Sarthak Industries Ltd.

October 03, 2019

Ratings

Facilities	Amount (Rs. Crore)	Ratings[1]	Rating Action
Long-term/ Short-term Bank Facilities	1.00	**CARE BB; Stable/ CARE A4 (Double B; Outlook : Stable/ A Four)**	**Revised from CARE BB+; Stable / CARE A4+ (Double B Plus; Outlook : Stable/ A Four Plus)**
Short-term Bank Facilities	24.00	**CARE A4 (A Four)**	**Revised from CARE A4+ (A Four Plus)**
Total Facilities	**25.00 (Rupees Twenty Five Crore Only)**		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The revision in the ratings for Sarthak Industries Ltd. (SIL) takes into account of decline in its profitability and cash accruals during FY19 (FY refers to the period from April 1 to March 31) and Q1FY20, adversely impacting its debt coverage indicators.

This decline in SIL's profitability reflects the collective impact of loss incurred on sale of real estate properties (in FY19) along with tax payments thereon (both in FY19 and Q1FY20), underperformance of its liquefied petroleum gas (LPG) cylinder manufacturing business during Q1FY20 and decline in profitability in its agri-commodity trading business.

The ratings continue to remain constrained on account of SIL's modest scale of LPG cylinders manufacturing operations with customer concentration risk, its thin profitability due to high proportion of volatile trading sales and susceptibility of profitability to volatility in raw material prices.

The ratings, however, continue to derive strength from SIL's established operations in LPG cylinders business, its reputed clientele and low leverage.

Ability of SIL to scale up and diversify its LPG cylinders manufacturing operations, improve its profitability, prudently manage various risks associated with its trading operations and effective management of its working capital requirements are the key rating sensitivities. This apart, any major debt-funded capex adversely affecting SIL's capital structure or debt coverage indicators shall also be a key rating monitorable.

Detailed description of the key rating drivers

Key Rating Weaknesses

Decline in profitability and cash accruals during FY19 and Q1FY20, leading to deterioration in debt coverage indicators: SIL reported a 9% y-o-y dip in its total operating income (TOI) during FY19, primarily due to lower income from its agri-commodity trading business, which offset the increase in its LPG cylinder sales during the year.

Furthermore, during FY19 and Q1FY20, company witnessed a decline in its profitability and cash accruals. During this period, SIL sold some of its real estate properties. These properties were acquired as a part of its acquisition of Gloryshine Property Developers Pvt. Ltd. in FY12 and were recorded in the books at the price of their acquisition by SIL. However, their carried forward values for income tax purposes (which are used for arriving at the profit on sale and income tax thereon) were substantially lower (as these carried forward values for tax purposes were not revised). Due to this, a loss was booked in the books of accounts of SIL in FY19 with marginal profits in Q1FY20, while the tax payments were higher in FY19 as well as Q1FY20. As a result, SIL's PAT declined from Rs.1.76 crore in FY18 to Rs.0.45 crore in FY19 and it further reported a net loss of Rs.1.11 crore with cash loss of Rs.1.03 crore in Q1FY20).

Further, decline in the operating profitability in its agri-commodity trading division in FY19 (PBIT declined form 1.66 crore in FY18 to Rs.0.48 crore in FY19) and that of its LPG cylinders business in Q1FY20 (loss of Rs.0.02 crore at PBIT level in Q1FY20 compared with profit of Rs.0.95 crore in previous comparable quarter) also contributed to the decline in SIL's overall profitability over the last 15 months. This adversely impacted SIL's debt coverage indicators; marked by an increase in its total debt/gross cash accruals (TD/GCA) to 18.32x in FY19 compared with 6.92x in the previous year. Further, despite a profit of around Rs.2.08 crore on sale of real estate properties during Q1FY20, SIL reported cash loss of Rs.1.03 crore during the quarter, driven by sizeable tax payment on sale of land as well as certain other extra-ordinary tax payments during the quarter.

Susceptibility of profitability to volatile raw material and traded commodity prices: In LPG cylinder segment, hot rolled steel, copper & zinc constitute major raw material for SIL, the prices of same are inherently volatile. While a majority of the tenders allow for some variation in prices (generally on a monthly basis), any adverse movement in these which SIL

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

is not able to pass on to customers can affect is profitability. Further, in its agri-commodities trading division, the prices of SIL's traded products are inherently volatile due their linkage to agro-climatic conditions and are also affected by various interventions by the government in the form of minimum support price (MSP), import and export duties and restrictions. While there are mechanisms available through commodity exchange to hedge the exposure to a particular commodity, SIL generally does not avail these measures, exposing its profitability to aforementioned risks.

