September 10, 2019

Kataria Automobiles Pvt. Ltd.: Ratings downgraded to [ICRA]BB+/[ICRA]A4+; Outlook revised to 'Negative'

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based Term Loan	21.65	21.65	[ICRA]BB+; downgraded from [ICRA]BBB-; Outlook revised to 'Negative' from 'Stable'
Fund-based Working Capital Facilities	155.00	155.00	[ICRA]BB+; downgraded from [ICRA]BBB-; Outlook revised to 'Negative' from 'Stable'
Non-fund Based Bank Guarantee (BG)	30.00	30.00	[ICRA]A4+; downgraded from [ICRA]A3
Total	**206.65**	**206.65**	

**Instrument details are provided in Annexure-1*

Rationale

The revision in the ratings reflect the deterioration in the financial profile of Kataria Automobiles Pvt. Ltd. (KAPL) as indicated by de-growth in scale of operations, increase in inventory levels and the resultantly high working capital borrowings consequently leading to deterioration in capital structure and debt coverage indicators for FY2019. The rating revision also factors in the ongoing slowdown in the domestic passenger vehicle (PV) industry, which coupled with higher than-envisaged debt-funded capital expenditure (capex) undertaken by the company in the past two fiscals is likely to exert pressure on its credit metrics over the medium term. The ratings continue to remain constrained by the stiff competition faced by the company from a number of established dealers of Maruti Suzuki India Limited (MSIL) and other Original Equipment Manufacturer (OEM)'s as well as new entrants in the dealership business, resulting in pressure to pass on the price discounts to customers and thereby limiting the profitability. The profitability remains inherently low in the automobile-dealership business, with the commission structure decided by the principal, although, the revenues derived from higher-margin segments including workshop income, sale of spares and accessories support the profitability to an extent. ICRA also takes into account the significant advances extended to its Group companies as any delay in recovery or any increase in the quantum of these advances would adversely impact its credit profile.

The ratings positively factor in the management's commitment to deleveraging the balance sheet by efficient inventory management, recovery of advances extended to group entities as well as various cost optimisation measures undertaken in FY2020, which are likely to support liquidity, going forward. The ratings continue to take comfort from the extensive experience of its promoters in the auto-dealership business, MSIL's leadership position and KAPL's strong market position through widespread presence in Gujarat.

The Negative outlook reflects ICRA's expectations of a further deterioration in the credit profile of KAPL, primarily due to the expected continued slowdown in the PV industry, which may pressurise its sales volumes and could lead to significant inventory pile up, which could in turn further impact the company's credit metrics and liquidity. The outlook may be revised to Stable in case of faster-than-expected recovery in the domestic PV industry and pickup in MSIL's sales, which augur well for the company's cash flows. The revision in outlook could also be supported by the company's efforts to deleverage by efficient inventory management or through inorganic means, such as equity fund raising, or significant recovery of advances extended to group companies and related parties.

Key rating drivers and their description

Credit strengths

Extensive experience in the auto-dealership business - Kataria Group has an extensive experience of over three decades in the automobile-dealership business. Apart from MSIL dealership in Gujarat, the Group also has authorised dealerships for TVS' two and three wheelers, Porsche's four wheelers and Bharat Benz (Daimler Trucks).

MSIL's leadership position and KAPL's strong market position through widespread presence in Gujarat - KAPL is an authorised dealer of MSIL, the market leader in the passenger car segment with over 50% share in India. KAPL has an established presence in Gujarat and has in the recent past ventured in the Bengaluru market. In terms of volume, KAPL is amongst the largest MSIL dealer in India, accounting for 2.29% of MSIL's volume during FY2019.

Cost optimisation, expected recovery of advances from group entities and flexibility on interest and lease payments to support liquidity, going forward – The company has undertaken cost optimisation measures such as cutdown in manpower and director's salary and savings in power costs to the tune of ~Rs. 3.00 crore p.a. with the installation of windmill. It also has flexibility with regards to lease payments and interest payment on unsecured loans from promoters and related parties (cumulatively worth ~14 crore). KAPL has extended advances worth ~Rs. 108.72 crore to its group concerns. The group entities have monetised assets worth Rs. 46.00 crore during the current fiscal and repaid advance of Rs. 13.90 crore to KAPL. Going forward, the balance advances may be recovered on need basis. Moreover, KAPL has plans to liquidate the unsold real estate inventory (market value of ~Rs. 27.00 crore), which also provides some comfort.

Credit challenges

Weakening of financial profile in FY2019 – The company's financial profile weakened in FY2019 as indicated by de-growth in scale of operations (11% de-growth in operating income from Rs. 2339.48 crore in FY2018 to Rs. 2077.62 crore in FY2019), increase in debt levels (from Rs. 467.70 crore as on March 31, 2018 to Rs. 540.86 crore as on March 31, 2019) resulting in deterioration in capital structure and coverage indicators (Total Debt/OPBDITA of 7.17 times, interest cover at 1.39 in FY2019 as compared to 6.67 times and 1.44 times respectively in FY2018). The DSCR also stood at 1 time for FY2019.

