July 05, 2019

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	10.00	1.00	[ICRA]AA (Stable); Reaffirmed
Long term non-fund based	30.00	30.00	[ICRA]AA (Stable); Reaffirmed
Short term non-fund based (sublimit)	(30.00)	(23.00)	[ICRA]A1+; Reaffirmed
Long term/ short term unallocated	10.00	19.00	[ICRA]AA (Stable)/ [ICRA]A1+; Reaffirmed
Total	**50.00**	**50.00**	

*Instrument details are provided in Annexure-1

Rationale

The reaffirmation of ratings factors in the strong parentage of Shanthi Gears Limited (SGL/ the company), SGL's strong financial profile characterised by healthy margins, zero debt and sizeable cash/ liquid balances of ~Rs. 128.4 crore as on March 31, 2019 (excluding Rs. 17.5 crore of deposit in buyback escrow account). Although there has been a further cash out flow of Rs. 70.0 crore during April 2019 on account of the share buyback, cash /liquid investments are expected to remain in excess of Rs. 70 crore as on date. The company's operational performance continued to be strong in the last three fiscals, with a three-year CAGR of 13.8% in revenues for the period ending FY2019. Also, SGL's healthy order book (of Rs. 168 crore as on March 31, 2019) provides revenue visibility and helps to absorb any intermediary shocks in demand as witnessed during elections in April and May 2019. The ratings also draw comfort from SGL's established presence in the industrial gears segment and its diversified customer profile.

The ratings are constrained by the company's modest scale of operations and the inherent cyclicality in the engineering industry linked to economic downturns. However, with considerable share of revenues from the replacement market and presence across multiple segments with no segment contributing to more than one fourth of the revenues, the risk is mitigated to an extent.

Outlook: Stable

ICRA believes that SGL will continue to maintain its strong liquidity profile supported by healthy accruals and sizeable cash/liquid balances. The outlook may be revised to Positive if substantial growth in revenue and improved working capital management further strengthens the financial risk profile. The outlook may be revised to Negative if there is any further upstreaming of cash, thereby deteriorating the liquidity of the company or if there is any substantial de-growth in revenue as witnessed in the past.

Key rating drivers

Credit strengths

Strong parentage being part of the Murugappa Group - Tube Investments of India Limited (TIIL) (rated [ICRA]AA+/ Stable/ A1+), the flagship company of the Murugappa Group acquired ~70% stake in SGL in 2012. Ever since, the company has benefitted from the strong management support extended by the parent company.

Strong financial profile characterised by healthy margins, sizeable cash balances and nil borrowings – SGL's operating and net margins remained healthy at 17.3% and 13.7% during FY2019. The company has continued to remain debt free over the past seven years primarily aided by healthy cash flows from operations and sizeable cash/ liquid balances of Rs. 128.4 crore as on March 31, 2019.

SGL has paid interim dividend of Rs. 5 per share (paid in Q4 FY2019) and has undertaken a share buyback of fifty lakh equity shares in April 2019 (at a cost of Rs. 140 per share). These two announcements have resulted in a cash outflow of Rs. 110.9 crore (excluding dividend distribution tax and operational costs for buy back). However, ICRA expects that the company would continue to maintain strong liquidity maintaining the cash / liquid investments in excess of Rs. 70 crore as on date.

Healthy order book provides revenue visibility - The company has a pending order book of Rs. 168 crore as on March 31, 2019 (~69% of FY2019 revenues) as against an order book of Rs. 130 crore as on March 31, 2018. Its healthy order book provides revenue visibility and helps to absorb any intermediary shocks in demand as witnessed during elections in April and May 2019.

Established presence in the industry with a diversified customer base - SGL has extensive presence in the field of industrial gears for five decades and caters to a reputed clientele. With the company deriving only around 28% of its revenues from its top-ten customers, SGL's customer profile is well diversified, insulating its revenues from the customer concentration risk.

Credit challenges

Modest scale of operations - The company's scale of operations continue to be modest with Rs. 243.0 crore of revenue in FY2019. Its scale of operations has been volatile since peaking at ~Rs. 252 crore in FY2009. Higher scale enhances resilience to changes in demand and enables better cost absorption. Nevertheless, with a three-year CAGR of 13.8% in revenues for the period ending FY2019, ICRA expects the scale to improve over the medium term with a favourable demand outlook from the end-user industries.

