Lokesh Machines Limited

August 28, 2019

Ratings

Facilities	Amount (Rs. crore)	Rating[1]	Rating Action
Long term Bank Facilities	62.61 (reduced from 65.69)	**CARE BB+; Stable (Double B Plus; Outlook: Stable)**	Revised from CARE BB; Stable (Double B; Outlook: Stable)
Short term Bank Facilities	13.25 (reduced from 19.50)	**CARE A4 (A Four)**	Reaffirmed
Long term/ Short term Bank Facilities	6.25	**CARE BB+; Stable / CARE A4 (Double B Plus; Outlook: Stable/ A Four)**	Revised from CARE A4 (A Four)
Total Facilities	**82.11 (Eighty two crore and eleven lakhs only)**		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The revision in long term rating assigned to the bank facilities of Lokesh Machines Limited takes into account increasing scale of operations and profits with satisfactory profitability margins during FY19 (FY refers to the period from April 01 to March 31), comfortable capital structure with healthy coverage indicators backed by consistent decline in debt levels and increased albeit moderate order book position of the company. The ratings however remains constrained by the decline in financial performance during Q1FY20, continuing high reliance on bank borrowings owing to elongated operating cycle although the same witnessed improvement during FY19, significant exposure of the company towards the auto ancillary industry albeit decline in the exposure y-o-y and cyclical nature and muted growth prospects of the auto industry, The ratings continue to derive strength from the experienced promoters, long standing relationships with reputed clientele albeit client concentration-risk, and strategic alliances with key global players. The ability of the company to continue to further increase its scale of operations while maintaining satisfactory profitability margins, maintain comfortable capital structure and efficiently manage its working capital requirements are the key rating sensitivities.

Detailed description of the key rating drivers

Key Rating Strengths

Increasing scale of operations and profits with satisfactory profitability margins: The Total Operating Income (TOI) of the company has been on an increasing trend and has increased at a CAGR of 20.35% during FY17-19. TOI increased from Rs 175.49 crore in FY18 to Rs 191.39 crore on FY19 registering a growth of over 9%. PBILDT margin of the company was at satisfactory level at 16.74% for FY19. LML registered PAT of Rs. 6.49 crore in FY19 as against Rs. 4.72 crore in FY18 (growth of ~ 44%).

Comfortable capital structure with healthy coverage indicators backed by consistent decline in debt levels: The capital structure of LML witnessed improvement and continues to remain comfortable. The overall gearing of the company has improved from 0.61x as on March 31, 2018 to 0.54x as on March 31, 2019 at the back of decreased debt levels of the company coupled with accretion of profits to net worth. The debt levels of the company have been consistently declining over the last couple of years. Further, the debt coverage indicators of the company improved and were healthy. PBILDT Interest coverage ratio of the company improved from 2.05x for FY18 to 2.48x for FY19.

Increased albeit moderate order book: The company's order book position witnessed improvement and stood at a moderate level. The company has an outstanding order book of Rs 115.03 crore as on May 31, 2019 as against Rs. 95.88 crore as on Oct. 30, 2018.

Experienced Promoters: LML promoted by Mr M. Lokeswara Rao, has four decades of experience in Machines Tools industry. The company also derives strength and managerial capabilities from the experience of the other promoters i.e. Mr. Kishore Babu, Mr. M. Srikrishna and Mr. M. Srinivas who also have rich experience in the Machine Tools design and manufacturing segment. The company is also supported by four other directors from diversified fields like finance, power and designing.

Long standing relationships with reputed clientele albeit client concentration-risk: The customer profile of LML includes some major automobile players in the industry like Mahindra and Mahindra, Kirloskar Oil Engines Ltd, VE commercial

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

Vehicles Ltd., and Azad Engineering Private Limited among others. With an operational experience of over three decades, the company has developed and maintained healthy relationships with these clientele. The company has set up a dedicated component division at Pune for meeting the demand from Mahindra & Mahindra (M & M). Lately, the company has been bagging orders from Azad Engineering which is into aerospace technologies.
Although the company caters to reputed clientele, the top three customers together constituted about 40% of gross sales during FY19 (FY18: 41%). This makes LML more dependent on these customers for repeated orders and hence reduces the bargaining power for the company.

Strategic alliances with key global players: During FY17, the company had entered into strategic alliance with Tongtai Machine & Tool Company Ltd. Taiwan (one of the leading machine tool manufacturing companies in the world) to manufacture Hi-Speed Vertical Machining center model for the Indian Market. Further during FY17, company had also entered an agreement with EMCO GmbH for manufacturing and selling their machines in India. Once approved, revenues are expected from FY21. These technical tie-ups will help LML to manufacture next generation multitasking machines for Indian markets as well as re-export and expand the customer base and offer specialized manufacturing to a host of manufacturers.

Key Rating Weaknesses
Decline in financial performance during Q1FY20: The sale of the company witnessed decline of around 24% during Q1FY20 vis-à-vis Q1FY19 on account of slow-down in auto sector. Further, the net profit of the company also witnessed significant decline and was Rs. 0.09 crore for Q1FY20 (Rs. 0.48 crore for Q1FY19). **Significant reliance on auto sector:** LML has primarily been catering to the auto segment. However, the reliance on same has been declining gradually. Reliance on auto sector has declined from contributing around 68% of the company's sales for FY18 to 57% of company's sales for FY19.

