December 06, 2022

Veljan Denison Limited: Rating reaffirmed; outlook revised to Positive from Stable

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund based – Cash credit	32.00	20.25	[ICRA]BBB+ (Positive) reaffirmed; outlook changed to Positive from Stable
Bank guarantee	7.00	3.00	[ICRA]BBB+ (Positive) reaffirmed; outlook changed to Positive from Stable
Letter of credit	6.00	10.00	[ICRA]A2; reaffirmed
Unallocated	12.00	23.75	[ICRA]BBB+ (Positive) reaffirmed; outlook changed to Positive from Stable
Total	**57.00**	**57.00**	

**Instrument details are provided in Annexure-I*

Rationale

The revision in the outlook on the long-term rating of Veljan Denison Limited (VDL) factors in ICRA's expectation of the company registering a steady revenue growth, while maintaining healthy profit margins, robust debt protection metrics and a strong liquidity position. The revenue growth is to be aided by increased order inflows from the domestic market and sales from the recently acquired subsidiary Adan Holdings Limited. The operating income improved by 33% to Rs. 97.85 crore in FY2022 from Rs. 73.57 crore in FY2021. Further, the revenues increased to Rs. 57.09 crore in H1 FY2023 from Rs. 42.66 crore in H1 FY2022.

The ratings positively factor in the established track record of VDL as a manufacturer of hydraulic pumps, valves and power pack systems, and its comfortable capital structure and healthy coverage indicators with negligible debt levels. The ratings also factor in VDL's diversified customer base comprising both domestic and overseas customers.

The ratings are, however, constrained by the company's moderate scale of operations with VDL's revenues remaining at sub-Rs. 100 crore levels in the last five years owing to intense competition from cheaper imports and demand linked to capital expenditure across industries. The ratings also take into account the high working capital intensity owing to the high debtor and inventory days, though there have been some improvement in the receivables cycle in FY2022 and H1 FY2023. Also, the profitability is susceptible to volatility in raw material prices.

Key rating drivers and their description

Credit strengths

Long track record in manufacturing hydraulic pumps and valves – VDL has more than five decades of experience in manufacturing vane-based hydraulic pumps, valves and power pack systems. The company's customer base is geographically diversified as VDL caters to around 250 customers, domestically and internationally. Over these years, the company has been able to forge strong relationship with reputed OEMs. The company acquired a 100% shareholding in Adan Holdings Limited, England and Wales, in August 2022, mainly to support revenue growth and market reach.

Healthy operating profit margins – The operating profit margins had remained healthy at ~24-28% in the last five years (except for FY2021) because of VDL's presence in the niche hydraulic pump manufacturing segment. The company's operating profit margins improved to 26.2% in FY2022 from 18.29% in FY2021 owing to a benefit of inventory holding in increasing prices reign along with the economies of the scale. However, the operating profit margin moderated to 23.67% in 6M FY2023 owing to the increase in raw material prices.

Comfortable capital structure and moderate debt metrics - VDL's capital structure remains comfortable, characterised by a gearing of 0.04 times as on March 31, 2022 and 0.3 times as on September 30, 2022. Healthy profitability levels coupled with low dependence on debt ensured that the coverage indicators remained robust as seen in an interest coverage of 111 times and TD/OPBDITA of 0.27 times in FY2022. Despite the expected addition of debt for the envisaged capex over the medium term, the capital structure and debt coverage metrics are expected to remain healthy.

Credit challenges

High working capital intensity – VDL's working capital intensity remained elevated, as indicated by NWC/OI of 69% in FY2022; though it improved from 81% in the last fiscal. The elevated working capital intensity is primarily driven by the high inventory holdings (~262 days in FY2022) and high debtor days (~123 days in FY2022). The company keeps an inventory of major raw materials like castings and steel owing to the long lead time in procurement. Notwithstanding this, the liquidity position is comfortable with free cash and bank balance of Rs. 37.12 crore as on March 31, 2022 and negligible utilisation of the working capital limits. The high working capital intensity of operations kept the core RoCE at modest levels of around ~17.04% in FY2022, improved from to 7.06% inFY2021 with the improvement in profitability.

Modest scale of operations – VDL's scale of operations has remained modest, with an operating income of Rs. 97.85 crore in FY2022, though the same is expected to improve in FY2023, supported by domestic order inflows and additional sales from the recently acquired entity Adan Holdings Limited. The revenues increased to Rs. 57.09 crore in H1 FY2023 from Rs. 42.66-crore in H1 FY2022. Going forward, VDL's ability to scale up its operations by ensuring a healthy inflow of orders while sustaining robust profitability levels would remain a key rating monitorable.

Vulnerability of profitability to adverse fluctuations in input and steel prices – The company keeps an inventory of major raw materials like castings and steel owing to the long lead time in procurement. Hence, its margins are exposed to the adverse fluctuations in the prices of key inputs used to manufacture the end products. Though the company revises the prices periodically, the minor fluctuations cannot be passed on immediately to remain competitive in the market.

