January 31, 2023

Subros Limited: Ratings reaffirmed; outlook revised to Positive

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term Loans	25.00	13.40	[ICRA]AA-(Positive); reaffirmed and outlook revised to Positive from Stable
Non Fund-Based Facilities	95.00	95.00	[ICRA]A1+; reaffirmed
Fund Based Limits	80.00	80.00	[ICRA]AA-(Positive)/ [ICRA]A1+; reaffirmed and outlook revised to Positive from Stable
Fund/Non Fund-based Limits	100.00	100.00	[ICRA]AA-(Positive)/ [ICRA]A1+; reaffirmed and outlook revised to Positive from Stable
Unallocated Limits	3.50	15.10	[ICRA]AA-(Positive)/ [ICRA]A1+; reaffirmed and outlook revised to Positive from Stable
Total Bank Facilities	**303.50**	**303.50**	
Commercial Paper	**75.00**	**40.00**	[ICRA]A1+; reaffirmed

**Instrument details are provided in Annexure-I*

Rationale

The revision in outlook to Positive from Stable factors in an expectation of continuation of a healthy operating performance of Subros Limited (Subros) and a gradual improvement in its operating profit margin, which would help further strengthen the company's credit profile. Subros reported a healthy revenue growth of 25% (revenues of Rs. 2,238.6 crore) in FY2022 and 32% (revenues of Rs. 2,058.2 crore) in 9M FY2023, aided by a healthy underlying demand in the passenger vehicle (PV) industry. Its medium term prospects remain healthy, given its strong market position in the PV industry and healthy underlying demand in the industry, as well as an expectation of an enhanced contribution from the other business segments (commercial vehicles or CVs, railways and home air conditioner (AC) segments), which is expected to aid segment diversification and support revenue growth (expected CAGR of 11-13% over the medium term) of the company.

The rating reaffirmation for Subros continues to factor in its strong market position in the thermal products segment of the PV industry, benefitting from its integrated manufacturing operations and strong product development capabilities, which is supported by technical support from Denso Corporation. The rating reaffirmation also favourably factors in Subros' healthy financial risk profile, characterised by a net negative debt position, strong debt coverage indicators (total debt/OPBDITA of 0.2 time, interest coverage of 13.8 times and DSCR of 5.1 times in FY2022) and a strong liquidity profile (cash and bank balances of ~Rs. 130 crore as of September 30, 2022).

The company's business remains characterised by high customer concentration risk with sales to Maruti Suzuki India Limited (MSIL; including indirect sales) accounting for ~82% of revenues in FY2022. Although the company faces customer and segment concentration risks, they are mitigated to an extent by its strong share of business with MSIL and the OEM's market leadership in the PV segment. Moreover, business gains from new segments are also expected to lead to some moderation in the segment and client concentration risk, going forward.

Even as the company's operating profitability has remained impacted in the last two years by high commodity prices, increase in diesel prices, logistics and packaging costs, the profitability indicators are expected to recover over the medium term, aided by various operational efficiency measures undertaken. ICRA expects the company's operating margins and return indicators to gradually improve over the medium term, benefitting from economies of scale, measures to rationalise costs as well as increased localisation. With capex requirements expected to remain at moderate levels, going forward, an expectation of improved cash accruals is likely to help the company maintain its strong financial risk profile and liquidity position.

Key rating drivers and their description

Credit strengths

Strong market share in thermal products for PV industry; ramp up in supplies for other businesses to aid sector diversification over medium term – Subros is a leading automotive thermal system manufacturer in the domestic market. Despite intense competition in the sector, it has successfully maintained a strong market position (an estimated market share of ~42% in the addressable product range in the PV industry), benefitting from its integrated manufacturing operations and strong product development capabilities (aided by a technical collaboration agreement with one of its key shareholders, Denso Corporation). The company's revenue mix has remained skewed towards the PV segment; however, over the last few years, it has expanded its product range to cater to CV OEMs, besides other segments such as home ACs (through contract manufacturing operations for other brands) and the Indian Railways. Although the PV segment is likely to remain the mainstay of the company's business prospects, its dependence on the segment is expected to reduce over the medium term as supplies for new business segments scale up.

Technical collaboration with Denso Corporation strengthens product development capabilities and competitive positioning – Subros has a technical collaboration with Denso Corporation, a leading automotive manufacturer in the global market. The company's strong product development capabilities, coupled with its considerable scale of operations and low cost structure, have enabled it to sustain a strong market position over the years. Its strong parentage (Suzuki Motor Corporation and Denso Corporation hold ~12% and ~20% equity stakes, respectively) has also helped it to maintain strong business relationships with its primary customer, MSIL, while aiding in establishing relationships with new customers.

