Emson Gears Limited

October 04, 2022

Rating

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Long Term Bank Facilities	49.40 (Enhanced from 25.15)	CARE BBB-; Stable (Triple B Minus; Outlook: Stable)	Revised from CARE BB+; Positive (Double B Plus; Outlook: Positive)
Total Bank Facilities	**49.40 (₹ Forty-Nine Crore and Forty Lakhs Only)**		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

While arriving at the rating of Emson Gears Limited (EGL), CARE has taken a combined view of EGL and Osho Forge Limited [OFL ; rated CARE BBB-; Stable], as both companies (together referred to as 'Group') have common promoters, common management and operational linkages. The revision in the ratings of Emson Gears Limited (EGL) factors in the growth in scale of operations in FY22, moderate profitability margins, business synergies due to operational linkages within the group, well-established clientele, albeit high customer concentration risk and adequate liquidity position. The ratings, further continues to derive strength from experienced promoters with long track record of operations, stable demand outlook from automobiles albeit competitive auto-component industry and cyclical end-user automobile industry.

The ratings, however, continues to remain constrained due to leveraged capital structure and moderate debt coverage indicators, elongated operating cycle, susceptibility of margins to volatility in raw material prices and foreign exchange risk and presence in competitive auto-component industry and cyclical automobile industry.

Rating Sensitivities

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

- Improvement in total operating income above Rs. 400 crores with PBILDT margin at 10%
- Improvement in the operating cycle of the group below 80 days

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

- Decline in scale of operations with TOI going below Rs.300 crore on a sustained basis
- Decline in profitability margins as marked by PBILDT and PAT margin below 8.00% and 1.50% respectively

Detailed description of the key rating drivers

Key Rating Strengths

Experienced promoters with long track record of operations

The group was promoted by Mr. Ashok Kumar Dhall and Mr. Gautam Dhall. The promoters/directors have rich experience of around four decades in the industry. Both the promoters are involved in the overall business operations of the group and are ably supported by a team of professionals who are highly experienced in their respective domains. To fund various business requirement of the group in the past, regular funds have been infused by the promoters and related parties. As on March 31, 2022, the promoters and their associates has infused unsecured loan of Rs. 27.97 crores in both the companies of which Rs.24.09 crores is subordinated to the bank debt as per the terms of the sanction letter.

Growth in scale of operations in FY22

Total operating income though improved by 44% and stood at Rs. 360.13 crore in FY22 *(post adjusting intra-group sales/ purchases transactions)* on the back of pickup in demand from existing customers resulting in increase in quantum of sales across product categories. Nevertheless, the scale remains modest, modest scale limits the company's financial flexibility in times of stress and deprives it of scale benefits. The group has achieved a turnover of Rs.254.67 Cr in 5MFY23- (excluding intra group sales/purchases). The improvement in scale of operations is on the back of increased capacities, pricing impact and increase in demand from existing customers.

[2]Complete definition of the ratings assigned are available at www.careedge.in and other CARE Ratings Ltd.'s publications

Moderate profitability margins

The profitability margins of the group stood moderate for the last three financial years (FY20-FY22) wherein the company reaps benefits of its established image in the regional market. PBILDT margin of the group stood at 9.69% in FY22 and declined from 11.87% in FY21 on the back of disproportionate increase in the raw material prices in comparison to increase in its scale of operations. The sudden increase in raw material prices are settled at the end of each quarter, based on average prices prevailing in the previous quarter with the customers however, due to sharp increase in the raw material prices, the company was not able to fully absorb the price hikes. However, PAT margin improved and stood at 1.90% in FY22 as against 1.72% in FY21 on account of comparatively low finance cost. Further despite of the decline in the PBILDT margin, the GCA of the group has improved to Rs.19.87 crores in FY22 as compared to Rs.16.26 crores in FY21. Further in 5MFY23, the PBILDT margin stood 6.83% and PAT margin stood 2.56%.

