

October 23, 2020

SAC Engine Components Private Limited: Ratings reaffirmed

Summary of rated action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long Term - Term Loans	50.00	50.00	[ICRA]A- (Negative); reaffirmed
Long Term - Fund based CC	45.00	45.00	
Short Term - Unallocated	4.42	4.42	[ICRA]A2+; reaffirmed
Total	99.42	99.42	

*Instrument details are provided in Annexure-1;

Rationale

The reaffirmation of ratings consider SAC Engine Components Private Limited's (SAC) established track record in manufacturing camshafts and tappets, promoter's vast industry experience and reputed client base. The ratings also consider SAC's healthy market position in the camshaft industry, diversified revenue profile across end-user segments and balanced revenue mix with blend of auto and non-auto segments, geographical mix (38% exports) and improving demand from domestic tractor segment (accounts for ~37% of revenues in FY2020). SAC's debt protection metrics are comfortable with gearing of 0.8 times, total debt / OPBITDA of 1.2 times and interest coverage ratio of 5.6 times in FY2020.

The ratings are however constrained by the expectation of moderation in SAC's financial profile during FY2021 due to the impact of Covid-19 pandemic on Indian auto component industry and weak demand outlook for domestic/global automotive and construction equipment segments, from which SAC derives over half of its revenues. The pandemic led lockdown had significantly impacted economic activity and disrupted the supply chain. The ratings also consider SAC's vulnerability of earnings to the fluctuations in input prices, product and customer concentration risks, although the same are mitigated by wide end-use potential for its product portfolio and the long-standing relationship with its clientele.

ICRA has a negative outlook on the domestic automotive industry in FY2021 with double-digit growth decline in passenger vehicle (PV) and commercial vehicle (CV) segments. The tractor industry is, however, expected to register a single-digit growth, supported by favourable rural demand. While the improving tractor demand is a positive, the trajectory of demand recovery in PV, CV and industrial segments will be a key monitorable for SAC's performance.

While the strength of the eventual recovery will be contingent on the duration and breadth of the pandemic before an eventual containment, a relatively prolonged period of curtailed automotive demand, as the consumer stays wary of large capital commitments is likely. Given the environment, the liquidity cushion between the cash balances and available lines of credit and debt servicing requirements is a key rating driver. ICRA notes that the company had availed phase-I (March – May 2020) moratorium on payments of principal and interest on its term loans from its lenders as a part of the Covid-19 Regulatory Package announced by the Reserve Bank of India (RBI) on March 27, 2020. With the operations affected during the lockdown, SAC had primarily relied on customer collections, additional credit line of Rs. 4.5 crore from its lenders and working capital buffer for servicing its fixed costs and payments to vendors. Post the lockdowns in March and April 2020, the company's operations have normalised in recent months.

SAC's financial performance in FY2020 was weaker than expectations; its revenue de-grew by 16.5% YoY to Rs. 226.4 crore in FY2020 due to weak order execution, non-materialization of few orders and logistic related disruptions in Q4 FY2020 due to Covid-19. The revenue moderation accordingly resulted in weaker absorption of fixed costs and

consequently resulting contraction of operating margins by 700bps YoY in FY2020. Moreover, the company has also been incurring sizeable capex over the last three years (over Rs.100 crore), which had been partly debt funded. Accordingly, the coverage indicators posted moderation with TD/OPBITDA moderating from 1.2 times in FY2019 to 2.0 times in FY2020 and interest cover moderating from 9.4 times in FY2019 to 5.6 times in FY2020. The company has debt repayment obligations of ~Rs. 14 crore per annum over the next two to three years.

Key rating drivers and their description

Credit strengths

Promoter's vast experience lends business stability - Incorporated in 1991, SAC has a long track record of manufacturing critical engine components for automobile industry. The promoters have four decades of experience in the engineering and automotive industry and have been supported by a well-qualified and experienced management team.

