RACL Geartech Limited

October 27, 2021

Ratings

Facilities/Instruments	Amount (Rs. crore)	Rating[1]	Rating Action
Long Term Bank Facilities	131.53 (Enhanced from 106.52)	CARE A-; Stable (Single A Minus; Outlook: Stable)	Revised from CARE BBB+; Stable (Triple B Plus; Outlook: Stable)
Short Term Bank Facilities	5.00	CARE A2 (A Two)	Revised from CARE A3+ (A Three Plus)
Total Bank Facilities	**136.53 (Rs. One Hundred Thirty-Six Crore and Fifty-Three Lakhs Only)**		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The revision in the ratings assigned to the bank facilities of RACL Geartech Limited factors in the consistent improvement in the operational performance of the company during FY21 (refers to period from April 01 to March 31) marked by higher than envisaged profitability margins supported by y-o-y increase in exports and addition of new customers. Further, the ratings of the company continue to derive strength from experienced promoters along with their long track record of operations, established player in the transmission gears and shafts for automotive applications along with the reputed customer base, comfortable financial risk profile marked by improvement in the capital structure and comfortable debt coverage indicators and the geographically diversified revenue mix. However, the ratings are constrained by raw material price volatility risk along with the presence of foreign exchange fluctuation risk, high working capital intensive nature of operations along with cyclical nature of the automotive industry.

Rating Sensitivities

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

- Sustained improvement in the scale of operations beyond Rs.300 crores while maintaining the profitability margins and continued relationship with its key customers.
- Further improvement in the capital structure leading to overall gearing of below 0.75x.

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

- Decline in the scale of operations below Rs.200 crores.
- Higher than envisaged capex leading to deterioration in the capital structure with an overall gearing of more than 1.2x.

Detailed description of the key rating drivers

Key Rating Strengths

Improved operational performance

The improvement in the operational performance of the company during FY21 is reflected by its higher than envisaged profitability margins. The company's PBILDT margin improved by 556 bps and stood at 26.48% during FY21 (PY: 20.92%). The same is due to the sale of prototypes (which consist of high margins), modernization and cost-efficient measures adopted by the company alongside significant presence in the export market. Further, the PAT margin also improved and stood at 11.28% during FY21 (PY: 7.98%) in line with the improvement in PBILDT.

Even though the company had modest scale of operations whereby its total operating income stood at Rs.207.35 crore during FY21, however the same is mitigated by the company's significant presence into the export market and catering to some of the premium segment customers. Despite Q1FY21 being a subdued quarter for the company due to COVID-19 led disruptions, the company picked up significant pace since H2FY21, recording sales of Rs.134.46 cr. as against Rs.73.26 cr. in H1FY21.

Q1FY22 (refers to period from April 01 to March 31) Performance: The company reported top-line of Rs.57.52 crore in Q1FY22 as against Rs.23.41 crore in Q1FY21 and Rs.52.89 crore in Q4FY21, thereby reporting better performance even from pre-covid levels.

Experienced promoters

RGL has more than three and a half decades of presence in the automobile component industry. Mr. Gursharan Singh, CMD of the company, joined the company as a plant head and has been associated with the company since its inception. He is a mechanical engineer with Post-Graduate Diploma in Export Management. He is ably supported by a team of professionals who have been with the company for more than two decades.

[1]*Complete definition of the ratings assigned are available at www.careratings.com and other CARE publications*

Established player in transmission gears and shafts for automotive and industrial applications
RGL is engaged in the business of manufacturing of transmission gears and shafts for automotive and industrial applications since 1980s. The company has renowned Original Equipment Manufacturers (OEMs) in the auto as well as industrial segment as its long-standing customers. It has an established relationship with some of the leading global original equipment manufacturers (OEMs) which cater to the premium segment. RGL's business risk profile has improved over the years by adding new customers by increasing its product portfolio and entering into new segment of automobile industry. The addition in customer base was supported by supply of quality products while adhering to international standards laid down by international quality assessment team.

Reputed customer base
Though, RGL has moderate concentration risk with top five customers contributing ~78% revenue in FY21 (PY: 73%), however, comfort is drawn from the fact that the company is a preferred vendor for many of its premium segment export customers with whom it has long-term relationships. Also, the management as a part of its strategy ensures that sales does not exceed 20% to any single customer. The largest contributor during FY21 was 18% of the sales and thereby reduces dependence on few customers.

Geographical and segment-wise diversification
The export sales of the company have been increasing consistently and it formed around 76% of total gross sales during FY21 (PY: 70% of total gross sales). Of the total sales in FY21, nearly 51% of the sales were in Europe, 39% in India and Asia Pacific region and remaining from USA and Mexico. RGL earns relatively higher margins in export as the company is exporting its products to OEMs catering to premium segment. In terms of end-user segmentation, 2-wheelers contributed 45% of revenue in FY21 as against 47% in FY20 followed by tractors which contributed ~22% to the total gross sales during FY21 (PY: ~16%). Diversified product offering provides a competitive edge to the company /and makes it more sustainable in the long run.

Comfortable Financial Risk Profile
The capital structure of the company remained moderate, however it slightly improved with an overall gearing of 1.02x as on March 31, 2021 (PY: 1.07x as on March 31, 2020). The improvement is on account of increase in the net-worth base of the company with accretion of profits. Owing to better profitability, the coverage indicators also improved. The interest coverage ratio and Total Debt to GCA ratio stood at 6.48x and 2.87x as on March 31, 2021 (PY: 5.27x and 3.29x respectively).