Close linkage to capex cycle in the economy exposes revenues to cyclicality in end-user industries - SGL's revenues are exposed to the cyclicality in the domestic capex cycle and any economic slowdown could impact its revenues as witnessed in the past. However, with considerable share of revenues from the replacement market and presence across multiple segments with no segment contributing to more than one fourth of the revenues, the risk is mitigated to an extent.

Liquidity Position:

SGL's liquidity has remained strong over the years with healthy accruals and sizeable cash/ liquid balances of over Rs. 70 crore as on date. The company has remained debt free and utilisation on the fund-based facilities has been nil over the years. Although, the company has moderate capex plans over the medium term, they are expected to be funded through internal accruals. With moderate accrual funded capex and nil repayment obligations, ICRA expects SGL's liquidity position to remain strong over the medium term.

Analytical approach:

Analytical Approach	Comments
Applicable Rating Methodologies	[Corporate Credit Rating Methodology](#)
Parent/Group Support	Parent/Group Company: Tube Investments of India Limited The ratings are based on implicit support derived by being part of the Murugappa Group's TIIL. SGL receives strong management support from the parent entity.
Consolidation / Standalone	The ratings are based on the standalone financial profile of the company.

About the company:

Commencing business as a gear manufacturer for the textile industry in 1969, SGL diversified into manufacturing standard (off-the-shelf) and customised (non-standard) gears over the years. SGL caters to various industries including steel, power, earthmoving equipment, cement, railways, defence and textiles. SGL's 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) located in and around Coimbatore, Tamil Nadu. SGL is listed in both the BSE and NSE.

The company was founded in 1969 by Mr. P. Subramanian, a first-generation entrepreneur based out of Coimbatore. In July 2012, Tamil Nadu-based Murugappa Group's Tube Investments of India Limited (TIIL) (rated [ICRA]AA+/ Stable/ A1+) announced the acquisition of the promoter's entire 44.12% stake in SGL for a sum of Rs. 292.01 crore; the acquisition was completed in September 2012. Subsequently, via tendering of an open offer, TIIL increased its stake in the company to 70.12% for a sum of Rs. 173.54 crore. Following the acquisition, SGL is now a subsidiary of TIIL, with minority shareholding by public and financial institutions. In April 2019, the company has bought back fifty lakh equity shares at Rs. 140 per share with out major change in parent shareholding.

Key financial indicators (Audited)

	FY2018	FY2019
Operating Income (Rs. crore)	214.1	243.0
PAT (Rs. crore)	28.6	33.4
OPBDIT/OI (%)	17.5%	17.3%
RoCE (%)	10.7%	13.7%
Total Debt/TNW (times)	-	-
Total Debt/OPBDIT (times)	-	-
Interest coverage (times)	249.5	310.7

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

	Instrument	Current Rating (FY2020) Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date &Rating July 2019	Chronology of Rating History for the Past 3 Years Date &Rating May 2018	Date & Rating in FY2018 May 2017	Date & Rating in FY2017 Sep 2016
1	Fund based limits	Long Term	1.00		**[ICRA]AA (Stable)**	**[ICRA]AA (Stable)**	**[ICRA]AA (Stable)**	**[ICRA]AA (Stable)**
2	Non-fund-based limits	Long Term	30.00		**[ICRA]AA (Stable)**	**[ICRA]AA (Stable)**	**[ICRA]AA (Stable)**	**[ICRA]AA (Stable)**
3	Non-fund-based limits (sublimit)	Short Term	(23.00)		**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**
4	Unallocated limits	Long Term/ Short Term	19.00		**[ICRA]AA (Stable)/ [ICRA]A1+**	**[ICRA]AA (Stable)/ [ICRA]A1+**	**[ICRA]AA (Stable)/ [ICRA]A1+**	**[ICRA]AA (Stable)/ [ICRA]A1+**

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	Cash Credit				1.00	[ICRA]AA (Stable)
NA	Non-fund-based limits				30.00	[ICRA]AA (Stable)
NA	Non-fund-based limits (sublimit)				(23.00)	[ICRA]A1+
NA	Unallocated limits				19.00	[ICRA]AA (Stable)/ [ICRA]A1+

Source: Shanthi Gears Limited

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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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