July 24, 2020

Sundaram Brake Linings Limited: Ratings reaffirmed; outlook on the long-term rating revised to Negative from Stable

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long term - Fund-based-CC	55.00	55.00	[ICRA]BBB+ (Negative); reaffirmed and outlook revised to Negative from Stable
Short term – Non-fund based	4.07	4.07	[ICRA]A2; reaffirmed
Short term – Fund-based sub limits	(45.00)	(45.00)	[ICRA]A2; reaffirmed
Short term –Non-fund based sub limits	(1.50)	(1.50)	[ICRA]A2; reaffirmed
Total	**59.07**	**59.07**	

**Instrument details are provided in Annexure-1;*

Rationale

The revision in outlook on the long-term rating follows the impact of the Covid-19 pandemic on both the Indian and the global auto component industry, and is in line with ICRA's Negative outlook for the sector. An unprecedented large-scale global lockdown of all non-essential services has led to production disruptions for original equipment manufacturers (OEMs) and down the supply chain in March 2020 and YTD FY2021. Further, demand for commercial vehicles has contracted sharply because of the weak macroeconomic scenario and significant impact on goods movement and freight availability. As against the earlier estimates of growth in the domestic CV industry in FY2021, ICRA currently estimates a decline of over 25% in the Indian M&HCV (trucks) segment, 15-17% decrease in the domestic LCV segment, and sluggish domestic aftermarket demand going forward. The global CV demand is also expected to decline significantly owing to the pandemic. This is expected to result in a sharp decline in revenues for Sundaram Brake Linings Limited (SBLL) in FY2021. The company has had weak profit margins and moderate coverage metrics in the last several years and the margins are expected to remain subdued in FY2021, owing to the anticipated decline in revenues.

The ratings remain supported by SBLL's established position in the friction material space, its reputed clientele, and its established pan-India/global presence in the aftermarket segment. Further, the company has adequate liquidity position supported by cash and liquid investments of Rs. 6.39 crore (including proceeds from Rs. 5.5 crore of Covid-emergency credit line) and buffer on working capital lines of Rs. 38.82 crore as on July 21, 2020. It also has a conservative capital structure with gearing of 0.3 times as on March 31, 2020, supported by relatively low working capital borrowings and absence of long-term debt. With no major incremental debt proposed over the next three years, ICRA expects SBLL's capital structure to remain comfortable in the medium term. ICRA also positively factors in the financial flexibility enjoyed by the company as part of the larger T.V. Sundaram Iyengar (TVS) Group of Companies. The margins also remain vulnerable to unfavourable forex movements and raw material price fluctuations. The company's relatively high geographical concentration in North America exposes it to regional risks. Further, it continues to witness competition from industry incumbents and the unorganised segment, although its established presence and market standing mitigate the risks from competitive threat to an extent.

Key rating drivers and their description

Credit strengths

Established market position in friction material space in India with favourable domestic-export mix: SBLL is a reputed player in the Indian friction material industry. The company counts established tier-I automotive suppliers and auto OEMs catering to the commercial vehicle, two-wheeler and passenger vehicle segments among its direct and indirect clients. In the domestic aftermarket space, SBLL has a pan-India network and caters through seven distributors. Apart from this, the company derives a significant portion of its revenues from exports (48.6% in FY2020), which provides diversification.

Financial profile characterised by conservative capital structure and absence of long-term debt: The company has not undertaken any major capex in the past five years and has reduced its long-term borrowings through periodic repayments, with nil long-term debt on its books since FY2018. As on March 31, 2020, the company had only working capital borrowings of Rs. 24.0 crore and its gearing was 0.3 times. With minimal capex plans for the next three years and funding of the same through internal accruals, ICRA expects SBLL's capital structure to remain comfortable going forward.

