	3.5
RoCE (%)	14.1	10.5
Total Outside Liabilities/Tangible Net Worth (times)	3.2	3.7
Total Debt/OPBDIT (times)	6.1	6.5
Interest Coverage (times)	2.2	1.8
DSCR	1.8	1.5

Source: VE

Status of non-cooperation with previous CRA: NA

Any other information: None

Rating history for past three years

Instrument	Current Rating (FY2020)				Rating History for the Past 3 Years		
	Type	Amount Rated	Amount Outstanding	Rating 29-Nov-2019	FY2019 31-May-2018	FY2018	FY2017
Fund-based facilities (CC/BD)	Long Term	15.50	-	[ICRA]BB-(Stable)	[ICRA]BB-(Stable)	-	-

Amount in Rs. crore

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: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	SODH	NA	NA	NA	3.00	[ICRA]BB-(Stable)
NA	Channel Finance	NA	NA	NA	12.50	[ICRA]BB-(Stable)

Source: VE

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