Environmental and Social Risks

Environmental concerns – VDL remains dependent on the consumption of power and fuel to run its operations which results in greenhouse emission. Also, hydraulic products operate on hydraulic fluids and various factors lead to oil leakage in hydraulic products and is a concern for environment. Thus, in the long term, the replacement of hydraulic equipment with electro-mechanical systems may restrain the growth of the hydraulic equipment market. Nevertheless, the company's exposure to litigation/penalties from issues related to waste and water management remains relatively low. The company has formed a risk management policy to identify, evaluate, mitigate and monitor the risks associated with the business carried by the company. The board reviews the risk management plan and ensures its effectiveness. A mechanism has been put in place which will be reviewed at regular intervals.

Social concerns – The social risk for capital goods manufacturers manifest from the health and safety of employees involved in the manufacturing activity. Casualties/accidents at operating units due to gaps in safety practices may not only lead to production outages, but also invite penal actions from regulatory bodies. The sector is exposed to labour-related risks and risks of protests/social issues with local communities, which might impact expansion/modernisation plans.

Liquidity position: Strong

VDL's liquidity position is strong with healthy cash flow from operations against debt obligations. It had a liquid cash surplus of Rs. 37.12 crore as on September 30, 2022 and a buffer of ~Rs. 14 crore in working capital borrowings with no fixed debt repayment obligations in the near future. The average working capital utilisation has remained low at 2% during the last 12 months ended September 2022.

Rating sensitivities

Positive factors – The ratings could be upgraded if there is an improvement in the scale of operations amid healthy profit margins along with an improvement in the working capital cycle on a sustained basis.

Negative factors – The ratings could be downgraded if there is a significant decline in revenues or margins or deterioration in the working capital cycle, adversely impacting the key credit metrics and liquidity position.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology
Parent/Group support	Not applicable
Consolidation/Standalone	Standalone

About the company

Veljan Denison Limited (VDL), incorporated in 1973, is a listed company on the BSE. It manufactures hydraulic vane pumps, motors, valves and power pack systems. The company has its manufacturing unit at Patancheru, Hyderabad. The company is promoted by Mr. V C Janardan Rao, a qualified engineer with specialisation in fluid power. The company indigenously manufactures precision engineering components and has its own research and development (R&D) wing.

Key financial indicators

VDL Standalone	FY2021	FY2022	H1FY2023
Operating income	73.6	97.9	57.1
PAT	6.9	16.9	8.9
OPBDIT/OI	18.3%	26.2%	23.7%
PAT/OI	9.3%	17.3%	15.6%
Total outside liabilities/Tangible net worth (times)	0.2	0.2	0.2
Total debt/OPBDIT (times)	0.7	0.3	0.2
Interest coverage (times)	32.0	111.4	51.2

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2023)				Chronology of rating history for the past 3 years		
		Type	Amount rated (Rs. crore)	Amount outstanding as on Mar 31, 2022 (Rs. crore)	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021	Date & rating in FY2020
					Dec 6, 2022	Dec 03, 2021	Feb 16, 2021	Dec 17, 2019
1	**Fund based – Cash credit**	Long-term	20.25	-	**[ICRA]BBB+ (Positive)**	**[ICRA]BBB+ (Stable)**	**[ICRA]BBB+ (Stable)**	**[ICRA]BBB+ (Stable)**
2	**Bank guarantee**	Long-term	3.00	-	**[ICRA]BBB+ (Positive)**	**[ICRA]BBB+ (Stable)**	**[ICRA]BBB+ (Stable)**	**[ICRA]BBB+ (Stable)**
3	**Letter of credit**	Short-term	10.00	-	**[ICRA]A2**	**[ICRA]A2**	**[ICRA]A2**	**[ICRA]A2**
4	**Unallocated**	Long-term	23.75	-	**[ICRA]BBB+ (Positive)**	**[ICRA]BBB+ (Stable)**	**[ICRA]BBB+ (Stable)**	**[ICRA]BBB+ (Stable)**

Complexity level of the rated instruments

Instrument	Complexity Indicator
Cash Credit	Simple
Bank Guarantee	Very Simple
Letter of credit	Very Simple
Unallocated	Not applicable

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA’s website: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Cash Credit	NA	NA	NA	20.25	[ICRA]BBB+ (Positive)
NA	Bank Guarantee	NA	NA	NA	3.00	[ICRA]BBB+ (Positive)
NA	Letter of credit	NA	NA	NA	10.00	[ICRA]A2
NA	Unallocated	NA	NA	NA	23.75	[ICRA]BBB+ (Positive)

Source: Company

Please click here to view details of lender-wise facilities rated by ICRA

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

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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