Financial flexibility as part of TVS Group of Companies: SBLL enjoys healthy financial flexibility by virtue of belonging to the larger TVS Group of Companies—an established name in the domestic auto ancillary industry. The TVS Group holds a 65.5% stake[1], with T.V. Sundram Iyengar and Sons (rated [ICRA]AA (Stable)/ [ICRA]A1+) and Sundaram Industries Limited (rated [ICRA]AA (Stable)/ [ICRA]A1+)— the two holding companies in the Group—holding a 14.1% and a 6.5% stake, respectively (as on March 31, 2019). While SBLL leverages on the TVS brand, the company has not received/is unlikely to receive any financial support from the parent in the medium term.

Credit challenges

Revenues likely to remain under pressure in FY2021 due to sharp demand drop in both domestic and export markets amid Covid-19 crisis: The company derives ~51.4% of its revenues from the domestic market, primarily from the sales of brake linings to the CV industry and the balance 48.6% from the export markets (wherein it predominantly caters to the US HCV aftermarket). In terms of segment, the majority of the revenues are derived from the CV segment, while a small portion of the same is from the PV and 2W segments. As against the earlier expectations of growth in CV sales in the domestic markets in FY2021, ICRA currently expects a decline of over 25% in the Indian M&HCV (trucks) industry and 15-17% decline in the domestic LCV segment. The domestic aftermarket is expected to be sluggish until movement of goods and vehicles starts in a full-fledged manner. Furthermore, the European and US HCV demand is likely to remain subdued

[1] *The TVS Group holds 65.54% stake, through its group companies: T.V. Sundram Iyengar and Sons (rated [ICRA]AA (Stable)/ [ICRA]A1+, 14.05% stake), Southern Roadways Private Limited (12.16% stake), Sundaram Industries Limited (rated [ICRA]AA (Stable)/ [ICRA]A1+, 6.45% stake) and other members belonging to the promoter group holding 32.88% stake, while the balance 34.46% stake is held by the public*

in the near term due to the ongoing macroeconomic slowdown. Subsequently, SBLL is expected to post a sharp contraction in revenues in FY2021.

Low profit margins and RoCE in last eight years; expected to remain subdued in FY2021: SBLL's margins have remained weak in the past several years and the company's OPM and NPM declined to 2.3% (PY: 4.1%) and 1.0% (PY: 2.5%) respectively in FY2020, owing to negative operating leverage. Despite relatively low debt levels, SBLL's RoCE and coverage metrics remained impacted because of thin profits with RoCE of 4.6% in FY2020 (PY: 7.6%) and Total Debt/OPBITDA of 4.0 times as on March 31, 2020 (PY: 2.9 times). While the significant decline in revenues is expected to cap the company's margins in FY2021, it would be supported to an extent by accommodative raw material prices and cost-saving initiatives undertaken by the company, including downsizing of operating manpower.

Company continues to face competition from industry incumbents and unorganised segment in domestic markets; exports remain concentrated in North America: SBLL has a favourable exports-domestic mix, however it derives a significant portion of its export revenues from North America, which exposes it to regional risks. While the company is looking at diversifying its export presence, the concentration in North America is likely to remain over the medium term. In the domestic market, SBLL continues to witness competition from industry incumbents such as Rane Brake Lining Limited (rated [ICRA]AA- (Stable)/[ICRA]A1+), Masu Brakes Private Limited and Hindustan Composites Limited, to name a few. In addition, the company witnesses competition from the unorganised segment in the replacement markets. However, its established presence in the friction industry and strong market position mitigate the risk to an extent.

Margins susceptible to volatility in raw material price fluctuations and unfavourable forex movements: SBLL derives a sizeable part of its revenues from exports, and imports part of its raw materials. This exposes the company to risks arising from unfavourable forex fluctuations. However, the natural hedge and borrowings in foreign currency mitigate the risk to an extent.

