

## JK TORNEL S.A DE C.V.

August 25, 2020

### Ratings

Facilities	Amount (Rs. crore)	Rating <sup>1</sup>	Rating Action
Long term Bank Facilities	362.00	<b>CARE BBB; Negative (Triple B; Outlook: Negative)</b>	<b>Revised from CARE BBB+; Negative (Triple B Plus; Outlook: Negative)</b>
<b>Total Facilities</b>	<b>362.00 (Rs. Three hundred sixty two crore only)</b>		

*Details of instruments/facilities in Annexure-1*

### Detailed Rationale & Key Rating Drivers

The revision in the ratings for the bank facilities of JK Tornel SA de CV (JKTSA) takes into account the deterioration in its financial risk profile in FY20 (refers to period from April 01 to March 31) characterized by the decline in its total operating income and profitability due to overall slowdown in the automotive sector in Mexico & devaluation of Mexican currency. Lower than expected profitability has also resulted into deterioration in coverage & return indicators of the company in FY20. The financials profile continues to remain subdued in Q1FY21 (UA) on account of continuous slowdown in the end user auto industry and Covid-19 related demand & supply disruptions. The rating revision also factors in the intense competition in the tyre industry, challenging operating environment for the automobiles & ancillary industry and susceptibility to fluctuations in the prices of raw material and foreign exchange rate movement. The ratings however continue to draw strength from its strong parentage, group synergies from JK Tyre & Industries Ltd (JKTI) in the form of operational and management support with same line of business. The rating also continues to factor in its experienced promoters with long track record of operations, established market position and wide distribution network.

As per discussion with the management, company had applied and received moratorium for the scheduled repayments of certain term loans from the Mexican banks and consequently the repayments with these banks were deferred. These term loans, where the moratorium was sought are not being rated by CARE. Accordingly, CARE has not recognized this instance as a Default. Non-recognition of default in this case is as per the guidance provided by the SEBI circular, SEBI/HO/ MIRSD/CRADT/ CIR/ P/ 2020/ 53, dated March 30, 2020.

### Rating Sensitivities:

#### Positive Factors:

- Ability of the company to increase its scale of operations by more than 30% from its current levels and maintain that scale of operations on a sustained basis
- Improvement in its profitability margins with PBILDT of more than 12% on a sustained basis going forward.
- Ability to improve the capital structure marked by overall gearing of less than 1.00x on a sustained basis.

#### Negative Factors:

- Further decline in profitability margins from the current levels.
- Increase in collection period of the company resulting in stretched working capital cycle.
- Decline in interest coverage indicators below 2x in any of the year going forward.

### Outlook: Negative

The continuation of the negative outlook is on account of CARE's belief that the financial & liquidity profile of JKTSA is likely to deteriorate further on account of unfavorable industry scenario globally accentuated by outbreak of COVID-19. The performance of the company during Q1FY21 (refers to period from April 01, 2020 to June 30, 2020) has been subdued on account of moderation in its sales volumes due to weak industry scenario & devaluation of Mexican currency vis-à-vis USD. CARE believes that the debt & interest coverage indicators may weaken further due to contraction in revenue owing to slowdown in the tyre industry globally. Going forward, CARE will continue to monitor the situation as it evolves. The outlook may be revised back to Stable, depending on the ability of JKTSA to revert back to its operational and financial stability.

<sup>1</sup>Complete definition of the ratings assigned are available at [www.careratings.com](http://www.careratings.com) and other CARE publications

## Detailed description of the key rating drivers

### Key Rating Strengths

#### ***Experienced Promoters and strong management***

JKTSA which is wholly owned subsidiary of JKTI derives its managerial expertise from JKTI (rated CARE A-; Negative/ CARE A2+), which is headed by Dr. Raghupati Singhania (Chairman) and ably supported by a team of professionals with considerable experience in tyre industry. The promoters of JKTI have more than four decades of experience in the tyre industry. JKTI also extends managerial support to JKTSA in the form of the key functional heads being appointed and deputed by JKTI and are responsible for day to day operations and decision making. JKTSA's board is headed by Dr. Raghupati Singhania (Chairman, JKTI) and is supported by other professionals who have more than 30 years of experience in the tyre industry. JKTI has also supported JKTSA in rationalizing plant operation and overheads over a period of time through right sizing of workforce across operational plants. JKTI further extends financial support to JKTSA as & when required by the company.

