Akar Auto Industries Limited

March 05, 2020

Ratings

Facilities	Amount (Rs.crore)	Rating	Rating Action
Long Term / Short Term Bank Facilities	20.00	**CARE BB; Stable / CARE A4 (Double B, Outlook: Stable; A Four)**	**Assigned**
Short term Bank Facilities	5.00	**CARE A4 (A Four)**	**Assigned**
Total Facilities	**25.00 (Rs. Twenty five crore only)**		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of Akar Auto Industries Limited (AAIL) are constrained by modest scale of operations, below average profitability margins, volatile input prices, working capital intensive nature of business reflected in the highly utilized bank limits and moderately higher leverage, pricing pressure from the OEM's, susceptibility to the cyclicality of domestic automobile segment.

However, the ratings derive strength from promoter's experience in the field of auto ancillary and steel industry, long term relationship with reputed and diversified clientele, continuous growth in total operating income however the operating performance of AAIL is expected to remain subdued during FY20 owing to the automobile slowdown.

The ratings also reflect the subdued 9MFY20 (refers to the period April 1, 2019 to December 31, 2019) performance of the company.

Rating Sensitivities

Positive Factors

- Ability to improve scale of operations ~Rs.300 crore and improve operating profitability margin beyond 8.00%.
- Moderation in the average utilization of the cash credit facility below 90%
- Improvement in Term Debt to GCA (TDGCA) ratio below 6.00 times
- Turnaround in the automobile sector

Negative Factors

- Any incremental debt which would lead to deterioration in the overall gearing above 3.00x
- Further weakening of the profitability margins
- Sustained higher bank utilization levels

Detailed description of the key rating drivers

Key Rating Weaknesses

Decline in Total operating income and thin profitability as reflected in the 9MFY20 numbers

During the 9MFY20, the total operating income contracted to Rs. 154.47 crore from Rs.217.88 crore during 9MFY19 registering a y-o-y decline of 29% on account of subdued demand owing to the current slowdown in the domestic automobile industry. Likewise the PBILDT and PAT margin also declined and was at 6.77% and 1.15% respectively. However, AAIL is trying to diversify its customer portfolio and is concentrating more on export market to fetch better margins.

Volatility in raw material prices and dependence on Group Company for procurement

The prices of steel have had been fluctuating in the past due to volatility in the global commodity markets. Moreover, AAIL operates in an industry where the raw material cost is one of the major cost drivers (constituting about ~65% of TOI over the years) and one of the major components to impact operating margin. AAIL procures around 60% of raw material from its group companies for various grades of steels manufactured by them. Any adverse impact on the operations of these group companies may impact the timely procurement of raw materials and subsequently costs of these materials, thus creating concentration risk. The prices are negotiated with customers especially OEMs, when the price of the raw material increases, the same is incorporated within the next quarter, however impact of time lag remains.

Susceptibility to cyclicality in the end user segment
The leaf spring industry in India is a commoditized business and prone to cyclicality from the automobile segment. AAIL derives majority of its income from the two-wheeler segment, commercial vehicle & passenger vehicle segment, with hardly any replacement demand for AAIL products. This inherent cyclicality in these industries could pose a challenge for the company and hamper its growth prospects in future, thereby affecting its revenue generation capabilities and profitability. A fall in the level of economic activity can impact the sales of the automotive industry as the automobile manufacturers may limit the production levels. Also, customer proximity through multiple-location manufacturing and cost-efficiency to manage end-segment cyclicality are imperative for a strong competitive positioning. AAIL mitigates this risk with its manufacturing facilities located in the proximity of the industrial hubs at Aurangabad.

Competition from organized and unorganized players
AAIL manufactures products and operates in an industry which comprises of several players in the unorganized sector and is also characterized by high degree of fragmentation. There also exist big sized players resulting in intense competition in the industry. The industry is characterized by low entry barriers and low level of product differentiation due to minimal technological inputs and availability of standardized machinery for production. Further, it is also challenging for smaller players to achieve the preferred vendor status.

Risk associated to foreign exchange fluctuation
The company faces foreign exchange fluctuation risk as it exports various products to its overseas customer. The company partially hedges its foreign exchange exposure by using forward contracts. AAIL hedges nearly 50% of the export receivables through forward contracts.

Key Rating Strengths
Long track record of operations and over two decades of experience possessed by the promoters
Akar Auto Industries Limited (AAIL) has a track record of more than two decades of operations. The company is promoted by Mr. R.L. Gupta (Chairman) and family group, holding ~73% of shares as on December 31, 2019. He has a vast experience of more than five decades in the industry. Mr. N.K. Gupta (Director), son of Mr. R.L. Gupta, is a graduate and has an experience of 40 years in steel, hand tools & forging industries. He is responsible for the production and administration activities in the company. The directors are involved in the day to day activities of the business and are ably supported by a qualified and professional management team who looks after various activities of production, procurement, finance and administration.