Healthy financial risk profile characterised by conservative capital structure and strong debt coverage indicators – Subros received an equity infusion of Rs. 209.88 crore from the issue of equity shares on preferential basis to Denso Corporation, Japan, in December 2018 (FY2019). The company utilised the equity proceeds for part repayment of its debt and creditors, and continues to maintain healthy cash and bank balances (~Rs. 130 crore as of September 30, 2022). The financial risk profile of the entity improved significantly post the equity infusion, and is now characterised by a net negative debt position and strong debt coverage indicators (total debt/OPBDITA of 0.2 time, interest coverage of 13.8 times and DSCR of 5.1 times in FY2022). The total outside liabilities/ total net worth ratio also remains at moderate levels of 0.8 time, despite the significant creditors on the company's balance sheet. With capex requirements expected to remain at moderate levels, going forward, an expectation of improved cash accruals is likely to help the company maintain its strong financial risk profile and liquidity position.

Credit challenges

High client and segment concentration risks with MSIL driving ~82% of sales – The company remains exposed to customer concentration risk with sales to MSIL accounting for ~82% (including indirect sales) of its total revenues in FY2022. Although the heavy dependence on MSIL results in high client concentration risk, the same is mitigated to a large extent by the OEM's market leadership in the PV segment and Subros' strong share of business across various models the OEM. Subros also remains focused on reducing its segment and client concentration risks through business gains from new segments, such as CVs, home ACs and the railways.

Moderate profitability and return indicators – Subros' operating profitability had remained at stable levels of 10-11% till FY2019, aided by the company's efforts to increase its localisation levels with a view of improving operational efficiency. However, the operating profitability has moderated over the last 2-3 years because of change in product mix (with increase in contribution from the home AC segment which entails relatively lower margins), near washout of operations in Q1 FY2021 and May 2021 due to lockdowns and high commodity prices, increase in diesel prices, logistics and packaging costs. Nevertheless, the company's operating margins are expected to gradually improve over the medium term benefitting from economies of scale, measures to rationalise costs as well as increased localisation (operating margins to range between 7-9%). Post a moderation in RoCE in FY2021-FY2022 to levels of 6.5-8.5%, an expectation of a gradual improvement in operating margin, going forward, is likely to help the company improve its return indicators (RoCE expected to improve to 12-15% over the medium term).

Environmental and Social Risks

Environmental considerations: Even as Subros is not directly exposed to climate-transition risks from a likelihood of tightening emission-control requirements, with its products being used across different fuel powertrains, its automotive- manufacturing customers remain highly exposed to the same. Accordingly, Subros's prospects are linked to the ability of its customers to meet tightening emission requirements. The company may need to invest materially to develop products to cater to electric vehicles, even as a transition towards the same in the segments catered is likely to be only gradual. The company's exposure to litigation/ penalties from issues related to waste and water management remains relatively low.

Social considerations: Subros, like most automotive-component suppliers, has a healthy dependence on human capital; and retaining human capital, maintaining healthy employee relations and supplier ecosystem remain essential for disruption-free operations for the entity. Another social risk that Subros faces pertains to product safety and quality, wherein instances of product recalls and high-warranty costs may not only lead to a financial implication but could also harm the reputation and create a more long-lasting adverse impact. In this regard, Subros' strong track record in catering to leading automotive manufacturers underscore its ability to mitigate these risks to an extent. The company's strong technological capabilities, aided by support from Denso Corporation, are likely to help it align its products with any change in customer preferences.

Liquidity position: Strong

The liquidity position of the entity is strong, supported by sizeable cash and bank balances (~Rs. 130 crore of cash and liquid investments as of September 30, 2022), nil utilisation of working capital facilities and expectation of strong cash accruals (~Rs. 150-170 crore per annum). The entity continues to have more than sufficient liquidity to meet its debt repayments (~Rs. 6 crore in H2 FY2023 and Rs. 8.7 crore in FY2024) and moderate capex plans (~Rs. 100-120 crore p.a.).

Rating sensitivities

Positive factors – ICRA could upgrade Subros' rating in case of a sustained improvement in its operational profile through material diversification of its automotive segment mix or in case of continuation of a healthy demand scenario, leading to an improvement in the company's return metrics.

Negative factors – ICRA could downgrade Subros' rating in case of a significant deterioration in its operational profile led by a decline in SOB with key OEMs, especially MSIL. The ratings could also be downgraded in case of a deterioration in profitability indicators or a higher-than-expected capital expenditure/ acquisition outlay, which adversely impacts its credit profile. Specific credit metric, which could lead to a downgrade include Debt/OPBDITA greater than 1.5 times 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	Not Applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of Subros Limited. As on March 31, 2022, the company had a JV, which is enlisted in Annexure-2.

