July 24, 2023

Shanthi Gears Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Fund-based – Cash Credit	1.00	1.00	[ICRA]AA (Stable); reaffirmed
Long-term Non-fund Based	28.00	28.00	[ICRA]AA (Stable); reaffirmed
Short-term – Interchangeable	(11.00)	(11.00)	[ICRA]A1+; reaffirmed
Short-term Fund-based	2.00	2.00	[ICRA]A1+; reaffirmed
Total	**31.00**	**31.00**	

**Instrument details are provided in Annexure-I*

Rationale

The ratings outstanding on the bank lines of Shanthi Gears Limited (SGL/the company) considers the company's strong business and financial profile and ICRA's expectation of a sustained financial performance in the near to medium term, supported by its established presence, diversified revenue base and healthy order book. Further, the company has a strong parentage by virtue of being a subsidiary of Tube Investments of India Limited (TIIL; rated [ICRA]AA+ (Stable)/[ICRA]A1+) and part of the larger Murugappa Group. SGL also has strong liquidity, nil borrowings and sizeable unencumbered cash and liquid investments of Rs. 126.2 crore, in addition to non-current investments in tax free bonds of Rs. 20.2 crore as on March 31, 2023. With no major debt-funded capex plans in the medium term, ICRA expects the company's debt coverage metrics and liquidity to remain strong going forward as well.

SGL has a moderate scale, with an operating income of Rs. 445.7 crore in FY2023 and has witnessed healthy improvement over the years. While close linkage to capex cycles exposes revenues to cyclicality in end-user industries, considerable share of revenues from the replacement segment and presence across multiple segments, with no segment generating more than 30% of its revenues in FY2023, mitigate the risk to an extent. Also, although SGL's margins are exposed to volatility in raw material prices and competitive pressures, it would benefit from better absorption of costs as revenues scale and its periodic cost optimisation measures, going forward.

Key rating drivers and their description

Credit strengths

Strong parentage – TIIL, the flagship company of the Murugappa Group, holds 70.47% stake in SGL. Ever since the acquisition, the company has benefitted from the strong management support and the operational synergies derived as a subsidiary of TIIL. SGL has healthy financial profile and is expected to remain net debt negative going forward as well. Thus, it does not require financial support from its parent (TIIL). However, SGL enjoys implicit financial and operational support from its parentage.

Established presence in industrial gears; diversified clientele and end-user sectors support revenue stability – SGL has had extensive presence in the industrial gears segment for five decades and caters to a reputed clientele from diversified sectors such as general engineering, steel, lifts, railways, cement and power, among others. It has a diversified client base with its top 10 customers accounting for only one-third of its revenues in FY2023, thereby insulating its revenues from customer concentration risk.

Strong financial profile – The company's operating margins were healthy at 20.2% in FY2023 (FY2022: 17.9%) aided by benefits from operating leverage and cost optimisation initiatives. Also, SGL has remained debt free since FY2013, primarily aided by healthy net cash accruals (Rs. 50.9 crore in FY2023) and sizeable unencumbered cash and liquid investments (Rs. 126.2 crore as on March 31, 2023). Besides, it has non-current investments of Rs. 20.2 crore in tax-free bonds. Consequently, the company has strong capital structure and coverage metrics. Further, with no major debt-funded capex plans in the medium term, SGL's capital structure and debt coverage metrics are expected to remain strong going forward as well.

Healthy order book – SGL's pending order book position was over Rs. 250.0 crore as on March 31, 2023, supported by demand from both original equipment manufacturers (OEM) and replacement segments. The healthy order book provides revenue visibility for the next few quarters.

Credit challenges

Moderate scale of operations – The company has a moderate scale of operations with revenues of Rs. 445.7 crore in FY2023, despite healthy improvement. A higher scale would enhance resilience to volatility in demand and enable better cost absorption. Nevertheless, the company's healthy pending order book position and demand prospects are likely to support revenue growth, going forward.

Close linkage to capex cycle exposes revenues to cyclicality in end-user industries – SGL's revenues are exposed to the cyclicality in the domestic capex cycles and any economic slowdown could impact its revenues as witnessed in the past. However, considerable share of revenues from the replacement segment and presence across multiple segments, with no segment generating more than 30% of its revenues in FY2023**,** mitigate the risk to an extent.

Margins susceptible to fluctuations in raw material prices – SGL's major raw materials include steel and steel components. The company's margins are susceptible to fluctuations in raw material prices, given its limited pricing flexibility for procured orders. Nonetheless, SGL's ability to pass through the increase in raw material prices in new orders and advance procurement of raw material for the existing orders mitigates the risk to an extent. Further, the company's margins are also likely to benefit from the operating leverage and periodic cost-optimisation initiatives, although competitive pressures remain. SGL's operating margins improved by 230 bps to 20.2% in FY2023, despite increase in raw material prices during the year.

