October 17, 2019

PRABHA AUTOMOTIVE ENGINEERS PVT LTD.: Ratings reaffirmed; Outlook revised to Negative

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long term - Fund Based – Term Loan	38.0	38.0	[ICRA]BBB; Reaffirmed; Outlook revised to Negative from Positive
Short term – Fund Based	58.0	58.0	[ICRA]A2; Reaffirmed
Total	**96.0**	**96.0**	

**Instrument details are provided in Annexure-1*

Rationale

The ratings reaffirmation continues to factor in the significant experience of Prabha Automotive Engineers Pvt Ltd.'s (PAEPL) promoters in the auto ancillary industry spanning three decades, and its established relationship with its single reputed auto-original equipment manufacturer (OEM) customer - Ashok Leyland Limited (ALL). The ratings also favourably factors in the company's availability of adequate capacities located at proximity to ALL's facilities in Hosur, Alwar, Pantnagar and Chennai coupled with its well-equipped-in-house capabilities providing competitive advantage. The company also has a sizable market share in its top 2 products (Front-end structures and cabins) cumulatively accounting for ~25% share in ALL's Medium and Heavy Commercial Vehicle (M&HCV) production in India.

The ratings, however, remain constrained by PAEPL's high customer-concentration risk with entire revenues being derived from ALL coupled with its limited pricing flexibility, and its exposure to inherent cyclicality in the automobile sector especially in the M&HCV segment which is witnessing demand slowdown since the beginning of Q2FY2020. The demand slowdown has affected the company's revenue growth in Q2FY2020 and the company is likely to witness decline in its scale of operations in FY2020. The likely reduction in scale in FY2020 comes at a time when the company had heavily invested in expanding its capacities over the last two years which in turn is expected to moderate its return indicators. The ratings are also constrained by the company's moderated capital structure and debt-coverage metrics due to the recent debt-funded capital expenditure incurred for expansion of facilities.

The Negative outlook on the [ICRA]BBB rating reflects ICRA's opinion that PAEPL being an auto-ancillary company is affected by the current demand slowdown in the auto sector which is reflected in the reduced orders from its customer, ALL since the beginning of Q2FY2020.

Key rating drivers and their description

Credit strengths

Long track record of promoters in auto ancillary industry - Mr. S. Kubher is a Mechanical Engineer and has significant experience in the auto-ancillary space for more than three decades, including at the Tube Investments of India Limited, Indian Bright Steel Company Limited, and the Prabha Group, which is in existence for the past three decades. Mr.Vinod

Kubher, son of Mr Kubher, is the managing partner of Prabha Industries and has worked in Daimler Chrysler Corporation, USA, and holds a master's degree in Manufacturing Engineering from Wayne State University (Detroit, USA).

Established relationship with Ashok Leyland Limited – PAEPL is one of the oldest vendors of ALL, with proven track record of established relationship with it for three decades. It has about 25% share in the cumulative production of Front End Structure (FES) and cabins with respect to ALL's M&HCV production. FES and cabins are the top two products of the firm constituting ~50% of the total revenues of the firm.

Proximity to ALL's facilities - In order to facilitate uninterrupted supply to ALL, PAEPL has set up its manufacturing plants close to ALL's plants. Of the five locations where ALL has its facilities across India, PAEPL has its units in four locations – Hosur, Alwar, Chennai and Pantnagar. Its well-equipped in-house capabilities and its proximity to ALL's plants provide competitive advantage.

Credit challenges

Exposed to inherent cyclicality in the automobile sector especially in M&HCV segment - Since inception, PAEPL has been exclusively supplying assembled auto components to ALL. Its current product portfolio is diversified to include manufacturing tipper cabins, FES, load bodies, cowl and fuel tanks catering to M&HCV segment and load bodies to Light and Commercial Vehicle (LCV) segment. However, PAEPL derives about 80% of its revenue from M&HCV segment and this exposes it to the inherent cyclicality in this segment.

High customer concentration risk – With its entire revenues derived from a single customer - ALL, it is exposed to high customer concentration risk and its performance is directly dependent on the performance of ALL. Though ALL has been able to expand its business reach and leverage its brand equity to continue gaining market share, given the heightened competitive intensity in the domestic CV industry, ability to sustain the current pace of growth will be a challenge.

Thin margins due to limited pricing flexibility with ALL – Though the company's profit margins are unaffected by raw material price movements since both increase or decrease in input prices are passed on to ALL and its designated buyers, the profit margins remain thin due to limited pricing flexibility. The increase in in operating margins to 5.5% in FY2019 from 4.6% in FY2018 was mainly because of economies of scale as the company witnessed a revenue growth of 53.3% in FY2019 with revenues of Rs 727.0 crore increased from Rs 474.0 crore in FY2018. However, in view of the likely reduction in scale of operations in FY2020, the management has tightened its control over cost of production and other overheads in the current year in order to maintain its profit margins at current level.

