

May 21, 2020

Sterling Tools Limited: Ratings reaffirmed; Outlook revised to Negative from Stable for long-term rating

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term Loan	76.58	76.58	[ICRA]AA-(Negative); Reaffirmed and outlook revised to Negative from Stable
Long-term Fund-based Facilities	95.00	95.00	[ICRA]AA-(Negative); Reaffirmed and outlook revised to Negative from Stable
Non-fund Based Limits	34.09	34.09	[ICRA]A1+; reaffirmed
Total	205.67	205.67	

*Instrument details are provided in Annexure-1

Rationale

The rating action on Sterling Tools Limited (STL) follows the impact of the novel coronavirus (Covid-19) pandemic on the Indian auto component industry and is in line with ICRA's Negative outlook for the sector. To contain the rapid proliferation of the disease, the Government of India has imposed a nationwide lockdown since March 24, 2020, which was subsequently extended till May 31, 2020. The unprecedented, large-scale lockdown has disrupted production at automobile OEMs and its supply chain from March 2020 onwards.

In addition to the production disruptions, the demand shock on account of the pandemic could be significant, going forward, in an already weak demand environment. Automotive demand, both for the commercial and consumer segments (passenger vehicles or PVs and two-wheelers or 2Ws), has contracted sharply following the lockdown and is likely to remain muted in the near-term owing to subdued consumer sentiments. While the strength of the eventual recovery will be a function of various factors such as the duration of the lockdown, the pace at which normal business activity resumes and the quantum of Government and regulatory support, a relatively prolonged period of curtailed automotive demand, given the discretionary nature of the spend, is likely.

With approximately 92% of revenues derived from the domestic automotive market, STL's business prospects remain linked to the underlying demand trends in the Indian automobile industry. An extended period of demand slowdown, as witnessed at present, could result in weak financial performance, despite some flexibility that the company might have in pruning down costs. Additionally, the ramp-up in demand and production is likely to be gradual, even after lifting of the lockdown, on concerns of macro-economic slowdown. In likelihood of sharp downward revision in schedules from OEMs, STL's revenues, earnings and cash flows are likely to weaken over the near-term (vis-à-vis earlier expectations).

Given the environment, the liquidity cushion between cash balances and available lines of credit, and debt servicing requirements remains key. ICRA believes that STL is adequately positioned from a liquidity standpoint with sufficient buffer available in the form of unutilised working capital limits of approximately Rs. 47.3 crore and free cash balances and liquid investments of Rs. 53.1 crore as on April 15, 2020. Against these sources of cash, the

company has limited debt servicing obligations of approximately Rs. 7-8 crore in Q1 FY2021 and Rs. 29.2 crore in FY2021, in addition to supporting its fixed expenses.

Although the company's liquidity remains comfortable for tiding over the current lockdown, STL remains exposed to any prolonged weakness in demand in the domestic automotive industry. A higher-than-expected downturn in automobile demand and a resulting inability to achieve adequate capacity utilisation (especially for the greenfield facility set up recently in Karnataka), could lead to a moderation in its profitability and return indicators, and would remain a rating sensitivity. Additionally, the company's scale is expected to decline quite significantly, given two consecutive years of demand slowdown, resulting in much lower scale compared to its current rating category. Accordingly, ICRA will continue to monitor the situation as it evolves over the near-term and assess its impact on STL.

Key rating drivers and their description

Credit strengths

Second largest player in automotive fastener segment – STL is positioned as the second largest automotive fastener manufacturer in India, trailing behind only Sundaram Fasteners in terms of market share. Aided by regular investments in product development (with focus on specialised fasteners), consistent quality standards and competitive cost structure, the company has been able to enhance its share of business with leading automobile OEMs in India. Accordingly, despite stiff competition from both organised and numerous unorganised players in the fastener segment, it the company has been able to maintain a stable operational profile.

Diversified revenue profile with presence across major automotive and non-automotive segments – STL's revenue profile is well-diversified, catering to all major automotive segments, as well as some non-automotive segments. Furthermore, its dependence on each segment is limited, with the largest contributor, viz. commercial vehicles (CVs), accounting for only 32% of its Original Equipment (OE) revenues followed by two-wheelers (30%) and passenger vehicles (PVs; 24%). STL's diversified presence protects its revenues and earnings, to some extent, from any segment-specific demand downturns.

