May 08, 2020

Suprajit Engineering Limited: Ratings reaffirmed; Rated amount enhanced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund Based – Term Loan	33.27	40.00	[ICRA]AA (Stable); reaffirmed
Fund Based – Working Capital Facilities	217.65	232.65	[ICRA]AA (Stable); reaffirmed
Non-fund Based – Working Capital Facilities	1.50	1.50	[ICRA]A1+; reaffirmed
Total	**252.42**	**274.15**	

**Instrument details are provided in Annexure-1*

Rationale

The reaffirmation of the ratings takes into account Suprajit Engineering Limited's (SEL/the company) strong market position and well-established relationships with all the major domestic two-wheeler (2W) and three-wheeler (3W) original equipment manufacturers (OEMs) with a market share of ~75%. The company also has a healthy market share of ~30% in the Indian four-wheeler (4W) cables industry. Despite the overall slowdown in the automotive industry, SEL witnessed an overall revenue growth of 1.3% (YoY) in 9M FY2020 on the back of growth of ~13% and ~7% in aftermarket sales and sales to 2W OEMs, respectively, supported by an increase in the wallet share with existing customers and higher realisation from the sale of BS-VI components. The ratings also continue to favourably factor in the company's diversified segmental and geographical presence, supported by its wholly-owned subsidiary, Wescon Controls (one of the largest manufacturers of outdoor power equipment (OPE) control cables in North America) and Phoenix Lamps Limited (a halogen bulb manufacturing company with an aftermarket presence in Europe and India). The ratings also consider SEL's strong financial profile characterised by a moderate gearing of 0.4 times, moderate total debt/OPBDITA of 1.7 times as on December 31, 2019 and high interest coverage of 9.7 times in 9M FY2020.

The company reported muted revenue growth in 9M FY2020 on account of a decline of ~13% in sales to 3W and 4W OEMs and a decline of ~5% in the non-automotive business. The automotive industry accounts for ~57% of the revenues. The operating margins declined to 13.9% in 9M FY2020 (14.6% in 9M FY2019) on account of the higher operating costs required to run the newly set up Narsapura plant, the weak product mix of Phoenix Lamps, the imposition of tariff on Chinese imports and the upfront costs associated with new product development at Wescon.

The automotive supply chain disruption, largely limited to China during January and February 2020, morphed into a demand shock owing to the deterioration in the economic environment. The unprecedented large-scale global lockdown of all non-essential services has led to production disruptions at OEMs and down the supply chain in March 2020 and Q1 FY2021. Further, the automotive demand for the commercial (commercial vehicles) as well as the consumer segment (passenger vehicles, 2Ws) has contracted sharply because of weakening liquidity and poor consumer sentiments.

The capital-intensive automotive industry operates at a moderate operating leverage with some scope to prune costs. Nevertheless, a sharp contraction in demand, as witnessed currently, will impact the operating leverage. Further, to conserve the immediate-term liquidity, a few OEMs are stretching their payment cycles to vendors and discontinuing long-established systems of short credit periods. For exporters, the slowing global demand could also lead to inventory build-up and stretched receivables in the coming quarters.

While the strength of the eventual recovery will be contingent on the duration and breadth of the Covid-19 pandemic before an eventual containment, a relatively prolonged period of curtailed automotive demand, as the consumer stays wary of large capital commitments, is likely. While ICRA expects the local demand dynamics in India to play out differently across sectors, most automotive sectors (barring tractors and light commercial vehicles) are expected to post double-digit declines in FY2021. However, considering the highly uncertain nature of the pandemic, these estimates will be reviewed further in the coming months.

The Stable outlook on the [ICRA]AA rating reflects ICRA's opinion that SEL will continue to benefit from its dominant market position in the domestic 2W and 3W cables industry, its healthy market position in the OPE cables industry in North America, experienced promoters, diversified geographical and segmental presence, its long-standing relationship with its customer base in the domestic and export markets, and its healthy financial risk profile.

Key rating drivers and their description

Credit strengths

Long-standing relationships with major OEMs aid long-term business stability – The company has long-standing and well-established relationships with all the major 2W and 3W OEMs in India, enjoying a strong wallet share of ~75% with most of its customers. It also enjoys a healthy market share of ~30% in the Indian 4W cables industry. SEL also has well-established relationships with reputed 4W OEMs in the European markets. With the acquisition of Wescon in FY2017, SEL is one of the largest producers of non-automotive control cables in USA. This is expected to continue supporting its business prospects going forward.