Business synergies due to operational linkages within the group

EGL procures raw material (forged components and semi-finished components) largely from its group company OFL. EGL then provides value addition to the product (through machining) and subsequently sells the product to the client. Given the significant operational linkages within the group, the operational risk on account of dependence on outside suppliers for raw materials remains low. During FY22, EGL has purchased inventory valued at Rs. 102.92 crores from OGL.

Well-established clientele; albeit, concentrated

The group has established relationship with Original Equipment Manufacturers (OEM's) such as Mahindra & Mahindra (M&M; rated CARE AAA; Stable/ CARE A1+), International Tractors Limited, SML Isuzu Limited (SML; ICRA A+; Negative/ ICRA A1+) etc. Further, the reputed client base ensures timely payments and lends comfort to the revenue realization for the products sold. The group has been associated with these customers for the more than 15 years and receives regular orders from them. However, the group faces customer concentration risk with the top customer, M&M, contributing ~50% of the total income in FY22. Going forward, any deterioration in the operational & financial performance of the OEM is expected to have an impact on the overall performance of the group.

Stable demand outlook from automobiles albeit competitive auto-component industry and cyclical end-user automobile industry

The Indian auto component industry is a critical part of the OEM value chain. An organized segment of this industry includes original equipment manufacturers (OEMs) who are engaged in the manufacture of high-value precision instruments, while the unorganized segment comprises of low-valued products catering to after-market services, resulting in high competition. However, one of the main challenges faced by the indigenous component manufacturers is the low-level of technology adaptation and R&D intensity which gives an edge to organized players. But organised, mid-sized players such as Osho Forge and Emerson gears are also indigenous companies and their level of technology adaptation and R&D intensity seems to be quite high.

Key Rating Weaknesses

Leveraged capital structure and moderate debt coverage indicators

The overall gearing ratio of the group remained leveraged at 1.20x, as on March 31, 2022 (PY: 1.19x). However, the debt coverage indicators of the group improved marked by TDGCA of 6.52 times, as on March 31, 2022 (PY: 7.43x) and interest coverage ratio of 2.34x in FY22 (PY:1.97x). The improvement in the ratios was mainly on account of improvement in the net worth backed by subordination of unsecured loans to Rs.24.09 crores and profitability of the group along with low finance cost. Further for 5MFY23, the overall gearing stood below unity at 0.91x.

Elongated operating cycle

The group generated healthy cash flow from operations of ~Rs.24.50 crore in FY22 despite increase in working capital requirement due to improvement in profitability.

However, the operating cycle of the group stood elongated to ~110 days, as on March 31, 2022 (PY: 143 days). In order to cater to the demand of various types of customers, the group has to maintain a high level of WIP and FG inventory. The group has a huge product portfolio of 480 items which also leads to high level of inventory holding (120 days as on March 31, 2022). On the client side, the group has a well-established and reputed customer base to which it extends a credit period of upto 120 days leading to average collection days stood at 53 days, as on March 31, 2022 (PY: 54 days). On the raw material procurement side, the group is offered payment terms ranging from 80 days to 150 days by its suppliers leading to average creditors days of 63 days.

Susceptibility of margins to volatility in raw material prices

The operations of the group are raw material intensive in nature with the raw material cost constituting ~50% of the income in FY21-22 period. With global steel prices highly volatile in nature and susceptible to speculative trading, the margins of group are exposed to raw material fluctuation risk. Given large variety of products being manufactured for different types of customers, which necessitates large inventory holding, the margins are exposed to any adverse movement in the raw material prices.

Presence in competitive auto-component industry and cyclical automobile industry

The Indian auto component industry is a critical part of the OEM value chain. An organized segment of this industry includes Original equipment manufacturers (OEMs) who are engaged in the manufacture of high-value precision instruments, while the unorganized segment comprises of low-valued products catering to after-market services, resulting in high competition. However, one of the main challenges faced by the indigenous component manufacturers is the low-level of technology adaptation and R&D intensity which gives an edge to organized players.

