

## SKH Marelli Exhaust Systems Private Limited

September 01, 2021

### Ratings

Facilities/Instruments	Amount (Rs. crore)	Ratings	Rating Action
Long Term / Short Term Bank Facilities	35.00	CARE BBB-; Stable / CARE A3 (Triple B Minus; Outlook: Stable/ A Three)	Assigned
Short Term Bank Facilities	2.59	CARE A3 (A Three)	Assigned
<b>Total Bank Facilities</b>	<b>37.59</b> <b>(Rs. Thirty-Seven Crore and Fifty-Nine Lakhs Only)</b>		

*Details of instruments/facilities in Annexure-1*

### Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of SKH Marelli Exhaust Systems Private Limited (SKH M) takes into account the strong parentage of the company, being a 50:50 joint venture between Marelli S.P.A., Italy and SKH Metals Limited, a Krishna group entity, alongside the technical assistance provided by the foreign JV partner. The ratings also factor in the strong association of the company with Maruti Suzuki India Limited (MSIL) being one of its key customers for the exhaust systems and comfortable financial risk profile of the company marked by overall gearing of less than 1x.

However, the ratings are constrained by modest scale of operations alongside low profitability margins during FY21, low bargaining power along with susceptibility of profitability margins to fluctuating raw material prices and cyclical nature of the automotive industry.

### Rating Sensitivities

*Positive Factors - Factors that could lead to positive rating action/upgrade:*

- Ability to scale up the operations as envisaged in a sustainable manner with the timely execution of new project orders and improvement in the PBILDT margin beyond 3% on a sustainable basis.
- Maintaining comfortable capital structure going forward with overall gearing below 1x.

*Negative Factors- Factors that could lead to negative rating action/downgrade:*

- Inability to scale up the operations as envisaged with delays in the execution of required production schedule with the OEMs, thereby leading to deterioration in the ROCE below 15% on sustained basis.
- Any significant deterioration in the overall gearing ratio above 1.2x owing to any major debt funded capex.

### Detailed description of the key rating drivers

#### Key Rating Strengths

##### **Strong Parentage with technical support from foreign JV**

SKH Marelli Exhaust Systems Private Limited, commenced its operations in 2008 as a manufacturer of exhaust systems [comprises of two parts: Hot-end part (catalytic converter) and cold-end part (silencer/muffler and tail pipe)] for Indian OEMs, primarily Maruti Suzuki India Limited (MSIL). It is a joint venture between SKH Metals Limited, part of Krishna group and Marelli S.P.A., Italy. Krishna Group, promoted by Kapur Holdings in 1994, is one of the largest automotive component manufacturers in India with SKH Metals Limited being the flagship company of the Metal division (SKH division) of the group. The group is one of the leading suppliers to OEMs for seat sets, door trims, mirror, roof liners, fuel tanks, exhaust systems and suspensions. Further, Marelli S.P.A., Italy is the 9<sup>th</sup> largest independent automotive supplier worldwide. Incorporated in 1919 as Magneti Marelli, the company united with Calsonic Kansei on May 10, 2019 under new worldwide brand- MARELLI. It is a diversified conglomerate having presence in diversified market segments such as electric powertrain, thermal comfort, thermal solutions, interior experience, green technology systems (exhausts), power efficiency, connected experience, automotive lighting and sensors, ride dynamics and motorsport technology leader in eco-mobility.

The company has received continuous technical assistance from Marelli S.P.A. Italy with respect to product research and development.

The company has board representation from the promoter of Krishna Group, Mr. Ashok Kapur and his son Mr. Sunandan Kapur (heads the metal division of the group). Further, Mr. Saju Mooken, Mr. Luiji Lubrano and Mr. Alessi Torti (board members of Marelli S.P.A., Italy) are also the directors of SKH Marelli Exhaust Systems Private Limited.

##### **Strong association with MSIL**

SKH M is able to leverage the strong association of Krishna Group with MSIL which contributes to around 70-75% of total revenue of the group. The company is a Tier-1 supplier of exhaust systems to one of the largest passenger vehicle OEM i.e.

Maruti Suzuki India Limited, which is currently the sole contributor to the total gross sales of the company. Although there is customer concentration risk, however, the same is offset to a certain extent as MSIL has strong presence in the Indian Automobile market and moreover, SKH M has been recently awarded 100% share of business for K10C, K15C and YG8 engines used in some of the new BSVI models of MSIL, which are expected to drive sales going forward.