Diversified geographical and segmental presence through global footprint – With the acquisition of Phoenix Lamps in FY2016, SEL gained a foothold in lighting in the automotive aftermarket segment in Europe and India. Moreover, with the acquisition of Wescon in FY2017, SEL increased its presence in the North American market in the non-automotive control cables segment. Consequently, the revenue contribution from the 2W segment reduced to ~38% in 9M FY2020 from ~53% in FY2015 while exports increased to ~38% in 9M FY2020 from 18.3% in FY2015. Further, the growth of ~13% in aftermarket sales has increased its revenue contribution to 24% in 9M FY2020 from ~21% in 9M FY2019.

Financial profile characterised by strong capitalisation, coverage indicators and sizeable cash and liquid investments – SEL's financial profile is characterised by a moderate gearing of 0.4 times, moderate total debt/OPBDITA of 1.7 times as on December 31, 2019 and high interest coverage of 9.7 times in 9M FY2020. The company also had sizeable cash and liquid investments of Rs. 317.6 crore as on December 31, 2019. Despite the overall slowdown in the automotive industry, the company witnessed a YoY revenue growth of 1.3% in 9M FY2020, primarily aided by a growth of ~13% in aftermarket sales and a growth of ~7% in sales to 2W OEMs. The revenue growth in 2W OEM sales was supported by an increase in the wallet share with the existing customers and higher realisation from the sale of BS-VI components.

Credit challenges

Muted revenue growth characterised by weak 3W and 4W OEM sales and decline in non-automotive business in 9M FY2020 – Despite witnessing revenue growth in aftermarket (~13%) and 2W OEM sales (~7%) in 9M FY2020, the company's overall growth was muted (1.3%) on account of a decline in 3W and 4W OEM sales (~-12%) and non-automotive (~-5%). 3W and 4W OEM sales declined due to the overall slowdown in the automotive industry and the higher base effect resulting from pre-orders (in FY2019) by European customers to mitigate the risk arising from the ongoing Brexit transition. Non-automotive sales witnessed a decline in 9M FY2020 primarily due to the reduced offtake from the North American non-automotive customers catered by Wescon. Going forward, SEL's ability to achieve a healthy top line amid the ongoing Covid-19 outbreak will remain a key monitorable.

Imposition of tariff on Chinese imports, higher operating cost at Narsapura plant, weak product mix at Phoenix Lamps and upfront business development expenses in USA affected margins in 9M FY2020 – SEL's operating margins declined by 70 bps YoY to 13.9% in 9M FY2020 from 14.6% in 9M FY2019. The margins declined primarily on account of the higher operating cost required to run the newly set up Narsapura plant. Wescon imports ~15% of its raw material requirements from China. While the imposition of a tariff of ~10% on the imports increased the raw material prices for the company, it led to other local suppliers in the US increasing the raw material prices. The import tariff, along with the negative operating leverage due to certain front-loaded costs (manpower expenses, office costs, etc) associated with new product development, impacted the non-automotive cables division's margins in 9M FY2020 by 310 bps. The margin decline recorded by Phoenix Lamps (60 bps) was also due to a weak product mix. Going forward, ICRA expects the prolonged slowdown in global growth on account of the Covid-19 outbreak and the weak demand outlook for the domestic auto industry to impact margins.

Exposure to inherent cyclicality in automotive industry – SEL derived ~57% of its revenues in 9M FY2020 from sales to automotive OEMs and is thus exposed to the cyclicality inherent in the industry. Further, the Indian automotive industry is expected to witness a degrowth in volumes in FY2021. However, the risk is mitigated to a certain extent by the company's continued diversification efforts by entering into newer segments in the non-automotive cables division in the US market (~19% of revenues in 9M FY2020). Its well-established relationships with major OEMs also partially mitigate the risk.

Liquidity position: Strong

SEL's liquidity is **strong** with a cash and bank balance and liquid investments of Rs. 317.6 crore and undrawn lines of more than ~Rs. 70 crore as on December 31, 2019. Its average working capital utilisation was 44.4% of the sanctioned limits and 55.0% of the drawing power for the 12-month period ended December 2019. The company had external term loans of Rs. 154.8 crore on its books as on December 31, 2019, of which Rs. 65.7 crore, Rs. 22.1 crore and Rs. 16.1 crore are scheduled to be repaid in FY2021, FY2022 and FY2023, respectively. Overall, ICRA expects SEL to be able to meet its near-to-medium-term commitments through internal sources of cash and yet be left with a sufficient cash surplus. Further, SEL enjoys strong financial flexibility and lender/investor comfort, which is expected to continue going forward as well.