#### ***Long-track record of operations***

JKTSA's brand "Tornel" is one of the established brands in the Latin American tyre markets. Tornel was originally founded in 1933. However, it was sold to JK group in 2008 and it is now a wholly-owned subsidiary of JKTI which was a strategic investment for JK group in order to cater to the Latin American export market through Mexico which has close proximity to both the markets.

#### ***Established market position with wide distribution network***

JKTSA has a well-established brand (Tornel) in Mexico & Latin American market. For supplies in Mexico, JKTSA has a distribution network of around 97 direct dealers & network of 144 third party dealers/distributors, JKTSA has tied up with retail chains such as Walmart, Bodega, etc for selling its PCR through their outlets in Mexico as well as other parts of America. Further, JKTSA has opened a sales office in United States to cater to its expanding customer base in the region. For the past 3-4 years, JKTSA is supplying tyres to major OEMs viz., Nissan, Daimler Chrysler and Case New Holland (CNH), Renault Nissan, FIAT in Brazil & KIA – Mexico. The sales to OEM however currently contribute only 5% to 7% of its total sales. JKTSA is primarily into replacement market & approximately 28% of its total operating income is generated through export to Brazil, USA and Latin American countries. The strategic location of the plants being located in close proximity to USA / Canada saves freight cost. JKTSA's product range includes Bias (Truck, Light Truck, Farm, and Industrial) and Radial (Passenger).

Further, the old NAFTA agreement between Mexico, US & Canada has now been replaced by USMCA & it was ratified by all the regions in March 2020. This is likely to benefit JKTSA going ahead. JKTSA already has started receiving export orders from US & as discussed with the management, after the USMCA they are focusing on a shift in their export market from Brazil to US gradually. The effect of this however remains to be seen on the overall financial profile of JKTSA going forward.

### Key Rating Weaknesses

#### ***Deterioration in the financial risk profile characterized by decline in its total operating income and profitability:***

JKTSA's operating income registered a ~10% decline from Rs. 1314 crores in FY19 to Rs. 1187 crores in FY20. Although, the total tyre sales increased from 4.15 million tyres in FY19 to 4.32 million tyres in FY20, however sales from higher realization segments (Truck & bus bias and Non-Truck Bias) has declined during the year. Sales of Truck & bus bias and Non-Truck Bias declined from 0.16 million tyres and 0.81 million tyres in FY19 to 0.11 million tyres and 0.62 million tyres in FY20 primarily on account of overall slowdown in the automotive sector in Mexico. Further, the four major export markets for the company are Brazil, Columbia, Argentina and Ecuador and there has been devaluation of currency in these countries which has made imports more expensive and domestic options more competitive. Also there was competition from cheaper Chinese tyres. All of these reasons have led to decline in average realization from different segments and which impacted the sales & the profitability margins of the company. The profitability is also significantly impacted with PBILDT margin declining from 8.84% in FY19 to 6.51% in FY20 mainly because of lower income leading to lower absorption of fixed overheads & expenses and also because of higher raw material cost on account of devaluation of Mexican currency as JKTSA imports nearly 60% of its raw material. The declining profitability has weakened the interest coverage indicators which moderated to 2.09x as for FY20 as against 2.88x for FY19. Further, the adverse movement of Mexican pesos as against the USD has resulted in the loss on account of devaluation to the tune of Rs 10 crore in FY20 which had also hampered the profitability of the company.

Overall gearing of the company has increased from 1.61x as on March 31, 2019 to 1.82x as on March 31, 2020 majorly on account lower net-worth due to losses incurred during the year and increased working capital borrowings. Total debt as on March 31, 2020 increased to Rs. 479 crores as against Rs. 457 crores as on March 31, 2019 on account of increase in working capital borrowings from Rs. 233 crores as on March 31, 2019 to Rs. 299 crores as on March 31, 2020.

During Q1FY21, sales have declined by ~75% to Rs. 84 crores from Rs. 339 crores in Q1FY20. JKTSA booked a PBILDT loss of Rs 42 crores in Q1FY21. The subdued performance is on account of lockdown imposed in Mexico due to spread of COVID-19. The Mexican government declared automotive industry as essential services in the end of May 2020 after two months of lockdown and operations were started for tyre companies from 1st week of July. For JK Tornel also operations were on halt for around 2 months (April and May) and restarted from June 01, 2020. JKTSA has cash and bank balance of Rs. 78.61 crores (239.69 Million MXN on June 30, 2020). During the lockdown period, company has worked toward realization of debtors to improve its cash flow position and the same has led to increase in cash and bank balance.

