

Marelli SKH Exhaust Systems Private Limited

September 01, 2021

Ratings

Facilities/Instruments	Amount (Rs. crore)	Ratings	Rating Action
Long Term Bank Facilities	4.00	CARE BBB-; Stable (Triple B Minus; Outlook: Stable)	Assigned
Short Term Bank Facilities	4.00	CARE A3 (A Three)	Assigned
Total Bank Facilities	8.00 (Rs. Eight Crore Only)		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of Marelli SKH Exhaust Systems Private Limited (M SKH) takes into account the strong parentage of the company, being a 50:50 joint venture between Marelli S.P.A., Italy and SKH Sheet Metal Components Limited, a Krishna group entity, alongside the technical assistance provided by the foreign JV partner. The ratings also factor in the reputed customer-base with established relationships and the comfortable financial risk profile of the company marked by overall gearing of less than 1x.

However, the ratings are constrained by small scale of operations alongside modest 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 7.50% 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 16% on a 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

Marelli SKH 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. It is a joint venture between SKH Sheet Metal Components 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 and 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 9th 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 Mookan, Mr. Luiji Lubrano and Mr. Alessi Torti (board members of Marelli S.P.A., Italy) are also the directors of Marelli SKH Exhaust Systems Private Limited.

Reputed customer-base

The company is the Tier-1 supplier of exhaust systems to some of the reputed OEMs, namely, TATA Motors Limited, FIAT India Automobiles Private Limited, Renault Nissan Automotive India Private Limited, Ashok Leyland Limited, Nissan Motors India Private Limited and Daimler India Commercial Vehicles Private Limited. Though, the top-3 customers of the company contributed more than 90% to the total gross sales of the company during FY21, thereby leading to customer-concentration

risk, however, the same is mitigated to an extent as the top-customers are well-established players enjoying strong position in the industry. Further, the strength is also derived from the long track record of relationship with these OEMs.

Comfortable Financial Risk Profile

The company displayed strong solvency position with a comfortable capital structure, whereby the overall gearing stood nil as the company had negligible debt as on March 31, 2021 (UA). The company does not have any term debt. It has sanctioned fund-based (Cash Credit) facilities of Rs.4 crore, whose utilization usually remains nil. Due to the same, the coverage ratios stood comfortable, the interest coverage ratio and Total Debt to GCA stood at 28.79x and Nil (PY: 53.52x and nil respectively).

The debt coverage indicators of the company, though, stood comfortable, however, moderated due to decline in profitability indicators. The interest coverage ratio stood at 19.38x and the Total Debt to GCA stood at 1.51x as on March 31, 2021 (PY: 24.10x and 0.40x as on March 31, 2020).

Key Rating Weaknesses

Small scale of operations alongside modest profitability

The company has small scale of operations as characterized by total operating income and net-worth base of Rs.56.17 crore and Rs.18.89 crore respectively, which derives the same of the benefits of economies of scale. The top-line of the company recorded moderation of around 5% over the past three fiscals, primarily due to the impact on the volumes of the cold-end part of the exhaust systems, which contributed major proportion of overall sales of the company. However, the company has recently bagged new orders from Piaggio India for the two-wheeler business.

The profitability margins of the company stood relatively stable during the year. The PBILDT margin stood at 7.25% during FY21 (PY: 7.28%). Further, the PAT margin stood at 2.61% during FY21 as against 2.60% during FY20.

Q1FY22 (refers to the period from April 01, 2021 to June 30, 2021) Performance: The company reported top-line of Rs.18.09 crore during Q1FY22 vs. Rs.6.85 crore in Q1FY21 and Rs.17.93 crore reported during 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 ~75% 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. Marelli SKH Exhaust Systems Private Limited lodges the claim with the OEMs and after negotiations, the increase in input prices is compensated by them; however, there is a 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 grew 14.2% and the cumulative sales of five players in the commercial vehicles industry grew 28.9% over previous month. When compared with July 2020, the domestic sales volumes of passenger vehicles, and commercial vehicles witnessed strong growth of 44.7%, and 61.6% respectively in July 2021.