Rating sensitivities

Positive triggers – ICRA could upgrade the rating if the company demonstrates a sustained improvement in its operational metrics, leading to an improvement in the margins and a reduction in the leverage metrics on a consolidated basis. Specific credit metrics that could lead to a rating upgrade include RoCE of more than 25% on a sustained basis.

Negative triggers – Pressure on the ratings could arise on a sharp deterioration in SEL's financial profile due to a delay in the recovery of the demand scenario in the automotive sector and the Covid-19 related operational shutdown. Specific credit metrics that could lead to a downgrade include Net Debt/OPBDITA of more than 1.0 time 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	The ratings are based on the consolidated financial statements of the rated entity

About the company

Suprajit Engineering Limited primarily manufactures mechanical control cables for the automotive and non-automotive sectors, speedometers for 2Ws and halogen lamps for 2Ws, 3Ws, passenger cars, and commercial vehicles and off-road applications. Under the cables division, SEL's product profile comprises a wide variety of control cables like brake cables, clutch cables, throttle cables, starting cables, gear shifter cables, choke cables, tachometer cables, window regulator cables, mirror cable assemblies, seat recliner cables and latch release cables. Under halogen lamps, SEL's product profile comprises fog lights, side position lights, front lights, position and parking lights, dashboard and interior lights, brake light lamps, trunk lights, front indicator lights, rear parking lights, number plate lights, rear indicator lights, stop lights, low beam/high beam lights, etc.

SEL is currently the largest manufacturer of automotive cables in India with the capacity to manufacture about 300 million cables per annum. It is also the largest manufacturer of halogen lamps with a manufacturing capacity of about 110 million halogen lamps per annum. SEL is operational across geographies with 22 manufacturing facilities (including a technology centre in the UK) across the globe catering to the automotive as well as the non-automotive business.

SEL's customer profile comprises reputed OEMs in the 2W space such as Bajaj Auto Limited (BAL), Hero MotoCorp Limited (HMCL), TVS Motor Company Limited (TVS) and Honda Motorcycle & Scooter India (HMSI) among others. In the 3W segment, SEL caters to customers such as Atul Auto Limited (AAL), Piaggio Vehicles Private Limited (PVPL) and TVS while its customers under the 4W segment include Mahindra & Mahindra (M&M), BMW AG (BMW) and Volkswagen AG (VW) among others. Under its non-automotive vertical, the company's customers include John Deere (JD), Whirlpool Corporation (WC), Kubota Corporation (Kubota) and Club Car LLC (Club car).

Key financial indicators (audited consolidated)

	FY2018	FY2019
Operating Income (Rs. crore)	1,431.1	1,589.9
PAT (Rs. crore)	138.5	133.8
OPBDIT/OI (%)	16.9%	14.8%
RoCE (%)	22.1%	20.7%
Total Outside Liabilities/Tangible Net Worth (times)	1.0	0.9
Total Debt/OPBDIT (times)	1.4	1.5
Interest Coverage (times)	8.4	9.6
DSCR	2.5	2.4

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2021)				Rating History for the Past 3 Years		
		Type	Amount Rated	Amount Outstanding	Rating	FY2019	FY2018	
					8-May-2020	15-Mar-2019	28-Dec-2017	20-Jul-2017
1	Cash Credit	Long Term	232.65	-	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)
2	Term Loan	Long Term	40.00	40.00	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)
3	Letter of Credit & Bank Guarantee	Short Term	1.50	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+

Amount in Rs. crore

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	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Cash Credit	NA	7.95 – 9.50%	-	232.65	[ICRA]AA (Stable)
NA	Term Loans	FY2020	1.25%	FY2024	40.00	[ICRA]AA (Stable)
NA	LC/BG	NA	NA	-	1.50	[ICRA]A1+

Source: Company

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Suprajit Automotive Private Limited	100.00%	Full Consolidation
Suprajit Europe Limited	100.00%	Full Consolidation
Suprajit USA Inc.	100.00%	Full Consolidation
Trifa Lamps, Germany GmbH	100.00%	Full Consolidation
Luxlite Lamps SARL	100.00%	Full Consolidation
Wescon Controls LLC[1]	100.00%	Full Consolidation

[1] *Subsidiary of Suprajit USA Inc.*

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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.

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