**Stretched Liquidity:**

Owing to the lower than envisaged profitability & cash accruals in FY20, the liquidity profile of JKTSA has deteriorated. Further, the operating cycle has increased to 44 days in FY20 as compared to 38 days in FY19 primarily due to increase in collection days from 87 days in FY19 to 129 days in FY20. Creditor days of company also increased to 142 days in FY20 from 88 days in FY19 majorly on account of payables of around Rs. 165 crores to JKTI, which were stretched to support the cash flow of the company to meet the scheduled repayment. The repayments in FY21 will be partly funded through the internal accruals & for the balance if required parent shall extend the support as demonstrated in the past. JKTSA has a working capital loan for a fixed tenor of one year on revolving basis to finance its working capital requirements which largely remain fully utilized. JKTSA had cash and bank balance of Rs. 78.61 crores (239.69 Million MXN @3.28 INR as on June 30, 2020). During the lockdown period, company has worked toward realization of debtors to improve its cash flow position and the same has led to increase in cash and bank balance. Company has also negotiated labour wages to be cut by around 40% for the month of April, May and June 2020 which has also led to savings in the cost.

**Exposure to volatility in the raw material prices and exchange rate movement**

Raw materials constitute more than 55-60% of the total cost of sales. The major raw materials are natural rubber, synthetic rubber and carbon black. These are global commodities and prices vary across all international markets. The tyre business is highly sensitive to movement in rubber prices. Raw materials are procured locally as well as from international sources. The company has also availed foreign currency loans for augmenting its PCR plant. As the loans are denominated in USD, and the company's principal revenues and expenditures are in Mexican Peso, there is a risk of higher debt liability in case of depreciation of the Peso vis-à-vis USD. There was a loss on account of devaluation of Mexican pesos as against the USD to the tune of Rs 10 crore in FY20 (PY: Rs. 26 crores). Mexican Peso (MXN)/ US dollar (USD) has declined by ~19% from 19.16 MXN/USD as on April 01, 2019 to 22.82 MXN/USD as on August 07, 2020. As a part of the company's production is exported to the US, there is partial natural hedge available to the company against forex fluctuation. The USD denominated loans are however un-hedged & company is evaluating loan proposals to replace the same with Pesos.

**Competition in the Mexican Tyre Market:**

There is an intense competition in the Mexican tyre market which houses major tyre companies, viz. Bridgestone Americas Inc., Continental AG, Cooper Tyre & Rubber Co., JK Tornel and Pirelli, with ten tyre manufacturing facilities being operated in the country. The combined capacities for their plants exceed 36 million units a year. However, the established market position with wide distribution network and experienced promoters together with strong customer base with OEM such as Nissan, Daimler Chrysler, Case New Holland provide relative insulation to the company against the same.

**Challenging operating environment for the automobiles & ancillary industry**

The Company caters to both Mexican domestic market and several export markets in the North, Central and South America. A major Portion of the tyre export of JKTSA takes place to Brazil. Mexico and Brazil are key bases for global automakers, including General Motors Co, Ford Motor Co, Volkswagen AG and Fiat Chrysler Brazil's auto industry suffered on account of recessionary market conditions in Brazil in the past and is adversely impacted by spread of COVID-19. Since tyre is a derived demand, the growth in the auto industry directly affects the growth in the tyre industry. Auto production in Mexico and Brazil, Latin America's top producers has plunged significantly in April'20 as a result of the coronavirus crisis. The automotive industry in the United States also experienced a sharp drop in demand in March 2020 and vehicle sales were significantly affected. Tyre demand is divided into two segments: original equipment (OE) and replacement equipment (RE). The RE segment accounts for the majority demand of the tyre segment. The reduction in the vehicle production forecast will decrease demand for the OE tyre segment but COVID-19 will also have an impact on RE segment tyre demand as people are required to stay home, businesses require employees to work from home, and blockades are placed between countries, provinces, and cities to prevent the spread of the virus. These measures will eventually have a big impact on demand for tyres.

**Analytical approach:**

CARE has reviewed JK TSA on a consolidated basis with its subsidiaries. The rating assigned also factors in the support from JK Tyre & industries Ltd owing to common management and strong operational linkages.