Further, the company has also bagged new orders from CNH Industrial Private Limited for the tractor division, thereby de-risking the segment concentration risk.

### **Comfortable Financial Risk Profile**

The company has a comfortable capital structure with low overall gearing of 0.39x as on March 31,2021 (UA) as against 0.15x as on March 31,2020 (A). The slight moderation was primarily due to the higher utilization of the working capital limits as on balance sheet date. The total debt primarily comprised of the working capital limit of Rs.9.76 crore (against sanctioned limit of Rs.35 crore) as on March 31,2021 (PY: Rs. 3.46 crore) with negligible term debt.

### **Key Rating Weaknesses**

#### ***Modest scale of operations alongside low profitability margins***

The company reported total operating income of Rs.229.24 crore during FY21 (UA) (*refers to the period from April 01, 2020 to March 31, 2021*), recording a decline of ~21% in the past three fiscals. The company had the major share of business for the diesel vehicle engines, the production of which was severely impacted post the introduction of the BS VI norms. However, the company has recently received new business volumes from MSIL for the modified engines compatible with new BSVI variants and the same are expected to drive the sales going forward.

The profitability margins of the company stood relatively stable with during the year. The PBILDT margin slightly moderated by 35 bps and stood at 3.36% during FY21 (PY:3.71%). Further, the PAT margin stood at 0.86% during FY21 as against 1.35% during FY20.

**Q1FY22 (refers to period from April 01 2021 to June 30 2021) Performance:** The company reported top-line of Rs.76.61 crore in Q1FY22 vs. Rs.6.85 crore in Q1FY21 (sales were impacted in Q1FY21 due to complete lockdown) and Rs.75.99 crore in Q1FY20.

#### ***Low bargaining power and susceptibility of profitability margins to fluctuation in raw material prices***

The company's profitability remains exposed to the volatility in raw material price fluctuations. The main raw materials procured by the company include some precious metals, used in catalytic converters alongside steel products such as steel coils and steel pipes used in both catalytic converters and silencers. The same form major part of the overall cost structure of the company by constituting around ~92% to the gross sales of the company.

In the domestic market, the price reset is undertaken with the OEMs when there is an increase in the input prices. SKH Marelli Exhaust Systems Private Limited lodges the claim with MSIL and after negotiations, the increase in input prices is compensated by MSIL; however, there is quarterly time lag, thereby impacting the profitability margins of the company.

#### ***Cyclical nature of the automotive industry***

The automobile industry is cyclical in nature and automotive component suppliers' sales are directly linked to sales of auto OEMs. Furthermore, the auto-ancillary industry is competitive with the presence of many players in the organized as well as unorganized sector. While the organized segment majorly caters to the OEM segment, the unorganized segment mainly caters to the replacement market and to tier II and III suppliers.

As India exits the second Covid wave, the automobile sales volumes in July 2021 signify a bounce back in the industry. The domestic wholesale volumes in July 2021 have been surpassed by a wide margin compared on a YoY as well on a sequential basis. When compared with the previous month, factory dispatches of passenger vehicles, while tractor sales were lower by 40.9% due to the seasonality factor at play. When compared with July 2020, the domestic sales volumes of passenger vehicles witnessed strong growth of 44.7% in July 2021. Tractors which is already competing on a high base, grew further by 3.3% YoY.

#### **Liquidity: Adequate**

Adequate liquidity characterized by enough cushion in accruals vis-à-vis repayment obligations and moderate cash balance of Rs.1.49 Crore as on June 30, 2021. Its capex requirements are modular and expected to be funded using a combination of debt and internal accruals.

The company has efficiently managed working capital operations with negative operating cycle of 6 days in FY21 (PY: negative 10 days). Being TIER-1 supplier to one of the largest OEMs i.e. MSIL, it has limited bargaining power, with debtor days ranging between 25 to 40 days. Also, the company is required to maintain adequate inventory of raw materials for the smooth running of its production processes and as per the holding policy defined by the customers. The same usually remains in the range of 10 to 30 days (The same went up to 39 days in FY21, as it was an exceptional year due to the COVID

induced lockdowns leading to supply chain restrictions). Further, the company has comparatively relaxed payment terms with suppliers going up to 60 to 70 days.