Continuing high reliance on bank borrowings owing to elongated operating cycle albeit improved operating cycle backed by decreased inventory holding period: The operating cycle of the company although decreased during FY19 continues to remain elongated owing to the nature of business. The high inventory holding is due to nature of the business where each machines produced by LML requires 150-180 days for GPM and close to a year and sometimes even more for SPM for completion which led to high inventory holding. This apart, the company has a practice to offer a credit period of 90-120 days to few of its major clients which also results into high collection period. Due to high inventory holding, the reliance on bank borrowings is high and the average working capital utilization continues to remain on higher side.

Cyclical nature of the Automobile Industry: LML has majority of its clients from the automobile industry. Though the revenue contribution from the industry decreased in FY19 the company has a significant exposure towards the automobile industry. The performance of the automobile industry is directly related to various global and domestic economic conditions like seasonal trends in automobile manufacturing sector, evolving regulatory requirements and volatile fuel prices. An adverse fluctuation in these economic variables will have a direct impact on the financial health of Lokesh Machines Limited.

Muted industry outlook for Auto Industry: In Q1FY20, automobile sales witnessed the sharpest decline of 10.5% y-o-y in the last 5 years on back of price hikes in passenger vehicles and two wheeler segments due to new safety norms starting April 1, 2019, higher insurance costs, higher ownership costs, liquidity crisis in the NBFC sector, increased load carrying capacity for M&HCVs that led to high inventories at retail (dealers) level causing slow movement in wholesale movement of vehicles. CARE has therefore revised our outlook for overall auto sales (excluding tractors) to 7 – 9% for FY20. Going forward, CARE expects demand to continue to remain muted during Q2 FY20 and pick up only by Q3 FY20 and continue in Q4 FY20 with various planned product launches, festival demand and pre-buying of automobiles before the implementation of BS-VI norms on April 1, 2020. Also, with higher MSPs announced for FY20, farm income is expected to be marginally higher and encourage rural spending.

Liquidity: Adequate liquidity characterized by sufficient cushion in accruals and repayments obligations. However, the company's reliance on bank borrowings is high resulting in high utilization of bank limits. The cash balance of the company was modest at Rs 1.07 crore as on March 31, 2019. Further, the company is planning to infuse equity to the tune of Rs.5.51 crore during FY20 and FY21 to fund capex.

Analytical approach: Standalone

Applicable Criteria
Criteria on assigning 'outlook' and 'credit watch' to Credit Ratings
Rating Criteria for Short Term Instruments:
CARE's Policy on Default Recognition
Rating Methodology -Manufacturing Companies

Rating Methodology -Auto Ancillary Companies

About the Company
Lokesh Machines Ltd (LML) incorporated in December 1983 is promoted by Mr. M Lokeswara Rao and the company has started commercial operations from 1986. The company's operations can be segregated into two divisions namely Machines and Components division. The company initially started the operations by doing job works for Hindustan Machine Tools Limited (HMT) later on moved to manufacturing of machines. Under machinery division, LML manufactures Special Purpose Machines (SPM) and General Purpose Machines (GPM). Under component division, the company manufactures automobile components viz., cylinder heads, and cylinder blocks and also executes job work for automobile manufacturers like Mahindra & Mahindra (M&M) and Ashok Leyland etc.

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

(Rs crore)

Brief Financials (Rs. crore)	FY18(A)	FY19 (A)
Total operating income	175.24	191.18
PBILDT	28.87	32.00
PAT	4.70	6.77
Overall gearing (times)	0.61	0.54
Interest coverage (times)	2.05	2.48

A: Audited

Status of non-cooperation with previous CRA:

- ICRA Limited has suspended the ratings assigned to both fund based and non-fund bases bank facilities of Lokesh Machines Limited vide its press release dated December 05, 2012 on account of lack of requisite information to carry out rating surveillance.
- CRISIL has suspended its ratings assigned to the bank facilities of Lokesh Machines Ltd (LML) vide its press release dated September 08, 2014. The suspension of ratings is on account of non-cooperation by LML with CRISIL's efforts to undertake a review of the ratings outstanding

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	-	-	June 2021	2.61	CARE BB+; Stable
Fund-based - LT-Cash Credit	-	-	-	60.00	CARE BB+; Stable
Non-fund-based - ST-Letter of credit	-	-	-	10.00	CARE A4
Non-fund-based - ST-ILC/FLC	-	-	-	3.25	CARE A4
Non-fund-based - LT/ ST-Bank Guarantees	-	-	-	6.25	CARE BB+; Stable / 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-Term Loan	LT	2.61	CARE BB+; Stable	-	1)CARE BB; Stable (14-Jan-19)	1)CARE B-; Stable (03-Jan-18)	1)CARE D; ISSUER NOT COOPERATING* (07-Mar-17)
2.	Fund-based - LT-Cash Credit	LT	60.00	CARE BB+; Stable	-	1)CARE BB; Stable (14-Jan-19)	1)CARE B-; Stable (03-Jan-18)	1)CARE D; ISSUER NOT COOPERATING* (07-Mar-17)
3.	Non-fund-based - ST-Letter of credit	ST	10.00	CARE A4	-	1)CARE A4 (14-Jan-19)	1)CARE A4 (03-Jan-18)	1)CARE D; ISSUER NOT COOPERATING* (07-Mar-17)
4.	Non-fund-based - ST-ILC/FLC	ST	3.25	CARE A4	-	-	-	-
5.	Non-fund-based - LT/ ST-Bank Guarantees	LT/ST	6.25	CARE BB+; Stable / CARE A4	-	-	-	-

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

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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