Liquidity position: Adequate

SBLL's liquidity has remained **adequate** with positive retained cash flow from operations in FY2020. The company has cash and liquid investments of Rs. 6.39 crore (including the proceeds of Rs. 5.5 crore of Covid-emergency credit line, availed on July 18, 2020) and undrawn working capital lines of Rs. 38.82 crore as on July 21, 2020. While the company does not have any long-term loans as on March 31, 2020, the covid loan, is repayable over a period of 24 months, including six months of moratorium. Accordingly, the company has repayment obligations of Rs. 0.6 crore in FY2021 and Rs. 3.7 crore in FY2022. SBLL has negligible capex plans for FY2021 and this is expected to be funded entirely through internal accruals. ICRA expects the company's liquidity position to remain adequate over the medium term.

Rating sensitivities

Positive triggers – Given the Negative outlook on the auto component and CV industry, a rating upgrade is unlikely in the near term. Nonetheless, sustained improvement in its scale and profitability indicators, while maintaining its low debt levels and adequate liquidity position, could be a trigger for a revision in outlook to Stable.

Negative triggers – Negative pressure on ratings will emanate from a sharp contraction in revenues and earnings, leading to moderation in coverage metrics.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Auto Component Manufacturer
Parent/Group Support	Not applicable
Consolidation / Standalone	Standalone

About the company

Sundaram Brake Linings Limited (SBLL) primarily manufactures asbestos-free friction material such as brake linings, disc pads and clutch facings for the automobile industry. The company also manufactures tractor linings and friction material for industrial applications, and trades in rivets. SBLL caters to three broad segments – a) tier-I suppliers of automobile OEMs, b) aftermarkets—replacement, state transport units (STUs) and branded spares, and c) exports— to over 60 countries. The company has four operational manufacturing facilities in Tamil Nadu. As on March 31, 2020, the promoters (TVS Group) held a 65.5% stake in it. The company is at present managed by Mr. Krishna Mahesh, a fourth-generation TVS family member.

Key financial indicators (Audited)

Standalone	FY2019	FY2020
Operating Income (Rs. crore)	286.5	258.3
PAT (Rs. crore)	7.1	2.5
OPBDIT/OI (%)	4.1%	2.3%
PAT/OI (%)	2.5%	1.0%
Total Outside Liabilities/TNW (times)	1.3	1.1
Total Debt/OPBDIT (times)	2.9	4.0
Interest Coverage (times)	4.6	2.4

Source: Company data;

PAT: Profit after tax, OPBDIT: Operating profit before depreciation, interest and taxes, RoCE: Return on capital employed, TNW: Tangible net worth

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for the past three years

	Instrument	Current Rating (FY2021) Type	Amount Rated (Rs. crore)	Amount Outstanding as on March 31, 2020 (Rs. crore)	Date & Rating July 24, 2020	Chronology of Rating History for the Past 3 Years: Date & Rating in FY2020 December 02, 2019	Date & Rating in FY2019 September 20, 2018	Date & Rating in FY2018 September 18, 2017
1	CC	Long Term	55.00	**5.25**	[ICRA]BBB+ (Negative)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)
2	EPC/PCFC/ FBDN – Sublimit	Short Term	(45.00)	**18.75**	[ICRA]A2	[ICRA]A2	[ICRA]A2	[ICRA]A2
3	LC/CEL	Short Term	4.07	-	[ICRA]A2	[ICRA]A2	[ICRA]A2	[ICRA]A2
4	BG – Sublimit	Short Term	(1.50)	-	[ICRA]A2	[ICRA]A2	[ICRA]A2	[ICRA]A2

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 No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	CC	-	9.00%	-	55.00	[ICRA]BBB+ (Negative); reaffirmed
NA	EPC/PCFC/FBDN - Sublimit	-	5.55%	-	(45.00)	[ICRA]A2; reaffirmed
NA	LC/CEL	-	-	-	4.07	[ICRA]A2; reaffirmed
NA	BG Sublimit	-	-	-	(1.50)	[ICRA]A2; reaffirmed

Source: Sundaram Brake Linings 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.

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