**Analytical approach:** Standalone

**Applicable Criteria**

Criteria on assigning 'outlook' and 'credit watch'

CARE's Policy on Default Recognition

Rating Methodology-Manufacturing Companies

Criteria for Short-term Instruments

CARE's methodology for auto ancillary companies

CARE's methodology for financial ratios (Non-Financial Sector)

Liquidity analysis-Non-financial sector entities

Criteria on Factoring Linkages Parent Sub JV Group

**About the Company**

SKH Marelli Exhaust Systems Private Limited, incorporated in 2008, is a 50:50 joint venture between Marelli SPA, Italy and SKH Metals Limited, a Krishna group entity. The company is engaged into the manufacturing of exhaust systems, which primarily comprise of two-parts, hot-end (also known as catalytic converter), which had an installed capacity of 9,92,000 units during FY21 and cold-end (consists of silencer/muffler and tail pipe) with an installed capacity of 3,00,000 units during FY21. The company derives majority of its revenue from sales to Maruti Suzuki India Limited.

Brief Financials (Rs. crore)	FY20 (A)	FY21 (Prov.)
Total operating income	308.37	229.24
PBILDT	11.45	7.71
PAT	4.15	1.97
Overall gearing (times)	0.15	0.39
Interest coverage (times)	24.10	19.38

A: Audited; Prov.: Provisional

**Status of non-cooperation with previous CRA: Not Applicable**

**Any other information: Not Applicable**

**Rating History for last three years:** Please refer Annexure-2

**Covenants of rated instrument / facility:** Detailed explanation of covenants of the rated instruments/facilities is given in Annexure-3

**Complexity level of various instruments rated for this company:** Annexure 4

**Annexure-1: Details of Instruments/Facilities**

Name of the Instrument	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Fund-based - LT/ ST- Working Capital Limits	-	-	-	35.00	CARE BBB-; Stable / CARE A3
Non-fund-based - ST- Bank Guarantees	-	-	-	2.59	CARE A3

**Annexure-2: Rating History of last three years**

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2021-2022	Date(s) & Rating(s) assigned in 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019
1.	Fund-based - LT/ ST- Working Capital Limits	LT/ST	35.00	CARE BBB-; Stable / CARE A3	-	-	-	-
2.	Non-fund-based - ST- Bank Guarantees	ST	2.59	CARE A3	-	-	-	-

**Annexure-3: Detailed explanation of covenants of the rated instrument / facilities**

Name of the Instrument	Detailed explanation
<b>A. Financial covenants</b>	
<b>I. Invoice Finance of Maruti Suzuki India Limited</b>	Limits shall be proportionately reduced if escrow receipts are lower than Rs.28 crore in a month.
<b>II. Revolving loan against tentative delivery instruction from MSIL</b>	Limits shall be proportionately reduced if escrow receipts are lower than Rs.28 crore in any month.
<b>B. Non-financial covenants</b>	
<b>III. Invoice Finance of Maruti Suzuki India Limited</b>	<ul style="list-style-type: none"> <li>All invoices raised on MSIL shall be marked 'Pay to Kotak Mahindra Bank Ltd.'.</li> <li>The borrower shall submit monthly sales statements showing gross and net sales to MSIL on or before 15<sup>th</sup> of the following month.</li> </ul>
<b>IV. Bank Guarantee</b>	<ul style="list-style-type: none"> <li>Guarantee format shall be accepted by the borrower</li> <li>Guarantee format shall be accepted to the bank</li> <li>The borrower shall ensure that upon due fulfilment of the obligation underlying the bank guarantee, they shall arrange to obtain the original bank guarantee from the beneficiary and surrender the same to the bank.</li> <li>In case of discontinuation of facility from bank by the borrower, the borrower shall place term deposit of the equivalent amount with the bank for the balance of the tenor of all the bank guarantee.</li> </ul>

**Annexure 4: Complexity level of various instruments rated for this company**

Sr. No.	Name of the Instrument	Complexity Level
1.	Fund-based - LT/ ST-Working Capital Limits	Simple
2.	Non-Fund-based- ST- Bank Guarantee	Simple

**Note on complexity levels of the rated instrument:** CARE has classified instruments rated by it on the basis of complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.

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