RACL Geartech Limited

September 03, 2020

Ratings

Facilities	Amount (Rs. crore)	Rating[1]	Rating Action
Long Term Bank Facilities	106.52 (Enhanced from 97.58)	CARE BBB+; Stable (Triple B Plus; Outlook: Stable)	Revised from CARE BBB; Positive (Triple B; Outlook: Positive) and outlook revised from positive
Short Term Bank Facilities	5.00	CARE A3+ (A Three Plus)	Revised from CARE A3 (A Three)
Total Facilities	**111.52 (Rs. One Hundred Eleven Crore and Fifty-Two Lakhs Only)**		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The revision in the ratings of RACL Geartech Limited take into account improvement in business risk profile and financial risk profile in FY20 (April 01, 2019 to March 31, 2020) marked by increase in the scale of operations backed by rise in export business (contributing 70% to TOI), improvement in the profitability margins and debt service coverage indicators. Further, the ratings of the company continue to derive strength from experienced promoters, established player along with reputed customer base, satisfactory financial risk profile marked by above average profitability margins and comfortable debt coverage indicators and geographically diversified revenue mix. However, the ratings are constrained by moderate scale of operations, project implementation risk, and high working capital intensive nature of operations along with cyclical nature of the automotive industry.

Rating Sensitivities

Positive Factors:

- Sustained improvement in the scale of operations beyond Rs.250 crores while maintain with profitability margins and maintaining relationship with its key customers
- Further improvement in the capital structure leading to overall gearing of below 0.75x.

Negative Factors:

- Decline in the scale of operations below Rs.175 crores.
- Deterioration in the capital structure, thus leading to an overall gearing of more than 1.5x.

Detailed description of the key rating drivers

Key Rating Strengths

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.

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-standingcustomers. RGL 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 segments os automobile industry. The addition in customer base was supported by supply of quality products while adhering international standards laid down by international quality assessment team. Furthermore, owing to product quality and timely delivery, major reputed customers make their significant portion of purchases of gears for particular models from RGL.

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

Satisfactory Financial Risk Profile

During FY20, RACL's total operating income registered a y-o-y growth of 12% to Rs.212.83 crore as against Rs.190.59 crore during FY19 led by rise in export business coupled with repeat orders from existing clients.

The company's PBILDT margin improved by 448 bps and stood at 20.92% during FY20 (PY: 16.44%). The same is on account of growing scale of operations along with the manufacture of high-precision products (manufactures various types of transmission gears and shafts) for the premium segment, thus leading to value-additions. PAT margin also improved and stood at 7.98% during FY20 (PY: 5.13%). The improvement in margins was also on account of change in product mix. The company revenue is mainly driven by the overseas market than the domestic market. Therefore, profitability margins are exposed to volatility in foreign exchange.

The capital structure of the company remained moderate during FY20, however it slightly improved with an overall gearing of 1.07x as on March 31, 2020 (PY: 1.28x as on March 31, 2019). 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 5.27x and 3.29x as on March 31, 2020 (PY: 4.92x and 4.19x respectively).

Q1FY21 Performance: The Company reported TOI of Rs.23.41 crores during Q1FY21 as against Rs.52.89 crores during Q1FY20. The decline is on account of shut-down of the company's manufacturing plants from April, 2020 to mid of May, 2020 on account of the nation-wide lock-downs announced by the GOI.

However, the profitability margins have shown improvement on y-o-y basis. The PBILDT margin stood at 20. 89% during Q1FY21 (PY: 16.56%) and the PAT margin stood at 6.45% during Q1FY21 (PY: 6.01%).

Geographically Diversified revenue mix

The export sales of the company are continuously increasing and it formed around 70% of total gross sales during FY20 (PY: 61% of total gross sales). Of the total sales in FY20, nearly 43% of the sales were in India and Asia Pacific region and remaining 57% in Europe. The company mainly exports to European countries. RACL earns more margins in exports sales as the company is exporting its products to OEM catering to premium segment.

Reputed client base with moderate concentration risk

RGL has moderate concentration risk with top five customers contributing ~85% revenue in FY20 (PY: 71%). Segment-wise, the company's reliance on the 2-3 wheelers remained highest with the segment contributing 61% of revenue in FY20 as against 59% in FY19. This exposes the company towards customer concentration risk also. Any change in procurement policy of any of key customer may adversely impact the business of the company. However, comfort is drawn that the company is a preferred vendor for many of its customers with whom it has long-term relationships. Customer concentration also exposes the company's revenue growth and profitability to its customer's future growth plans. Furthermore, maintaining the relationship with its key customers is critical from analytical prospective.