Financial risk profile marked by growth in revenue coupled with low yet stable operating profit margins, moderate capital structure and debt coverage indicators
AAIL reported a CAGR growth of 16% in the total operating income for the last three years ending March 31, 2019. The company registered ~12% y-o-y growth in total operating income to Rs 277.41 crore in FY19 from Rs.246.70 crore in FY18 on account of better capacity utilization and sales realization for forging and leaf springs divisions. The overall gearing remained leveraged at 2.05x as on March 31, 2019 as against 2.09x as on March 31, 2016 however debt to equity ratio continued to remained moderate at 0.30x as on March 31, 2019 (as against 0.48x as on March 31, 2016). This is due to the unsecured loan extended by the promoters which will be subordinated in the current year, thereby moderately improving the capital structure. The total debt to GCA improved from 10.76x as on March 31, 2016 to 6.00x as on March 31, 2019, however remains high. Interest coverage ratio remained moderate at 2.16x during FY19.

Strong clientele base with more focus on acquisition of export clients
AAIL derives 80-85% of its total operating income from the domestic market and remaining from the export market. AAIL exports to global developed markets like USA, Europe and Mexico. However during H1FY20, export sale was ~23% of its total operating income.
The company's customer base includes clients such as Ashok Leyland Limited*,* Tata Motors Limited*,* York Transport Equipment (India) Private Limited and Bajaj Auto Limited *etc.* The clientele operates in diverse end user industries such as automotive and professional tools etc. The established track record of AAIL has assisted in ensuring repeat orders.

Diversified product portfolio
AAIL manufactures a diverse variety of products which caters to automotive and non-automotive original equipment manufacturers (OEMs). It includes leaf springs, forgings, tool kits and hand tools. Leaf springs and forgings majorly find its application in the automotive segment.

Liquidity: Stretched
Liquidity is marked by accruals of Rs.8.93 crore to repayment obligations of Rs.2.39 crore, fully utilized bank limits at 95% and modest cash balance.
AAIL operates in a working capital intensive industry, with the operating cycle in the range of 60- 75 days over the last 3 years. The collection period has been reducing over the years and stood at 50 days during FY19. The inventory period days also came down over the years and remained at 82 days in FY19. Current ratio stood at 1.17x as on March 31, 2019.

Analytical Approach: Standalone
Applicable Criteria
Criteria on assigning 'Outlook' and 'Credit Watch' to credit ratings
CARE's Policy on Default Recognition
Rating Methodology - Manufacturing Companies
Rating Methodology - Auto Ancillary Companies
Financial ratios – Non-Financial Sector

About the Company
Akar Auto Industries Limited (Formerly Akar Tools Limited), AAIL was founded by Mr. R.L. Gupta (Chairman) as a private limited company in the year 1989. AAIL manufactures hi- quality precision engineered forging components, Hand Tools, Tool kits and Leaf Springs to cater to major auto & non-auto OEM's. AAIL is a part of Aurangabad based R.L. Group of Industries whose sister concern R.L. Steels & Energy Limited is engaged in manufacturing alloy steel products in rounds, squares, flats and special profiles. AAIL procures majority of the raw material from its group entity R.L. Steels & Energy Limited and supplies its end products to major OEMs domestically and exports to competitive markets like North America, both in auto & non-auto OEM's. With a workforce of more than 400, AAIL has four manufacturing facilities with a total installed capacity of 44100 MTPA coupled with state-of-the art machining & testing facilities located in various industrial hubs in Aurangabad. AAIL became a Public Limited Company and was listed on BSE/NSE in 1994.

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

Brief Financials (Rs. crore)	FY18 (A)	FY19 (A)	9MFY20 (UA)
Total operating income	246.70	277.41	154.47
PBILDT	16.82	17.49	10.46
PAT	3.20	5.21	1.77
Overall gearing (times)	2.31	2.05	NM
Interest coverage (times)	1.99	2.16	NM

A: Audited, UA: Unaudited, NM: Not Meaningful

Status of non-cooperation with previous CRA: IND BB+/ IND A4+ (Issuer Not Cooperating) (Reaffirmed on April 26, 2018)

Any other information: NA

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

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-CC/PC/Bill Discounting	January 01, 1753	-	-	20.00	CARE BB; Stable / CARE A4
Non-fund-based - ST-Letter of credit	January 01, 1753	-	-	5.00	CARE A4

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 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017
1.	Fund-based - LT/ ST-CC/PC/Bill Discounting	LT/ST	20.00	CARE BB; Stable / CARE A4	-	-	-	-
2.	Non-fund-based - ST-Letter of credit	ST	5.00	CARE A4	-	-	-	-

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

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