About the company

Incorporated in 1985, Subros Limited is a leading thermal system manufacturer with the capability to manufacture compressors, condensers, hoses and tubes. The company is promoted by the Suri family, whose business interests are spread across diverse industries, such as education, hospitality and telecom access products. While the company was initially focused on providing cooling solutions for the PV segment, over the years it has gradually expanded its product portfolio to include thermal systems for homes, bus cabins, truck cabins, railway coaches and driver cabins.

The company's manufacturing plants at Noida (Uttar Pradesh), Manesar (Haryana), Pune (Maharashtra), Chennai and Karsanpura (Gujarat) have an annual production capacity of ~2.0 million AC kits. It also has a manufacturing and assembly unit for residential and commercial cooling products at Nalagarh (Himachal Pradesh). Subros has a technological agreement with Denso Corporation, Japan, a leading automotive manufacturer in the global market. Denso Corporation currently owns a 20% ownership interest in Subros. Suzuki Motor Corporation, Japan, also holds a ~11.96% share in the listed entity, with ~36.79% held by the Suri family.

Key financial indicators (audited)

Subros Consolidated	FY2021	FY2022	9M FY2023
Operating income	1,795.7	2,238.6	2,058.2
PAT	46.7	32.2	29.2
OPBDIT/OI	8.6%	6.7%	5.7%
PAT/OI	2.6%	1.4%	1.4%
Total outside liabilities/Tangible net worth (times)	0.8	0.8	-
Total debt/OPBDIT (times)	0.3	0.2	-
Interest coverage (times)	9.5	13.8	24.8

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

Source: Company, ICRA Research; All calculations are as per ICRA Research

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 of Jan 24, 2023 (Rs. crore)	Date & rating in FY2023	Date & rating in FY2022*	Date & rating in FY2021			Date & rating in FY2020
					Jan 31, 2023	Jan 24, 2022	Feb 26, 2021	May 13, 2020	Apr 24, 2020	Jan 24, 2020
1	Term loans	Long term	13.40	13.40	[ICRA]AA- (Positive)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)
2	Non Fund-Based Facilities	Short term	95.00	NA	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
3	Fund Based Limits	Long term and short term	80.00	NA	[ICRA]AA- (Positive)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+

4	**Fund/Non Fund-based Limits**	Long term and short term	100.00	NA	**[ICRA]AA- (Positive)/ [ICRA]A1+**	**[ICRA]AA- (Stable)/ [ICRA]A1+**	**[ICRA]AA- (Stable)/ [ICRA]A1+**	**[ICRA]AA- (Stable)/ [ICRA]A1+**	**[ICRA]AA- (Stable)/ [ICRA]A1+**	**[ICRA]AA- (Stable)/ [ICRA]A1+**
5	**Unallocated Limits**	Long term and short term	15.10	NA	**[ICRA]AA- (Positive)/ [ICRA]A1+**	**[ICRA]AA- (Stable)/ [ICRA]A1+**	**[ICRA]AA- (Stable)/ [ICRA]A1+**	**-**	**-**	**-**
6	**Commercial Paper**	Short term	40.00	NA	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**
7	**NCD Programme**	Long term	-	-	**-**	**-**	**-**	**[ICRA]AA- (Stable); withdrawn**	**[ICRA]AA- (Stable)**	**[ICRA]AA- (Stable)**

**Update on details of lender facilities was published on July 23, 2021*

Complexity level of the rated instruments

Instrument	Complexity Indicator
Term Loans	Simple
Non Fund-Based Facilities	Very simple
Fund Based Limits	Simple
Fund/Non Fund-based Limits	Simple
Unallocated Limits	Not applicable
Commercial Paper	Very simple

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	**Term Loan-I**	January 2018	NA	August 2023	4.95	[ICRA]AA-(Positive)
NA	**Term Loan-II**	June 2020	NA	June 2025	8.45	[ICRA]AA-(Positive)
NA	**Non Fund-Based Facilities**	NA	NA	NA	95.00	[ICRA]A1+
NA	**Fund Based Limits**	NA	NA	NA	80.00	[ICRA]AA-(Positive)/ [ICRA]A1+
NA	**Fund/Non Fund-based Limits**	NA	NA	NA	100.00	[ICRA]AA-(Positive)/ [ICRA]A1+
NA	**Unallocated Limits**	NA	NA	NA	15.10	[ICRA]AA-(Positive)/ [ICRA]A1+
NA	**Commercial Paper**	Yet to be placed			40.00	[ICRA]A1+

Source: Company

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

Annexure II: List of entities considered for consolidated analysis

Company Name	Subros Ownership	Consolidation Approach
Subros Limited	Rated entity	Full Consolidation
Denso Subros Thermal Engineering Centre India Limited	26.00%%	Equity Method

Source: Subros annual report FY2022

Note: ICRA has considered consolidated financials of Subros while assigning the ratings.

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