Key Rating Weaknesses

Project Implementation Risk

The company is expected to incur a capex of Rs.48.50 crores during FY21 for the installation of new plant and machinery. The funding of the same would be done by a combination of debt: equity mix of 3:1. The ongoing expansion is on account of the new orders received by the company from new customers in export market. The installation of the machinery is in line with order specifications provided by the new customers. The capital expansion will increase the installed capacity and product profile/portfolio, however company remains susceptible to risk related with implementation and funding. Any delays in the implementation may impact the company's financial risk profile adversely and is also crucial from credit prospective. The debt funded project is expected to increase in gearing levels in the medium term. The company is also exposed towards project execution risk, in terms of completion of the project with-in the envisaged time and cost. However, aforementioned risks are partially offset by the fact that capital expenditure is planned based on the product approvals from customers and marketing risk of the products from new line is negligible.

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). Significant inventory (around 50%) levels are in the form of stores and spares. These are mainly consumable being used in production process and are reusable; however having a life of less than 1 year. Also, to cater the demand of major customers, company stocks inventory at its warehouses near customers' factory for uninterrupted flow of products with minimum transit time. Credit period of close to 2 months is allowed to domestic customers, contributing 30% of total operating income, while collection from overseas customers, which contributes 70% 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 72.83% during 12 month period ended June, 2020.

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 Outlook
After a gloomy 1st quarter in on-going fiscal, the 2nd quarter began on a good note as July 2020 witnessed positive growth (M-o-M) in production, domestic sales and exports of automobiles. Passenger vehicles, tractors and 2&3 wheelers segments have shown good momentum during the month on a sequential basis, which gives us hope for recovery in the forthcoming future. The below chart depicts production, sales and exports for automobiles in July 2020. On M-o-M basis, passenger vehicles segment has shown the highest recovery in domestic sales of 73%, followed by 2 wheelers of 26% and 3-wheelers with 24%. Alongside, comparison on a YoY basis still depicts decline of 3.9%, 15.2% and 77.2% in passenger vehicles, 2&3 wheelers respectively.

Liquidity: Adequate
The company has adequate liquidity as characterized by sufficient cushion in cash accruals vis-à-vis repayment obligations and modest cash balance of Rs.0.66 crores as on March 31, 2020. Going forward, its capex requirements are modular and are expected to be funded in debt equity mix the promoter's contribution in the ongoing expansion is going to funded though cash accruals which might put some pressure on the liquidity. Its bank limits are utilized to the extent of 73% and has enhancement in bank lines, supported by above unity current ratio.
The company has to offer reasonable credit period to its customers as majority of them are OEMs and large-sized players which possess higher bargaining power. Furthermore, the inventory levels also remain high. Thus, this leads to higher working capital requirements.

Analytical approach: Standalone

Applicable Criteria
Criteria on assigning 'outlook' and 'credit watch'
CARE's Policy on Default Recognition
Rating Methodology-Manufacturing Companies
Criteria for Short-term Instruments
CARE's methodology for auto ancillary companies
CARE's methodology for financial ratios (Non-Financial Sector)

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)	FY19 (A)	FY20 (A)
Total operating income	190.59	212.83
PBILDT	31.34	44.53
PAT	9.77	16.98
Overall gearing (times)	1.28	1.07
Interest coverage (times)	4.92	5.27

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

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	-	-	March, 2024	37.02	CARE BBB+; Stable
Fund-based - LT-Cash Credit	-	-	-	69.50	CARE BBB+; Stable
Non-fund-based - ST-BG/LC	-	-	-	5.00	CARE A3+

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	37.02	CARE BBB+; Stable	-	1)CARE BBB; Positive (09-Aug-19)	1)CARE BBB; Stable (01-Aug-18)	1)CARE BBB; Stable (24-Jul-17)
2.	Fund-based - LT-Cash Credit	LT	69.50	CARE BBB+; Stable	-	1)CARE BBB; Positive (09-Aug-19)	1)CARE BBB; Stable (01-Aug-18)	1)CARE BBB; Stable (24-Jul-17)
3.	Non-fund-based - ST-BG/LC	ST	5.00	CARE A3+	-	1)CARE A3 (09-Aug-19)	1)CARE A3 (01-Aug-18)	1)CARE A3 (24-Jul-17)

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

Sr. No.	Name of the 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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