Diversified customer portfolio with healthy share of business – The company caters to multiple OEMs across the automotive spectrum, and enjoys a healthy share of business with most leading OEMs. It has limited dependence on a single customer. Its largest customer accounted for 22% of its FY2019 revenues, while its top five customers contributed to approximately 60% of revenues. STL's well-diversified revenue profile and healthy market position with major automotive OEMs augur well for its business prospects over the medium term.

Product development and business expansion capabilities to benefit from recent collaborations – In FY2018, STL entered into a business collaboration agreement with Meidoh Co. Ltd., Japan, to develop and sell high tensile fasteners in India. With Meidoh being one of the leading fastener developers in Japan, the collaboration is likely to enable STL to have access to product development in the fastener space and improve its business prospects with the Japanese OEMs. Additionally, the company is exploring opportunities to expand its product portfolio and collaborations for the same, scale-up in which would further strengthen the business profile.

Strong liquidity position with unutilised working capital facilities and healthy liquid investments – The company’s liquidity position is comfortable, characterised by healthy quantum of cash and liquid investments (Rs. 53 crore as of April 2020), as well as adequate buffer available in the form of unutilised working capital facilities.

Healthy financial risk profile with robust profitability, return indicators and comfortable credit metrics – Despite slight contraction in operating profit margins and debt-funded capex undertaken to set-up a new manufacturing unit in FY2019, and slowdown in the domestic automotive industry in FY2020, STL’s financial risk profile continues to be healthy with OPM of 16.9%, ROCE of 13.5% and comfortable credit metrics (interest cover of 10.5 times and NCA/Total Debt of 58.7% in 9M FY2020).

Credit challenges

Earnings likely to moderate further during current fiscal due to Covid-19 pandemic – With 86% of STL’s revenues derived from supplies to domestic automotive OEMs, it remains exposed to cyclicity in the domestic automobile market. With the market having witnessed sharp slowdown in automobile sales in FY2020, the company’s financial performance was also adversely impacted. Additionally, the pandemic outbreak and associated lockdown, as well as demand slowdown would continue to pose challenges over the near term. Accordingly, its revenues and earnings are likely to moderate during the near-term in line with the expected slowdown across automotive segments and OEMs.

Sizeable capex incurred with respect to greenfield facility to constrain return indicators in near term – STL has set up a greenfield facility in Karnataka, which commenced operations from September 2019 with an initial capacity of 500 MT per month. Given the current subdued demand environment, ramp-up at the plant is expected to be slower than envisaged, which is likely to exert some pressure on return indicators over the near-term till operations scale up to optimal levels.

Limited product diversification with presence restricted to fasteners segment – At present, STL operates in a single product category of fasteners, thereby limiting its product diversification and offerings. Nevertheless, the versatility of the product segment, along with STL’s strong market position as the second largest player and its healthy presence with its key OEMs, offers comfort regarding the stability of the business. Additionally, the company is exploring opportunities to enter new product segments, which augurs well for business prospects as well as diversification, if it materialises.

Liquidity position: Strong

STL’s liquidity is **strong** supported by expectation of adequate cash flow generation, despite some moderation expected on account of the Covid-19 lockdown and production shutdown. Its liquidity is also supported by surplus cash balances (Rs. 53 crore parked in fixed deposits and arbitrage funds) and availability of adequate unutilised working capital limits (Rs. 47.3 crore as on April 15, 2020). Furthermore, capex outgo is likely to remain restricted to routine capex and would be funded from internal accruals. STL’s debt repayments worth Rs. 19.6 crore in FY2021 also remain moderate vis-à-vis internal accruals and are expected to be serviced comfortably from internal cash generation and available liquidity sources.

Rating sensitivities

Positive triggers – Given the Negative outlook, an immediate upgrade in ratings is unlikely. Nevertheless, sustained improvement in business risk profile, characterised by expansion in product portfolio and significant scale up in operations, while maintaining profitability indicators, credit metrics and liquidity profile at the current healthy levels would be critical for an upward rating revision.