Liquidity analysis: Adequate

The current and quick ratios of the group stood moderate at 1.24x and 0.57x, as on March 31, 2022. The group had unencumbered cash and bank balance of Rs. 0.21 crore as on March 31, 2022. Further, the amount of Rs.10.20 crores has been utilised of CC to create FD as on March 31, 2022 due to which the cc utilisation appears higher. However, currently the unutilised cc limits stood ~Rs.4 crores.

Also, against expected cash accruals of Rs.25.38 crore in FY23, the group has scheduled repayments of Rs.13.80 crore indicating substantial cushion in its liquidity. Further, the group generated healthy cash flow from operations of ~Rs.24.50 crore in FY22 despite increase in working capital requirement due to improvement in profitability.

Analytical approach:

Combined Approach. The combined business and financial risk profiles of Emson Gears Limited (EGL) and Osho Forge Limited (OFL) have been considered as both companies (together referred to as 'Group') have common promoters, common management and have operational linkages.

Applicable Criteria

Policy on default recognition
Consolidation
Factoring Linkages Parent Sub JV Group
Financial Ratios – Non financial Sector
Liquidity Analysis of Non-financial sector entities
Rating Outlook and Credit Watch
Auto Ancillary Companies
Manufacturing Companies

About the Company

Emson Gears Limited (EGL) belongs to the Emson Group of Punjab, founded in 1970 and has a group company- Osho Forge Limited (OFL; rated CARE BBB-; Stable). EGL was incorporated as a partnership firm in 1970 by the name, 'M/s Emson Sales'. In April 1996, the firm was reconstituted as a closely held company to take-over the business carried out under the firm. EGL is engaged in the manufacturing and selling of automobile parts such as differential and transmission gears, crown wheels and pinions, etc. OFL is a closely held company incorporated in June 1993. It is engaged in the manufacturing of automobile parts such as axles, bull gears and shafts. The company has both forging and machining facilities at its manufacturing plants. The manufacturing facilities of the group are located in Ludhiana, Punjab and the parts manufactured are primarily sold to OEMs (Original Equipment Manufacturers) based in India catering to the tractor and commercial vehicle industry.

Brief Financials** (₹ crore)	March 31, 2021 (A)	March 31, 2022 (A)	5MFY23*
Total operating income	249.47	360.13	254.67
PBILDT	29.61	34.90	17.40
PAT	4.30	6.86	6.53
Overall gearing (times)	1.19	1.20	0.91
Interest coverage (times)	1.97	2.34	3.12

A: Audited

**refers to the period from April 1, 2022 to August 31, 2022.*

**Combined financials

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	ISIN	Date of Issuance (DD-MM-YYYY)	Coupon Rate (%)	Maturity Date (DD-MM-YYYY)	Size of the Issue (₹ crore)	Rating Assigned along with Rating Outlook
Fund-based - LT-Cash Credit		-	-	-	37.75	CARE BBB-; Stable
Fund-based - LT-Term Loan		-	-	November 2026	11.65	CARE BBB-; Stable

Annexure-2: Rating history for the last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating History			
		Type	Amount Outstanding (₹ crore)	Rating	Date(s) and Rating(s) assigned in 2022-2023	Date(s) and Rating(s) assigned in 2021-2022	Date(s) and Rating(s) assigned in 2020-2021	Date(s) and Rating(s) assigned in 2019-2020
1	Fund-based - LT-Cash Credit	LT	37.75	CARE BBB-; Stable	-	1)CARE BB+; Positive (03-Dec-21) 2)CARE BB+; Stable (05-Apr-21)	1)CARE BB+; Stable (07-Apr-20)	-
2	Fund-based - LT-Term Loan	LT	11.65	CARE BBB-; Stable	-	1)CARE BB+; Positive (03-Dec-21) 2)CARE BB+; Stable (05-Apr-21)	1)CARE BB+; Stable (07-Apr-20)	-

Annexure-3: Detailed explanation of covenants of the rated instrument / facilities: Not Applicable

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

Sr. No.	Name of Instrument	Complexity Level
1	Fund-based - LT-Cash Credit	Simple
2	Fund-based - LT-Term Loan	Simple

Annexure-5: Bank lender details for this company

To view the lender wise details of bank facilities please click here

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

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About us:
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