

Akar Auto Industries Limited

May 19, 2020

Ratings

Facilities	Amount (Rs.crore)	Rating	Rating Action
Long Term Bank Facilities	12.23	CARE BB; Stable (Double B, Outlook: Stable)	Assigned
Long Term / Short Term Bank Facilities	20.80 (enhanced from 20.00)	CARE BB; Stable / CARE A4 (Double B, Outlook: Stable; A Four)	Reaffirmed
Short term Bank Facilities	28.50 (enhanced from 5.00)	CARE A4 (A Four)	Reaffirmed
Total Facilities	61.53 (Rs. Sixty one crore and fifty three lakh only)		

Details of facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The reaffirmation of ratings to the long term and short term 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 cyclical nature of domestic automobile segment. The rating continues to factor in the subdued demand prevailing in the automobile sector which is further impacted by the outbreak of Covid-19 which led to shut down of the manufacturing facilities, slow inflow of customer advances.

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 FY20 (refers to the period April 1, 2019 to March 31, 2020) performance of the company and the impact of Covid-19 in the current quarter.

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
- Any major deterioration in operational or financial performance due to the Covid-19 outbreak

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. Further, the Q1FY21 numbers are likely to reflect the impact of Covid-19 outbreak. 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. 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. AAIL procures around 60% of its raw material requirement from its group companies for various grades of

steels manufactured by them. However, the company is lowering its dependence over the years. Hence this remains a key rating monitorable.

Susceptibility to cyclicalities in the end user segment

The leaf spring industry in India is a commoditized business and prone to cyclicalities 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 cyclicalities 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 cyclicalities 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. However, in the absence of any long term liabilities or assets, the risk associated with foreign exchange fluctuation is comparatively lower.

Subdued Industry Scenario

The automobile market was under the grips of weak demand with a drastic fall in growth, nationwide lockdown due to Covid-19 pandemic has put the brakes on production lines. The return of normal activities at factories could take a longer time. While major OEMs have announced restarting of their plants, the supply chain till the last mile component manufacturers will need to come on stream. Having faced with disruption, the small scale component manufacturers would have their own challenges to make a kickstart immediately. Due to this recent chain of events the sector is witnessing almost negligible sales and hence this shall remain a key rating monitorable.

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 1.19x as on March 31, 2019 as against 2.31x as on March 31, 2018 however debt to equity ratio continued to be moderate at 0.22x as on March 31, 2019 (as against 0.59x as on March 31, 2018). This is due to unsecured loan of Rs.12.74 crore extended by the promoters which is treated as Quasi Equity. The total debt to GCA improved from 7.39x as on March 31, 2018 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 it 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. The company had taken an additional WCDL loan Rs.4.13 crore to meet the liquidity mismatch arising due to Covid-19 outbreak. Further, to tide over the uncertainty related to the COVID-19 outbreak, AAIL has approached its lender for approval of moratorium for its working capital and term loans according to the banker the same had been granted. Hence the moratorium period for loan repayment obligations is in effect and hence a non-payment of principal as well as interest is not a credit event.

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	1.19	NA
Interest coverage (times)	1.99	2.16	NA

A: Audited, UA: Unaudited,

Status of non-cooperation with previous CRA:

1. IND BB+; Stable/ IND A4+ (Issuer Not Cooperating) (Reaffirmed on March 04, 2020)
2. BWR BB; Negative/ BWR A4 (Issuer Not cooperating) (Revised from BWR BBB-; Stable/ BWR A3 as on May 04, 2020)

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	-	-	-	20.80	CARE BB; Stable / CARE A4
Non-fund-based - ST-Letter of credit	-	-	-	8.00	CARE A4
Fund-based - LT-Term Loan	-	-	June 2022 and September 2024	9.73	CARE BB; Stable
Non-fund-based - LT-Bank Guarantees	-	-	-	2.50	CARE BB; Stable
Fund-based - ST-Packing Credit in Foreign Currency	-	-	-	12.50	CARE A4
Fund-based - ST-Foreign Bill Discounting	-	-	-	8.00	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 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018
1.	Fund-based - LT/ ST-CC/PC/Bill Discounting	LT/ST	20.80	CARE BB; Stable / CARE A4	-	1)CARE BB; Stable / CARE A4 (05-Mar-20)	-	-
2.	Non-fund-based - ST-Letter of credit	ST	8.00	CARE A4	-	1)CARE A4 (05-Mar-20)	-	-
3.	Fund-based - LT-Term Loan	LT	9.73	CARE BB; Stable	-	-	-	-
4.	Non-fund-based - LT-Bank Guarantees	LT	2.50	CARE BB; Stable	-	-	-	-
5.	Fund-based - ST-Packing Credit in Foreign Currency	ST	12.50	CARE A4	-	-	-	-
6.	Fund-based - ST-Foreign Bill Discounting	ST	8.00	CARE A4	-	-	-	-

Annexure 3: NA

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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