Modest scale of LPG cylinder manufacturing business with customer concentration risk: The scale of SIL's LPG cylinder manufacturing business has remained modest at around Rs.30.44 crore, forming around 27% of its total operating income in FY19. Furthermore, customer profile in this business has remained concentrated, as only oil marketing companies (OMCs) have a large requirement of these cylinders on a sustained basis with a tender-based procurement. Also, as a management policy, SIL has not diversified into other types of cylinders (higher capacity LPG, other gases like propane, oxygen or nitrogen). This limits the avenues available to the company to diversify its revenue base and efficiently utilize its manufacturing capacities.

Key Rating Strengths

Low leverage: SIL utilized a part of the proceeds of the sale of its real estate properties to repay its outstanding inter-corporate deposits (ICDs). During FY19, SIL repaid Rs.6.98 crore of its ICDs of Rs.9.66 crore outstanding as on March 31, 2018. Despite this, SIL's overall gearing did not improve and remained stable at 0.62x as on March 31, 2019, as the effect of repayment of these ICDs was offset by higher utilization of non-fund based limits (mainly letter of credit), primarily for imports for its agri-trading business.

Long track record of operations and reputed clientele in LPG cylinder manufacturing business: SIL is engaged in manufacturing of refillable and disposable LPG cylinders, primarily used for domestic supply of LPG. Over the years, it also has established relationship with reputed clientele consisting of OMCs engaged in supply and distribution of LPG in the country. SIL supplies cylinders to all the three major domestic OMCs, i.e., Indian Oil Corporation, Hindustan Petroleum Corporation Ltd. and Bharat Petroleum Corporation Ltd.

Liquidity Analysis - Stretched: SIL's liquidity was stretched in FY19 and Q1FY20, on account of its thin cash accruals and sizeable tax payments towards sale of real estate properties. Also, a part of the proceeds from the sale was utilized towards repayment of ICDs availed by the company, reducing the amount available for SIL's operations to that extent. While SIL's operating cycle was negative in FY19, it was largely supported by way of credit availed from suppliers under letter of credit obligations, underlining its limited bargaining power in the market. Further, SIL's collection period also elongated from 34 days in FY18 to 57 days in FY19, primarily driven by its extended credit offered to customers in its trading business. Also, SIL has no sanctioned line of credit, making it dependent on its promoters and group entities to meet fund requirement in case of any exigencies. However, absence of any major fixed repayment obligations (except some vehicle loans – outstanding of Rs.0.16 crore as on June 30, 2019) provides some support to its liquidity.

Analytical Approach: Standalone

Applicable Criteria:

Criteria on assigning Outlook to Credit Ratings

CARE's Policy on Default Recognition

Criteria for Short Term Instruments

Rating Methodology – Manufacturing Companies

CARE's Rating Methodology - Wholesale Trading

Financial ratios - Non- Financial Sector

About the Company

Promoted by Indore based Shahra family, Sarthak Industries Ltd. (SIL) is engaged in manufacturing of LPG cylinders and opportunity-based trading of agri-commodities. As on March 31, 2019, SIL had an installed capacity to manufacture six lakh pieces of LPG cylinders per annum at its plant located at the industrial area of Pithampur near Indore.

Brief financials of SIL are tabulated below:

Brief Financials (Rs. Crore)	FY18 (A)	FY19 (A)
Total operating income	124.06	113.39
PBILDT	4.46	3.99
PAT	1.76	0.45
Overall gearing (times)	0.52	0.62
Interest coverage (times)	2.56	2.49

A: Audited

Further, SIL reported a net loss of Rs.1.11 crore on a TOI of Rs.25.90 crore in Q1FY20, compared with a PAT of Rs.0.23 crore on a TOI of Rs.23.09 crore in Q1FY19.

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
Non-fund-based - LT/ ST-Bank Guarantees	-	-	-	1.00	CARE BB; Stable / CARE A4
Non-fund-based - ST-Letter of credit	-	-	-	24.00	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.	Non-fund-based - LT/ ST-Bank Guarantees	LT/ ST	1.00	CARE BB; Stable / CARE A4	-	1)CARE BB+; Stable / CARE A4+ (21-Jan-19)	1)CARE BB+; Stable / CARE A4+ (05-Feb-18)	1)CARE BB+; Stable / CARE A4+ (13-Jan-17)
2.	Non-fund-based - ST-Letter of credit	ST	24.00	CARE A4	-	1)CARE A4+ (21-Jan-19)	1)CARE A4+ (05-Feb-18)	1)CARE A4+ (13-Jan-17)
3.	Fund-based - ST-Bank Overdraft	ST	-	-	-	-	1)Withdrawn (05-Feb-18)	1)CARE A4+ (13-Jan-17)

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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