Liquidity: Adequate

Adequate liquidity characterized by sufficient cushion in accruals vis-à-vis repayment obligations and modest cash balance of Rs.0.97 crore as on June 30, 2021. Its capex requirements are modular and expected to be funded using internal accruals. Its bank limits usually remain unutilized.

The company has efficiently managed working capital operations with negative operating cycle of 3 days in FY21 (PY: positive operating cycle of 3 days). Being TIER-1 supplier to one of the largest OEMs i.e. TATA Motors Limited, FIAT India Automobiles Private Limited and Renault Nissan Automotive India Private Limited, it has limited bargaining power, with debtor days ranging between 40 to 55 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 30 to 60 days. Further, the company has comparatively relaxed payment terms with suppliers going up to 70 to 105 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

Marelli SKH Exhaust Systems Private Limited, incorporated in 2008, is a 50:50 joint venture between Marelli SPA, Italy and SKH Sheet Metal Components 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 66,080 units during FY21 and cold-end (consists of silencer/muffler and tail pipe) with an installed capacity of 11,06,600 units during FY21.

Brief Financials (Rs. crore)	FY20 (A)	FY21 (Prov.)
Total operating income	56.39	56.17
PBILDT	4.11	4.07
PAT	1.47	1.47
Overall gearing (times)	-	-
Interest coverage (times)	53.52	28.79

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-Cash Credit	-	-	-	4.00	CARE BBB-; Stable
Non-fund-based - ST-BG/LC	-	-	-	4.00	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-Cash Credit	LT	4.00	CARE BBB-; Stable	-	-	-	-
2.	Non-fund-based - ST-BG/LC	ST	4.00	CARE A3	-	-	-	-

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

Name of the Instrument	Detailed explanation
A. Non-financial covenants	
I. Letter of Credit	<ul style="list-style-type: none"> • LC shall be opened only for genuine trade transactions • LCs shall not be opened favoring group companies • The bank reserves the right to verify the status report on the suppliers or obtain copies of reports as available with existing working capital banker or the borrower. • No revolving LC shall be opened unless specifically approved. • Foreign LCs shall be subject to Exchange Control and Import trade regulations • Import LCs shall be opened against valid import licenses, wherever applicable • The borrower hereby agrees, declares and confirms to: <ul style="list-style-type: none"> ➤ Retire the documents received under Foreign LCs/Inland LCs from their own sources unless specifically agreed to by the Bank. ➤ To Bear exchange rate fluctuations risk, if any. It shall also arrange for the necessary forward cover, whenever called upon to do so by the bank. The borrower has to make adequate hedging arrangements as per the bank requirements.
II. Bank Guarantee	<ul style="list-style-type: none"> • Guarantee format shall be accepted by the borrower • Guarantee format shall be accepted to the bank • In case of performance guarantees, documents specified by the bank shall be furnished from time to time in evidence of progress of performance of the underlying obligation. • 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. • 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.
III. Cash Credit	<ul style="list-style-type: none"> • The working facility granted by the bank and other banks (if any), both secured and unsecured, shall be within the overall working capital requirements assessed by the bank.

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

Sr. No.	Name of the Instrument	Complexity Level
1.	Fund-based - LT-Cash Credit	Simple
2.	Non-fund-based - ST-BG/LC	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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About CARE Ratings:

CARE Ratings commenced operations in April 1993 and over two decades, it has established itself as one of the leading credit rating agencies in India. CARE is registered with the Securities and Exchange Board of India (SEBI) and also recognized as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI). CARE Ratings is proud of its rightful place in the Indian capital market built around investor confidence. CARE Ratings provides the entire spectrum of credit rating that helps the corporates to raise capital for their various requirements and assists the investors to form an informed investment decision based on the credit risk and their own risk-return expectations. Our rating and grading service offerings leverage our domain and analytical expertise backed by the methodologies congruent with the international best practices.

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