December 02, 2019

Sundaram Brake Linings Limited: Ratings reaffirmed

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+ (Stable); reaffirmed
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 ratings reaffirmation considers the established market position of Sundaram Brake Linings Limited (SBLL) in the friction material space, its favourable domestic-export mix, and its adequate liquidity position. The company has reputed tier-I automobile suppliers as its customers in the domestic original equipment manufacturers (OEM) segment and distributes through established pan-India players in the aftermarket segment. 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. Further, SBLL's conservative capital structure (0.4 times as on September 30, 2019), supported by relatively low working capital borrowings and absence of long-term debt support the ratings.

The ratings are, however, constrained by the company's relatively low improvement in scale of operations and weak profit margins in the last several years. While revenues grew by a modest ~4.9% CAGR in FY2015-FY2019, the operating margin (OPM) was in the range of 0.3–4.1% and net margins (NPM) were in the range of at -6.2% to 2.5% for the period. For F2019, the OPM and NPM stood at 4.1% (PY: 3.2%) and 2.5% (PY: 1.5%) respectively. For H1 FY2020, the OPM and NPM were at 2.6% (PY: 2.8%) and 0.7% (2.2%), respectively. As a cascading effect, the low profits impacted the RoCE and coverage metrics despite the relatively low debt levels. While RoCE was at 7.6% in FY2019 (PY: 5.4%), SBLL's Total Debt/OPBITDA was 4.5 times as on September 30, 2019. The company's relatively high geographical concentration in North America exposes it to regional risks. Further, the company 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.

ICRA's expects the company's revenues to remain subdued in FY2020 owing to the sharp decline in volumes in the domestic market and weak global demand, akin to other auto component players. Though the company has been undertaking strategic cost-saving initiatives, the margins were flattish on YoY basis at 2.6% in H1 FY2020, because of underutilisation of capacities resulting from subdued demand. The margins also remain vulnerable to unfavourable forex movements and raw material price fluctuations. With no incremental debt proposed over the next three years, ICRA expects SBLL's capital structure to remain comfortable in the medium term. The improvement in coverage metrics and liquidity position would largely be a function of profit improvement and cash accruals.

Key rating drivers

Credit strengths

Established market position in friction material space in India with favourable domestic-export mix: SBLL is a renowned player in the Indian friction material industry. The company counts established tier-1 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, 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 September 30, 2019, the company had only working capital borrowings of Rs. 31.2 crore and its gearing was 0.4 times (as on the same date). With minimal capex plans for the next three years and complete funding of the same through internal accruals, ICRA expects SBLL's capital structure to remain comfortable going forward.

Financial flexibility as part of the larger 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+) – two holding companies in the Group – holding a 14.1% and a 6.5% stake, respectively (as on September 30, 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

Muted automotive demand outlook in domestic and global market likely to impact FY2020 revenues: SBLL derives most of its revenues from the domestic CV industry (~36% in FY2019), though a significant port of its revenues also comes from the export markets, wherein it predominantly caters to the US HCV aftermarket. SBLL's revenues are expected to remain subdued in FY2020, akin to other auto component players, impacted by the domestic and global slowdown. While the company registered a healthy 15.6% revenue growth in FY2019, the ongoing domestic auto slowdown has resulted in its revenues declining by ~4.3% in H1 FY2020 to Rs. 134.5 crore.

Subdued profit margins and RoCE over past several years; moderate coverage metrics: SBLL's OPM remained weak in the past several years. Despite some marginal improvement in FY2019, the OPM was low at 4.1% in FY2019 (PY: 3.2%), while the net profit margin (NPM) was 2.5% in FY2019 (PY: 1.5%). For H1 FY2020, the margins were flat on a YoY basis at 2.6% because of subdued auto demand, despite the various cost-saving initiatives undertaken by the company. Despite relatively low debt levels, SBLL's RoCE and coverage metrics have been impacted because of thin profits. RoCE was at 7.6% in FY2019 (PY: 5.4%) and SBLL's Total Debt/OPBITDA was 4.5 times as on September 30, 2019.

Competition from industry incumbents and unorganised segment: 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

[1] *TVS Group holds 65.5% stake through group companies (42.3%) and individuals (2%), while the remaining stake is held by public*

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.

Exports concentrated to North America: SBLL 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.

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 FY2018 and FY2019. The company only has working capital debt and has no repayment obligations owing to the absence of long-term borrowings on its books. Its average working capital utilisation has remained comfortable over the past three years and stood at 49.4% of the drawing power and 56.3% of the sanctioned limits for the 12-month period that ended on September 30, 2019. The company had cash and liquid investments of Rs. 4.9 crore as on September 30, 2019 and undrawn working capital limits of Rs. 22.9 crore as on September 30, 2019. Going forward, SBLL does not have significant capex plans (~Rs. 5.0 crore per annum for the next three years) and this is expected to be entirely funded through internal accruals. ICRA expects the company's liquidity position to remain adequate over the medium term.

Rating sensitivities

Positive triggers –ICRA could upgrade SBLL's ratings if it achieves material improvement in its scale of operations and profit margins, with ROCE greater than 17.5% on a sustained basis, while maintaining its low debt levels.

Negative triggers – Negative pressure on ratings will emanate from sharp deterioration in earnings or significant rise in debt levels, 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

As part of the larger TVS Group, 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 September 30, 2019, the promoters (TVS Group) held a 65.5% stake in it.

The company is at present managed by Mr. Krishna Mahesh, a fourth-generation family member of Late TV Sundaram Iyengar, the founder of TVS Group of Companies.

Key financial indicators (Audited)

Standalone	FY2018	FY2019
Operating Income (Rs. crore)	247.8	286.5
PAT (Rs. crore)	3.8	7.1
OPBDIT/OI (%)	3.2%	4.1%
RoCE (%)	5.4%	7.6%
Total Outside Liabilities/Tangible Net Worth (times)	1.3	1.3
Total Debt/OPBDIT (times)	3.8	2.9
Interest Coverage (times)	3.3	4.6
DSCR	1.9	5.0

Source: company

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

	Instrument	Current Rating (FY2020)				Chronology of Rating History for the Past 3 Years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding as on June 30, 2019 (Rs. crore)	Date & Rating December 02, 2019	Date & Rating in FY2019 September 20, 2018	Date & Rating in FY2018 September 18, 2017	Date & Rating in FY2017 July 06, 2016
1	CC	Long Term	55.00	**8.80**	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)
2	EPC/PCFC/ FBDN – Sublimit	Short Term	(45.00)	**22.70**	[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

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	-	-	-	55.00	[ICRA]BBB+ (Stable)
NA	EPC/PCFC/FBDN - Sublimit	-	-	-	(45.00)	[ICRA]A2
NA	LC/CEL	-	-	-	4.07	[ICRA]A2
NA	BG Sublimit	-	-	-	(1.50)	[ICRA]A2

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.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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