One of the leading camshaft manufacturers in South India catering to reputed clientele - SAC's business risk profile is strong with its established market position in the safety critical camshaft market, tappets and rocker arms. SAC generates over three-fourths of its revenue from camshaft casting including both machined and semi-finished camshafts; while the balance is from tappets and rocker arms during FY2020. With presence of over three decades, SAC has developed strong relationships with Original Equipment Manufacturers, both within domestic and international markets. Key customers include Mahindra and Mahindra Limited, JCB India Limited, Simpson and Co., Perkins Engines Company Limited etc.

Diversified end-user segment mix consisting of both automotive and non-automotive segments – SAC has a diversified revenue profile with presence across the automotive and non-automotive industry. While the bulk of its revenues came from the tractor (36.5%) and utility vehicle (27.2%) segments in FY2020, SAC's product mix remains diversified across commercial vehicles (CV), off the road (OTR) vehicles, power generators and two-wheelers. Going forward, the diversified segment profile along with SAC's established relationship with major OEMs and 100% share of business of served models in automotive segment are expected to support its revenues.

Credit challenges

Covid-19 pandemic and demand slowdown to impact revenues in FY2021 – Muted auto demand had impacted SAC's revenues during FY2020, with revenues witnessing a de-growth of 16.5% SAC derived more than half of its revenues in FY2020 from automotive and construction equipment industries. SAC's revenues remain vulnerable to the vagaries in domestic and global auto industry. However, the impact of ongoing slowdown is cushioned by the fact the company derives about a third of its revenues from the tractor segment (wherein current demand is supported by rural demand) and presence of diversified end-user segments like non-automotive segments like stationary engines, generators, etc.

Product and client concentration risks – With over three-fourths of its revenues derived from a single product – camshafts – SAC remains exposed to product concentration risks. Moreover, the company derives over half of its revenues from top three customers. However, the same is mitigated by the fact the product is a critical product, has diversified end-use applications and the presence of long-standing relationship with reputed client base.

Vulnerability of revenues and profitability to cyclical trends in automobile industry - Camshaft is a critical component that is necessary for the functioning of an engine and hence any cyclicity in automobile demand has an impact on the auto ancillary demand. The demand scenario is impacted by general economic or industry conditions, including seasonal trends in the automobile manufacturing sector, volatile fuel prices, rising employee expenses and challenges in

maintaining amicable labour relations as well as evolving regulatory requirements, government initiatives, trade agreements, etc.

Liquidity Position: Adequate

SAC's liquidity position is **adequate** and is supported by healthy accruals (~Rs.30 crore per annum). It has debt repayment obligations of Rs ~14 crore per annum over the medium term and is estimated to spend a capex of ~Rs. 25 crore per annum over FY2021 to FY2023. The capex will be funded through a combination of fresh term loans and internal accruals. ICRA expects the company to be able to meet its near-term commitments through internal as well as external sources of funds. Working capital utilisation has remained at elevated levels with limited buffer on sanction limits - average utilisation for the past 13-months ended July 2020 stood at 81% of the sanctioned limits. The company has also availed a covid line of Rs. 4.5 crore to buffer its liquidity position.

Rating sensitivities

Positive triggers – Given the current Negative outlook, a rating upgrade is less likely in the near term. ICRA could change the outlook to 'Stable' if the company demonstrates sharp growth in its scale with diversified client base, stable growth in earnings and improvement in liquidity profile.

Negative triggers – Negative pressure on the ratings could emerge with sharp deterioration in the scale of operations owing to longer than expected slowdown in demand or significant debt-funded capex leading to deterioration in credit profile or deterioration in liquidity profile. Specific credit metrics that could lead to a rating downgrade include DSCR of less than 1.8 times or RoCE less than 15% on a sustained basis.

Analytical approach:

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating methodology for auto component suppliers
Parent/Group Support	NA
Consolidation / Standalone	Standalone

About the company

SAC Engine Components Private Limited (SAC), established in the year 1986 as a partnership firm and incorporated in 1991 as Southern Auto Castings Private Limited, manufactures raw/ machined castings targeting the automotive industry and power generation sector. SAC is a tier I/II auto component manufacturer supplying to major auto OEMs and auto ancillaries both in the domestic and global markets. The company manufactures camshafts, valve tappets (cam followers) and rocker arms for diesel and gasoline engines in specialized grey iron, ductile iron and hardened iron/ steel. The company changed its name to SAC Engine Components Private Limited in FY2011, to differentiate itself from generic foundries and to position itself as an engine component manufacturer. SAC has three manufacturing units (one foundry and two machining) and one more manufacturing unit for machining is set up in the SIPCOT Industrial Complex (government promoted) in Thiruvallur district near Chennai, Tamil Nadu and has employee strength of ~1,300 without any unions.

