

January 23, 2020

DH Limited: Change in rated limits

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based Cash Credit	7.0	7.0	[ICRA]BB+(Stable); Outstanding
Non-fund Based limits	10.0	10.0	[ICRA]A4+; Outstanding
Unallocated	30.50	18.0	[ICRA]A4+; Outstanding
Total	47.50	35.0	

*Instrument details are provided in Annexure-1

Rationale

The outstanding rating factors in the fluctuating demand trend that led to weak order inflows, particularly in FY2019, resulting in a decline in DH Limited's (DHL) scale of operations. This led to a significant decline in operating profits. High non-operating income aided net profits to some extent. The ratings are also constrained by the vulnerability of DHL's profitability to raw material price fluctuations and the typically lengthy project tenors. The rating is also constrained by the company's elongated working capital cycle owing to the long manufacturing and commissioning lead time and slow receivables realisation. ICRA further takes note of the stiff competition from bigger players.

However, the rating continues to positively factor in the technical expertise of the promoters operating in a niche market with collective experience of more than five decades in the defence equipment industry. ICRA takes comfort from the limited counterparty risk as the clientele primarily constitutes the Ministry of Defence (MoD), Government of India (GoI) and other Government-backed agencies. The ratings also positively factor in the company's healthy debt coverage metrics and adequate liquidity position.

The Stable outlook on the [ICRA]BB+ rating reflects ICRA's opinion that DHL will continue to benefit from its experienced promoters and its technical expertise in manufacturing defence-related products.

Key rating drivers and their description

Credit strengths

Technical expertise in niche segment; experience of more than five decades in defence equipment industry – The company forayed into manufacturing specialised systems for defence forces. In the recent years, it has gained specialisation in manufacturing different types of field shelters and masts to cater to the growing demand. DHL is one of the few approved vendors for the forces, which along with its track record has established its position in its product segments. It is a value-additive business and commands healthy margins. Further, DHL is involved in consistent research and development (R&D) to constantly innovate and improve.

Comfortable debt coverage and liquidity profile – DHL's margins have been high due to its presence in a niche segment. Further, its low debt and absence of any long-term debt repayment obligations have resulted in comfortable debt coverage metrics. The comfortable debt coverage indicators are characterised by healthy interest coverage of 4.81 times and TOL/TNW of 0.42 times as on March 31, 2019. This apart, DHL's liquidity is healthy due to the presence of unencumbered liquid investments of Rs. 6.23 crore as on the same date. The liquidity is also aided by unutilised

sanctioned limits and support from promoters through unsecured loans. Moreover, the working capital intensity remained comfortable at 7.64% in FY2019.

Limited counterparty risk – The company’s buyers include MoD, Defence Research Development Organisation (DRDO) and public-sector undertakings (PSUs) like Bharat Electronics Ltd (BEL), Electronics Corporation of India (ECIL), etc. Therefore, the counterparty risk is low. The payments might get delayed, but are generally secure. This apart, DHL takes sub-contractual work from bigger private players, apart from Government agencies, which provides further comfort to DHL.

Credit challenges

Declining scale of operations – The company faced slowing demand for the products and also witnessed delays in commissioning and installing its completed projects, which eventually delayed the billing for the executed projects. Since the final nod for commissioning comes from the Government and its agencies, depending upon the status of funds, there can be delays in the final commissioning of the project. However, the order book build-up has improved in Q3 FY2020.

Vulnerability to raw material price fluctuations amid stiff competition – With no hedging mechanism in place, the fluctuations in raw material prices is a threat to the company’s profitability. The tenor of the projects is generally lengthy, given the various client approvals and commissioning involved. This accentuates the risk of raw material price fluctuations. The company also faces stiff competition from bigger players.

Fluctuating working capital cycle with high inventory levels and varying receivable – DHL’s working capital cycle is long and there is high dependency upon the Government and other related agencies for the final nod on commissioning and release of payments, though there was an improvement in FY2019 due to early revenue booking and limited revenue realised in the last quarter of FY2019. The receivables cycle is also susceptible to various inspections and approvals, which may take varying time, differing from agency to agency. The inventory levels are high at times, as the inventory days include transportation, installation and commissioning time. The installation and commissioning period are subject to various other factors, including terrain of the site and complexity of the product.

Liquidity position: Adequate

On account of lower utilisations in the cash credit and substantial amount of unencumbered cash and liquid investments, the liquidity is **adequate**. The liquidity is further aided by the support from the promoters in terms of the unsecured loans and advance payments made by the clients during the course of execution of the order.

Rating sensitivities

Positive trigger: The rating might be upgraded if there is sustainable improvement in order book execution and order book inflow, resulting in increasing revenues on a sustained basis. The ability to sustain profitability amid weak order inflow might also result in an upgrade.

Negative trigger: The ratings might be downgraded if there are delays in the execution of order book resulting in further reduced scale of operations. Build-up in the receivables resulting in deterioration of working capital intensity might also trigger a downgrade.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	Not applicable
Standalone	Standalone

About the company

DHL was incorporated as Dass Hitachi Limited in 1960, a joint venture with Hitachi Limited of Japan, for the manufacture of watt-hour meters. The company continued with manufacturing of electric meters till 1994. Thereafter, due to delayed payments from state electricity boards, the company discontinued manufacturing electric meters. Over the years it has diversified into other products like cableway systems and specialised systems for the defence forces. At present, DHL caters to the requirements of the Indian Army and manufactures products like shelters and masts. The company owns 12.5 acres of land in Sahibabad, Uttar Pradesh, which is used for its manufacturing and testing operations.

Key financial indicators (audited)

	FY2018	FY2019
Operating Income (Rs. crore)	81.33	30.77
PAT (Rs. crore)	9.27	4.33
OPBDIT/OI (%)	17.22%	12.50%
RoCE (%)	42.27%	19.36%
Total Outside Liabilities/Tangible Net Worth (times)	1.47	0.42
Total Debt/OPBDITA (times)	0.91	1.43
Interest Coverage (times)	6.60	4.81
DSCR	5.40	2.65

Source: DH Limited

Status of non-cooperation with previous CRA: Not applicable

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			FY2019	FY2018	FY2017
					23-January-20	17-December-19	30-August-19	-	19-February-18	-
1	Fund based	Long term	7.0	-	[ICRA]BB+ (Stable)	[ICRA]BB+ (Stable); removed from 'issuer not cooperating' category	[ICRA]BBB- (Stable); ISSUER NOT COOPERATING	-	[ICRA]BBB- (Stable)	-
2	Non- fund based	Short term	10.0	-	[ICRA]A4+	[ICRA]A4+; removed from 'issuer not cooperating' category	[ICRA]A3; ISSUER NOT COOPERATING	-	[ICRA]A3	-
3	Unallocated	Short term	18.0	-	[ICRA]A4+	[ICRA]A4+; removed from 'issuer not cooperating' category	[ICRA]A3; ISSUER NOT COOPERATING	-	[ICRA]A3	-

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	Fund based	NA	NA	-	7.0	[ICRA]BB+(Stable)
NA	Non- fund based	NA	NA	-	10.0	[ICRA]A4+
NA	Unallocated	NA	NA	-	18.0	[ICRA]A4+

Source: DHL

Annexure-2: List of entities considered for consolidated analysis: Not Applicable

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