Companies consider under consideration	Subsidiary/Associate	% of share held
JK Tornel S.A. de C.V	Holding	-
Comercializadora America Universal, S.A. de C.V.	Subsidiary	100
Compania Hulera Tacuba, S.A. de C.V.	Subsidiary	100
Compania Hulera Tornel, S.A. de C.V	Subsidiary	100
Compania Inmobiliaria Norida, S.A. de C.V.	Subsidiary	100
General de Inmuebles Industriales, S.A. de C.V.	Subsidiary	100
Gintor Administracion, S.A. de C.V	Subsidiary	100
Hules Y Procesos Tornel, S.A. de C.V	Subsidiary	100

**Applicable Criteria**

[Criteria on assigning 'outlook' and 'credit watch' to Credit Ratings](#)

[CARE's Policy on Default Recognition](#)

[Financial Ratios - Non-Financial Sector](#)

[Rating Methodology - Manufacturing Companies](#)

[Rating Methodology- Auto Ancillary Companies](#)

[Rating Methodology: Consolidation and Factoring Linkages in Ratings](#)

**About the Company**

JK Tornel S.A. DE C.V (JK TSA) was formed and renamed to the present one after the merger of Sunrise Hold Co. Mexico S.A. DE C.V (SHCSA – Mexican SPV of JK TI) and Empresas Tornel S.A. DE C.V. (ETSA – holding company for Tornel group) in Nov 2010. JK TSA was engaged in the manufacturing of Bias & Radial tyres for passenger cars, light & heavy trucks & agricultural vehicles for the Mexican markets as well as other American countries and was acquired by JK TI through SHCSA in June'08 at a total consideration of USD 66.78 million (Rs.270crore).The present aggregate manufacturing capacity of JK TSA stood at 7.9 Million units per annum as on March 31, 2020. JK TSA is engaged in tyre manufacturing for Industrial farm & speciality tyres, passenger car radial (PCR) and Truck Bus Bias (TBB)/ light commercial vehicles (LCV) tyres. The Company caters to both Mexican domestic market and several export markets in the North, Central and South America.

Brief Financials (Rs. crore)	FY19 (A)	FY20 (A)
Total operating income	1314	1187
PBILDT	116	77
PAT	-1	-20
Overall gearing (times)	1.61	1.82
Interest coverage (times)	2.88	2.09

A: Audited

Note: The figures are denoted in INR & the Conversion rate considered is 1 Mexican Pesos = 3.17 INR as on 31<sup>st</sup> March 2020.

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

**Status of non-cooperation with previous CRA:** Not Applicable

**Any other information:** Not Applicable

**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-Term Loan	-	-	September 2020	236.00	CARE BBB; Negative
Non-Fund-based – LT – Standby Letter of Credit	-	-	-	126.00	CARE BBB; Negative

**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-Term Loan	LT	236.00	CARE BBB; Negative	1) CARE BBB+; Negative (21-May-20)	1) CARE BBB+; Stable (05-Jul-19)	1) CARE A; Stable (05-Oct-18)	1) CARE A (14-Aug-17)
2.	Non-Fund-based – LT – Standby Letter of Credit	LT	126.00	CARE BBB; Negative	1) CARE BBB+; Negative (21-May-20)	1) CARE BBB+; Stable (05-Jul-19)	-	-

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

Name of the Instrument	Detailed explanation
<b>A. Financial covenants</b>	
1. WCDL	Interest rate is 6 months libor+300 bps, payable quarterly
<b>B. Non-financial covenants</b>	
1. WCDL	Provisional standalone accounts shall be submitted to the bank within 90 days of the close of the financial year.

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

Sr. No.	Name of the Instrument	Complexity Level
1.	Fund-based - LT-Term Loan	Simple
2.	Non-Fund-based – LT – Standby Letter of Credit	Simple

**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](http://www.careratings.com). Investors/market intermediaries/regulators or others are welcome to write to [care@careratings.com](mailto: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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In case of partnership/proprietary concerns, the rating/outlook assigned by CARE is based on the capital deployed by the partners/proprietor and the financial strength of the firm at present. The rating/outlook may undergo change in case of withdrawal of capital or the unsecured loans brought in by the partners/proprietor in addition to the financial performance and other relevant factors.

Our ratings do not factor in any rating related trigger clauses as per the terms of the facility/instrument, which may involve acceleration of payments in case of rating downgrades. However, if any such clauses are introduced and if triggered, the ratings may see volatility and sharp downgrades.

**\*\*For detailed Rationale Report and subscription information, please contact us at [www.careratings.com](http://www.careratings.com)**