Liquidity position: Strong

SGL's liquidity position remains strong supported by healthy anticipated cash flows from operations, and unencumbered cash and liquid investments of Rs. 126.2 crore as on March 31, 2023. Besides, it has non-current investments of Rs. 20.2 crore in tax free bonds (as of March 31, 2023). The company has remained debt free, and the fund-based working capital utilisation has been nil over the last 10 years. In relation to these sources of cash, SGL has moderate capex plans over the medium term, to be funded by internal accruals. Further, it does not have any debt repayment obligations. Overall, the company's liquidity position is expected to remain strong over the medium term, supported by its strong operational profile and financial flexibility.

Rating sensitivities

Positive factors – ICRA could upgrade SGL's ratings if it demonstrates significant growth in its scale of operations and earnings, while sustaining its healthy debt protection metrics and liquidity profile.

Negative factors – Negative pressure on the company's ratings could arise if it witnesses a sharp deterioration in its earnings or significant rise in net debt; or weakening in the parent's credit profile or SGL's operational/financial linkages with the parent, TIIL.

Environmental and Social Risks

Environmental considerations: The company remains exposed to tightening environmental regulations with regard to waste/recycling and pollution norms, which can lead to an increase in operating costs and new capacity installment costs. SGL has been taking steps to minimise the impact of environmental risks on its operations by adopting practices like renewable energy generation for captive consumption, monitoring and tracking greenhouse gases in operations to reduce its carbon footprint, ensuring supplier evaluation on environment aspects, and reducing its waste and water consumption on continuous basis.

Social considerations: Social considerations for SGL relate primarily to maintaining healthy industrial relations and product safety. Attracting and nurturing skilled manpower is critical as it seeks to keep pace with innovation and technological changes. The company would need to adapt to an evolving social fabric, including changing consumer preferences, from time to time. SGL is also vulnerable to data security and data privacy risks and has reasonable reliance on human capital. Overall, there is moderate exposure to social risk.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating approach – Implicit Support from Parent or Group
Parent/Group support	Tube Investments of India Limited (TIIL, rated [ICRA]AA+ (Stable)/[ICRA]A1+) holds 70.46% in SGL.
Consolidation/Standalone	The ratings are based on the standalone financial profile of the company.

About the company

SGL manufactures standard and customised gears and caters to a reputed clientele from diversified sectors such as general engineering, steel, cement, railways, power and material handling, among others. Its product portfolio encompasses a range of customised gear boxes, loose gears, worm gear boxes and helical gear boxes. It has manufacturing facilities (including a foundry) in and around Coimbatore, Tamil Nadu. The company was founded in 1969 by Mr. P Subramanian, a first-generation entrepreneur from Coimbatore. In 2012, the Murugappa Group's Tube Investments of India Limited acquired the promoter's entire 44.12% stake in SGL. Subsequently, TIIL increased its stake in the company to 70.12% by tendering an open offer in 2012. In April 2019, the company bought back shares, increasing TIIL's shareholding to 70.46%. SGL is currently a subsidiary of TIIL, with minority shareholding by public and financial institutions.

Key financial indicators (audited)

Standalone	FY2022	FY2023
Operating income (OI)	337.1	445.7
PAT	42.5	67.1
OPBDIT/OI	17.9%	20.2%
PAT/OI	12.6%	15.0%
Total outside liabilities/Tangible net worth (times)	0.3	0.2
Total debt/OPBDIT (times)	0.0	0.0
Interest coverage (times)	251.2	243.8

Source: Company, ICRA Research; PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore; Financial ratios in the report are ICRA adjusted figures and may not be directly comparable with results reported by the company in some instances

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2024)				Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount outstanding as of March 31, 2023 (Rs. crore)	Date & Rating in FY2024	Date & Rating in FY2023	Date & Rating in FY2022	Date & Rating in FY2021
					July 24, 2023	Aug 04, 2022	Jul 05, 2021	Jun 15, 2020
1	**Cash Credit**	Long term	1.00	-	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)
2	**Non-fund based limits**	Long term	28.00	-	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)
3	**Interchangeable**	Short term	(11.00)	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
4	**Fund based**	Short term	2.00	-	[ICRA]A1+	[ICRA]A1+	-	-
5	**Unallocated**	Long term/short term	-	-	-	-	-	[ICRA]AA (Stable) /[ICRA]A1+

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term Fund-based – Cash Credit	Simple
Long term non-fund based	Very Simple
Short term- Interchangeable	Very Simple
Short term Fund based	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 No	Instrument Name	Date of Issuance	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Cash Credit	NA	NA	NA	1.00	[ICRA]AA (Stable)
NA	Non-fund based limits- Long term	NA	NA	NA	28.00	[ICRA]AA (Stable)
NA	Interchangeable – Short term	NA	NA	NA	(11.00)	[ICRA]A1+
NA	ST- fund-based facilities	NA	NA	NA	2.00	[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: 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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