Key Rating Weaknesses
Foreign Exchange fluctuation and raw material price risk
The company derives its revenue majorly through exports which is approx. 76% (PY: 67%). Though the profitability margins are exposed to volatility in foreign exchange however the same are mitigated with the availment of export credit in foreign exchange. Further, the company discounts the invoices with banks at an early stage to minimize the forex fluctuation risk. Further, the company's main raw material include steel and forgings and the increase/decrease in their prices also exposes the company to raw material price risk, however, the same is mitigated as there is pass through to the customers.

Working capital intensive nature of operations
Being in auto ancillary industry, the operations of the company are working capital intensive in nature. The company has to maintain inventory of around 3.5 months with large product range (more than 500 products under regular production). Credit period of close to 2 months is allowed to domestic customers, contributing 27% of total operating income, while collection from overseas customers, which contributes 76% of total operating income, usually happens in 3-4 months. Furthermore, the company gets credit period of up to 1.5 months from the suppliers which it has been reducing to avail cash discounts. Overall, this leads to a working capital cycle of around 5 months, which further leads to high reliance on the fund-based facilities to meet the working capital requirements. The average working capital utilization remained 68.2% during trailing 12-month period ended Aug, 2021.

Cyclicality nature of the automotive industry
The automobile industry is highly cyclical in nature and automotive component suppliers' sales are directly linked to sales of auto OEMs. Furthermore, the auto-ancillary industry is highly competitive with the presence of a large number of 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.

Industry Prospects
India manufactures several key auto components for customers in the US, Germany, Turkey, Thailand, Turkey, Thailand, UK, Brazil, Mexico, Bangladesh, Italy, U.A.E. and Sri Lanka, among others. Furthermore, the gap between international and national regulations on safety and emissions has narrowed down considerably, bolstered recently by the compulsory implementation

of BS-6 emission norms in April 2020. Also, as the need for reducing cost of manufacturing is increasingly being felt among the automobile OEMs in the developed countries, they seek to either set up their operations or source their component requirements from developing nations like India. FY21 was a year of transition for the Indian auto components industry. The year presented fresh challenges in the form of outbreak of covid-19 and the resultant supply side disruptions, loss in production of automobiles, rise in input costs, trade disruptions, etc. Alongside, the industry also witnessed business growth opportunities for the long term. The announcement of an incentive-based vehicle scrappage policy, though voluntary, is expected to lead to a rise in automobile sales in the country, which has a direct benefit for the auto components industry. Additionally, the government's focus on quick adoption of electric vehicles may create significant potential for auto component manufacturers. The PLI scheme would encourage investments in the industryFY22 is expected to witness a positive growth of 18 to 20%, after two consecutive fiscals of de-growth.

Liquidity: Adequate
Adequate liquidity characterized by sufficient cushion in estimated gross cash accruals of Rs.45.35 crore vis-à-vis repayment obligations of Rs.20.42 crore and modest cash balance of Rs.0.89 crore as on March 31, 2021. Further, the company is planning to undertake capex of Rs.50 crore in FY22 for the purpose of upgradation/modernization of its existing unit and the same is expected to be funded by addition in term debt by Rs.37.66 crore while remaining from internal accruals. The bank limits are utilized to the extent of 68.2% for the trailing twelve months and it has sought enhancement in bank lines, supported by above unity current ratio, which stood at 1.18x as on March 31, 2021 (PY: 1.19x).

Analytical approach: Standalone

Applicable Criteria
Policy on default recognition
Financial Ratios – Non financial Sector
Liquidity Analysis of Non-financial sector entities
Rating Outlook and Credit Watch
Short Term Instruments
Auto Ancillary Companies
Manufacturing Companies

About the Company
RGL (formerly Raunaq Automotive Components Limited) was incorporated in 1983 and is engaged in the business of manufacturing of transmission gears and shafts for automotive and industrial applications. The company was initially promoted by the Raunaq Group. However, due to financial difficulties the company was referred to Board for Industrial and Financial Reconstruction (BIFR) in 2001. Post-restructuring and with a new management team under leadership of Mr. Gursharan Singh (CMD), RGL came out of the BIFR purview in November 2007. The company has two manufacturing units in Uttar Pradesh at Gajraula and Noida.

Brief Financials (Rs. crore)	31-03-2020 (A)	31-03-2021 (A)
Total operating income	212.83	207.35
PBILDT	44.53	54.91
PAT	16.98	23.38
Overall gearing (times)	1.07	1.02
Interest coverage (times)	5.27	6.48

A: Audited

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	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Fund-based - LT-Term Loan		-	-	March, 2024	55.03	CARE A-; Stable
Fund-based - LT-Cash Credit		-	-	-	76.50	CARE A-; Stable
Non-fund-based - ST-BG/LC		-	-	-	5.00	CARE A2

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-Term Loan	LT	55.03	CARE A-; Stable	-	1)CARE BBB+; Stable (03-Sep-20)	1)CARE BBB; Positive (09-Aug-19)	1)CARE BBB; Stable (01-Aug-18)
2	Fund-based - LT-Cash Credit	LT	76.50	CARE A-; Stable	-	1)CARE BBB+; Stable (03-Sep-20)	1)CARE BBB; Positive (09-Aug-19)	1)CARE BBB; Stable (01-Aug-18)
3	Non-fund-based - ST-BG/LC	ST	5.00	CARE A2	-	1)CARE A3+ (03-Sep-20)	1)CARE A3 (09-Aug-19)	1)CARE A3 (01-Aug-18)

** Long Term / Short Term*

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

Name of the Instrument	Detailed explanation
A. Financial covenants	
I. Term Loan	a) DSCR to remain at minimum of 1.2x during the tenor of the facilities. b) External debt/EBITDA to remain <4x during the tenor of the facilities. Unsecured loans to be excluded.

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
3	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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