Capital structure moderated due to recent debt-funded capital expenditure – The company's gearing increased to 1.6 times as on March 31, 2019 from 1.1 times as on March 31, 2018 owing to the debt-funded capital expenditure incurred in FY2018 and FY2019 which was towards setting up a third plant in Hosur, Tamil Nadu and a plant in Pantnagar to cater to fresh orders for a new product – tipper load bodies for ALL. The company also incurred a debt-funded capital expenditure of Rs 13.0 crore in Q1FY2020 towards setting up fourth plant in Hosur, however, the capex programme has been put on hold due to the recent demand slowdown. The interest coverage is likely to reduce in FY2020 due to reduction in profitability following likely reduction in scale and DSCR to be moderated owing to high term loan repayment obligation in FY2020.

Liquidity position: Adequate

The company's liquidity position is adequate as its fund flow from operations (before working capital changes) of Rs 25.2 crore, along with opening cash balance of Rs 0.98 crore and opening undrawn working capital limit of Rs 5.0 crore were adequate to cover the margin requirement of capex, margin for incremental working capital limit, and term loan repayment in FY2020. It has a term loan repayment obligation of Rs 8.53 crore in FY2020, Rs 11.0 crore each in FY2021 and FY2022. Its average utilisation of working capital borrowings were 75% in the last twelve months ending August 2019. Overall, ICRA expects the company to meet its near-term commitments through its internal and external sources (working capital borrowings) and yet be left with sufficient cash surplus either in the form of cash balance or in the form of undrawn working capital limit.

Rating sensitivities

Positive triggers – The ratings upgrade is unlikely in the near term, given the negative outlook on the automobile sector. However, over the medium term, ICRA could upgrade the ratings if the company demonstrates a sustained improvement in its capacity utilisation resulting in improved scale of operations and profitability. Specific credit metrics that could lead to an upgrade of company's rating include DSCR above 1.6 time on a sustained basis.

Negative triggers – Negative pressure on the company's ratings could arise if the subdued industry condition prevails for a prolonged period leading to reduction in capacity utilisation which reflects in decline in scale, profitability and weakening of liquidity position of the company. The ratings could also be affected for any adverse development in business linkages with ALL. Any debt-funded capital expenditure resulting in increase in gearing or a weakening in DSCR below 1.2 time could also exert negative pressure on the company's rating.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Auto Component Manufacturer
Parent/Group Support	-
Consolidation/Standalone	Standalone

About the company

PAEPL, formerly Prabha Engineers was established in 1981 as a partnership firm by Mr. S. Kubher. It was incorporated as a company in 2019. It is engaged in the manufacturing of Front End Structures (FES), cabins, load bodies, cowl and other parts (sub-assemblies) of commercial vehicles for its single large customer-ALL**.** The firm's manufacturing facilities are located at proximity to ALL's facilities in Hosur (Bangalore), Alwar (Rajasthan) and Pantnagar (Uttrakhand) and Ennore (Chennai) to cater to other OEM.

PAEPL is a part of the Prabha Group, which has two other entities - Prabha Industries ([ICRA]BBB(Stable)/A3+), a partnership firm involved in manufacturing of dies and stamped parts for auto OEMs, and Prabha Auto Products Private Limited ([ICRA]BBB-(Stable)/A3), involved in manufacturing of cabin, tipper, load bodies and other structural parts for ALL and manufacturing of stamped parts for other OEMs. Prabha Group is promoted and owned primarily by Mr. Kubher and his son Mr Vinod Kubher.

In FY2019, on a provisional basis, the company reported a net profit of Rs. 18.3 crore on an operating income of Rs. 727.7 crore compared to a net profit of Rs. 12.2 crore on an operating income of Rs. 474.6 crore in the previous year.

Key financial indicators

	FY2018	FY2019 (provisional)
Operating Income (Rs. crore)	474.6	727.7
PAT (Rs. crore)	12.2	18.3
OPBDIT/OI (%)	4.6	5.5
RoCE (%)	30.1	30.0
Total Outside Liabilities/Tangible Net Worth (times)	4.9	4.2
Total Debt/OPBDIT (times)	2.0	2.3
Interest Coverage (times)	5.3	5.7
DSCR	2.7	2.8

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 as on March 31, 2019	Rating	FY2019	FY2018	FY2017
					17-Oct-2019	28-Dec-2018	15-Mar 2018	06-Feb 2017
1	Term loan	Long Term	38.0	29.42	[ICRA]BBB (Negative)	[ICRA]BBB (Positive)	[ICRA]BBB (Positive)	-
2	Bill discounting	Short Term	58.0	-	[ICRA]A2	[ICRA]A2	[ICRA]A2	[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
	Term Loan	Sep 2017		Mar 2022	18.0	[ICRA]BBB(Negative)
	Term loan 2	Oct 2018		Oct 2022	20.0	
	Bill Discounting	-	-	-	58.0	[ICRA]A2

Source: PAEPL

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