Negative triggers – Sustained pressure on revenues and earnings on account of the Covid-19 pandemic is likely to exert pressure on the ratings. Slower-than-expected ramp up at the greenfield facility with increased reliance on external borrowings, leading to sustained deterioration in profitability and credit metrics with Total Debt/OPBITDA above 1.5 times could, could also cause a downward rating movement.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Auto Component Manufacturers
Parent/Group Support	Not applicable
Consolidation/Standalone	The rating is based on STL's standalone financial statements

About the company

Established in 1979, STL is involved in the manufacturing and marketing of high tensile cold forged fasteners, primarily for the automobile industry. At present, it is positioned as the second largest fastener manufacturer in India, after Sundaram Fasteners. The company's business profile is characterised by high segment as well as customer diversification. In FY2019, the CV segment was the largest driver of its turnover (32%), followed by two-wheelers (30%) and PVs (24%). The company caters to leading automotive companies in India and tier-I auto component manufacturers in Europe. STL's product portfolio includes fasteners, which find application in both automotive and non-automotive segments.

STL has three manufacturing plants at Faridabad, Ballabhgarh and Palwal in Haryana and has set up its fourth manufacturing plant near Bengaluru, Karnataka. The company has a total installed capacity of approximately 50,000 MT per annum at its existing plants, and an additional 6,000-MTPA capacity installed at the new facility in Karnataka.

STL was founded by the first generation entrepreneur, Mr. Manohar Lal Aggarwal, and has thereafter been managed by his two sons, Mr. Anil Aggarwal and Mr. Atul Aggarwal. The company is listed on the Bombay Stock Exchange and National Stock Exchange. Other Group companies operated by the promoters are involved in automobile dealerships of Honda Cars India Limited (HCIL), Harley Davidson and Audi across Delhi, Haryana and Punjab.

In FY2018, STL entered into business collaboration with the Japan-based fastener manufacturer, Meidoh Co. Ltd, which would enhance its design and development capabilities in the automotive fastener segment and strengthen business prospects with the Indian subsidiaries of the Japanese OEMs. The Japanese company acquired 5% stake in STL at a consideration of Rs. 44.3 crore, as a part of the business collaboration agreement.

Key financial indicators (audited)

	FY2018	FY2019
Operating Income (Rs. crore)	454.9	514.1
PAT (Rs. crore)	48.7	44.9
OPBDIT/OI (%)	20.5%	17.1%
RoCE (%)	31.4%	23.4%
Total Outside Liabilities/Tangible Net Worth (times)	0.4	0.6
Total Debt/OPBDIT (times)	0.4	1.1
Interest Coverage (times)	24.7	24.0
DSCR	4.4	5.3

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

	Instrument	Current Rating (FY2021)			Rating History for the Past 3 Years			
		Type	Amount Rated	Amount Outstanding*	Rating	FY2020	FY2019	FY2018
					21-May-2020	24-Sep-2019	26-Jul-2018	6-Oct-2017
1	Term Loan	Long Term	76.58	67.27	[ICRA]AA- (Negative)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]A+ (Positive)
2	Long -term Fund-based Facilities	Long Term	95.00	32.30	[ICRA]AA- (Negative)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]A+ (Positive)
3	Non-fund Based Limits	Short Term	34.09	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
4	Unallocated	Long Term	-	-	-	-	-	[ICRA]A+ (Positive)

Amount in Rs. crore

*As on March 31, 2019

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	Term Loan I	FY2014	MCLR linked rate	FY2025	11.90	[ICRA]AA-(Negative)
NA	Term Loan II	FY2015	MCLR linked rate	FY2025	19.68	[ICRA]AA-(Negative)
NA	Term Loan III	FY2018	MCLR linked rate	FY2025	45.00	[ICRA]AA-(Negative)
NA	Fund-based facilities	NA	NA	NA	95.00	[ICRA]AA-(Negative)
NA	Non-fund Based facilities	NA	NA	NA	34.09	[ICRA]A1+

Source: Sterling Tools Limited

Annexure-2: List of entities considered for consolidated analysis – Not Applicable

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