Low profit margins with limited scope for margin expansion - Inherent to the automobile-dealership business, with the commission structure decided by the principal, the profit margins have been low for KAPL. However, the revenues derived from higher-margin segments including workshop income, sale of spares and accessories support the profitability to an extent.

Intense competition in the automobile-dealership industry - KAPL enjoys a strong competitive position, however, it faces stiff competition due to the presence of several dealerships. Along with the competition from dealers of other four-wheeler OEMs, the company also competes with other MSIL-authorised dealers in Gujarat. The rising competition forces the dealers to pass on higher discounts, thereby lowering the profitability.

Exposure to cyclical nature of the Indian PV industry - The slowdown in economy, inflationary trend and policy changes impact consumer discretionary items like car purchase. Although the demand for PVs was stable in H1 FY2019, various factors like high interest rates on car loans, increase in insurance costs, fluctuating fuel prices, etc, led to demand slowdown in H2 FY2019, which resulted in a moderate growth of ~4% in FY2019. Additionally, shared mobility, liquidity crunch and muted demand in rural areas in H2 FY2019, slowed the growth of the PV segment.

Liquidity position: Stretched

KAPL's liquidity is **stretched** with negative cash flow from operations in FY2019 given the heightened working capital requirements following inventory pile up, high average working capital utilisation of 90% in the past fifteen months period from April 2018 to June 2019 and high debt repayment obligation of ~Rs. 29 crore in FY2020 as compared to estimated net cash accruals of ~Rs. 30.66 crore. The availability of free cash of Rs. 11.25 crore as on March 31, 2019 and the recovery of advances from group companies of ~Rs. 14.00 crore in 5MFY2020 as well as further recovery of advances expected in the near term coupled with cost optimization measures undertaken by the management is expected to support the liquidity to a certain extent.

Rating sensitivities

Positive triggers – ICRA could upgrade KAPL's rating if the company demonstrates a sustained improvement in its sales volumes and profitability. Specific credit metrics that could lead to an upgrade of KAPL's rating include (1) Interest coverage above 2.0 times on a sustained basis; and (2) DSCR greater than 1.5 times on a sustained basis. Significant recovery of advances extended to its group concerns/related parties could be a positive trigger.

Negative triggers – Negative pressure on KAPL's rating could arise if, for reasons including a shift in the industry conditions, or a rise in capex or investments, the interest coverage falls below 1.3 times or DSCR weakens to below 1.0 times. Delay in recovery of advances extended to group concerns/related parties will also put pressure on the rating.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Automobile Dealership Industry
Parent/Group Support	Not Applicable
Consolidation/Standalone	The ratings are based on standalone financial statements of the rated entity.

About the company

Incorporated in 1990, KAPL is the flagship company of the Kataria Group. It is involved in the automobile dealership of MSIL's passenger vehicles. It has its presence in various cities of Gujarat, such as Ahmedabad, Baroda, Surat, Vapi, Daman, Rajkot, Silvassa, Valsad etc., through several showrooms, true-value outlets, e-outlets and workshops/servicing facilities. Recently, the company has also expanded its reach to Bangalore by opening three showrooms in the city.

In FY2017, on a provisional basis, the company reported a net profit of Rs. 0.42 crore on an operating income of Rs. 19.21 crore compared to a net profit of Rs. 0.24 crore on an operating income of Rs. 18.98 crore in the previous year.

Key financial indicators (audited)

	FY2017	FY2018	FY2019 (Prov.)
Operating Income (Rs. crore)	2,273.0	2,339.5	2,077.6
PAT (Rs. crore)	8.9	8.9	8.3
OPBDIT/OI (%)	2.8%	3.0%	3.6%
RoCE (%)	13.1%	11.9%	11.1%
Total Outside Liabilities/Tangible Net Worth (times)	4.7	4.9	5.2
Total Debt/OPBDIT (times)	6.3	6.7	7.2
Interest Coverage (times)	1.5	1.4	1.4
DSCR	1.1	1.1	1.0

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2020)				Rating History for the Past 3 Years		
		Type	Amount Rated	Amount Outstanding	Rating	FY2019	FY2018	FY2017
					10-Sep-2019	4-Apr-2018	-	10-Jan-2017
1	Term Loan	Long Term	21.65	-	[ICRA]BB+ (Negative)	[ICRA]BBB- (Stable)	-	[ICRA]BBB- (Stable)
2	Cash Credit	Long Term	155.00	-	[ICRA]BB+ (Negative)	[ICRA]BBB- (Stable)	-	[ICRA]BBB- (Stable)
3	Bank Guarantee	Short Term	30.00	-	[ICRA]A4+	[ICRA]A3	-	[ICRA]A3

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	Term Loan	FY2017*	NA	FY2022	21.65	[ICRA]BB+ (Negative)
NA	Cash Credit	NA	NA	NA	155.00	[ICRA]BB+ (Negative)
NA	Bank Guarantee	NA	NA	NA	30.00	[ICRA]A4+

** refers to renewal*
Source: Kataria Automobiles Private Limited

Annexure-2: List of entities considered for consolidated analysis

Not Applicable

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About ICRA Limited:

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