Key financial indicators

	FY2019	FY2020
Operating Income (Rs. crore)	271.1	226.4
PAT (Rs. crore)	33.6	17.2
OPBDIT/OI (%)	26.7%	19.7%
RoCE (%)	36.6%	15.3%
Total outside liabilities/Tangible Net Worth (times)	1.5	1.2
Total Debt/OPBDIT (times)	1.2	2.0
Interest coverage (times)	9.4	5.6
DSCR	3.2	1.9

Source: company

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

Instrument	Type	Current Rating (FY2021)		Chronology of Rating History for the past 3 years				
		Amount Rated (Rs. crore)	Amount Outstanding 31/3/20 (Rs Crore)	Date & Rating		Date & Rating in FY2020	Date & Rating in FY2019	Date & Rating in FY2018
				23 Oct 2020	June 01, 2020	13 Sep 2019	28 Sep 2018	09 Oct 2017
1 Fund-based facilities CC	Long Term	45.0	-	[ICRA]A-/Negative	[ICRA]A-/Negative	[ICRA]A-/Stable	[ICRA]A-/Stable	[ICRA]BBB+/Stable
2 Term Loan	Long Term	50.0	51.6	[ICRA]A-/Negative	[ICRA]A-/Negative	[ICRA]A-/Stable	[ICRA]A-/Stable	[ICRA]BBB+/Stable
3 Unallocated	Short Term	4.42	-	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+	[ICRA]A2

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 No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Long Term: Fund based facilities CC	-	-	-	45.00	
NA	Term Loan II	FY2019	-	FY2020	2.66	
NA	Term Loan III	FY2019	-	FY2022	7.28	
NA	Term Loan IV	FY2019	-	FY2020	1.03	
NA	Term Loan V	FY2019	-	FY2024	10.61	
NA	Term Loan VI	FY2019	-	FY2025	4.13	
NA	Term Loan VI (1)	FY2019	-	FY2025	2.75	
NA	Term Loan VI (2)	FY2019	-	FY2025	2.36	[ICRA]A-/ Negative
NA	Term Loan VI (3)	FY2019	-	FY2025	2.24	
NA	Term Loan VI (4)	FY2019	-	FY2025	0.61	
NA	Term Loan VI (5)	FY2019	-	FY2025	0.97	
NA	Term Loan VI (6)	FY2019	-	FY2025	3.42	
NA	Term Loan VI (7)	FY2019	-	FY2025	5.51	
NA	Term Loan VI (8)	FY2019	-	FY2025	4.61	
NA	Unallocated term loan	-	-	-	1.82	
NA	Short Term: Unallocated	-	-	-	4.42	[ICRA]A2+

Source: SAC Engine components P Ltd

ANALYST CONTACTS

Subrata Ray

+91 22 6114 3408

subrata@icraindia.com

K Srikumar

+91 44 4596 4318

ksrikumar@icraindia.com

Nareshkumar N

+91 44 4596 4313

nareshkumar.n@icraindia.com

RELATIONSHIP CONTACT

Jayanta Chatterjee

+91 80 4332 6401

jayantac@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani

Tel: +91 124 4545 860

communications@icraindia.com

Helpline for business queries:

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

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For more information, visit www.icra.in

ICRA Limited

Corporate Office

Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002

Tel: +91 124 4545300

Email: info@icraindia.com

Website: www.icra.in

Registered Office

1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001

Tel: +91 11 23357940-50

Branches

Mumbai + (91 22) 24331046/53/62/74/86/87

Chennai + (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,

Kolkata + (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008,

Bangalore + (91 80) 2559 7401/4049

Ahmedabad+ (91 79) 2658 4924/5049/2008

Hyderabad + (91 40) 2373 5061/7251

Pune + (91 20) 2556 0194/ 6606 9999

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