Talbros Engineering Limited (Revised)

October 08, 2020

Ratings

Facilities	Amount (Rs. crore)	Rating[1]	Rating Action
Long term Bank Facilities	5.59 (reduced from 11.72)	CARE BBB+; Negative (Triple B Plus; Outlook: Negative)	Reaffirmed and outlook revised from stable
Long Term/Short term Bank Facilities	62.80 (enhanced from 57.80)	CARE BBB+; Negative/CARE A2 (Triple B Plus; Outlook: Negative/ A Two)	Reaffirmed and outlook revised from stable
Total Facilities	68.39 (Rs. Sixty eight crores and thirty nine lakhs)		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of Talbros Engineering Limited continue to derive strength from experience of the promoters in the auto ancillary industry along with their long track record of operations, reputed customer-base with longstanding relationships, and moderate profitability margins, capital structure along with moderate debt coverage indicators.

However, the ratings are constrained by customer concentration risk, susceptibility of margins to volatility in raw material prices and dependence on the fortunes and cyclical nature of the auto industry. The rating also take cognizance of decline in Total operating income of the company during FY20 (FY refer to April, 2019 to March, 2020) and weak Q1FY21 (Refer to period April, 2019 to June, 2020) of the company attributed to nation-wide lockdowns imposed by the governments on account in order to curb the spread of the Coronavirus (Covid-19) pandemic.

<u>Rating Sensitivities</u>

Positive Factors

- Sustained improvement in the Total Operating Income of the company beyond Rs.270 crores, while maintaining the PBIDLT margin at above 11.50% on sustainable basis.
- Consistent improvement in working capital with operating cycle of less than around 80 days on sustained basis mainly supported by reduction in gross current assets days.

Negative Factors

- Decline in the Total Operating Income below Rs.165 crores.
- High reliance on debt to fund large capex and increase in working capital borrowings leading to moderation in overall gearing of more than 1.20x.

<u>Outlook: Negative</u>

The revision in the outlook from Stable to Negative reflects the company's presence in the Commercial Vehicle (CV) segment in which the signs of recovery are slow. Indian CV business was impacted since the second half of FY2019 on account of multiple factors such as liquidity crisis, revised axle load norms and slowdown in the economy. Further, the Covid-19 led economic downturn added to the negative sentiments in the industry, which reflects that the sales volume growth is expected to remain muted in this industry in the coming months of FY21. The outlook may be revised to Stable if the sales volume growth shows some meaningful positive growth for a period of six months.

Detailed description of the key rating drivers

Key Rating Strengths

Long track record of operations with experienced and resourceful promoters

TEL has a long track-record of operations dating back to 1980 and was earlier part of the erstwhile Talbros Group. The Talbros Group was founded in 1930s by Talwar family and has been into manufacturing of automotive

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

components since 1957. The BNT Talbros Group is original equipment (OE) suppliers to many vehicle manufacturers in India, including passenger vehicles, commercial vehicles, trucks, buses, light-utility vehicles etc. The key managerial personnel of TEL - Mr. Rajesh Talwar, President and Mr. Tarun Talwar, Chief Operating Officer have a vast experience in the automotive and engineering industry and are actively involved in the day-today operations of the company. The promoters have supported the company with infusion of unsecured loans which stood at Rs.11.97 crore as on March 30, 2020 (Rs.8.46 crore as on March 31, 2019).

Reputed customer base with established relationship albeit with a concentration risk

TEL has an established relationship with leading auto manufacturers and the company is dealing with its top-3 customers from the past 15 years. Its top revenue contributors are well established players who enjoy a strong market position in the industry. The top four customers of the company accounted for more than 75% of sale during last 3 financial years (FY18-FY20); thereby exposing the company towards customer concentration risk. Any change in procurement policy of this customer may adversely impact the business of the company. This also exposes the company's revenue growth and profitability to its customer's future growth plans. Although there is customer concentration risk; however, it is offset to some extent as TEL is sole supplier for few of the models.

TEL's total sales are diversified with ~80% (PY: 79%) sales derived from domestic market and the balance 20% (PY: 21%) from exports. The company exports to countries like USA, Brazil and Canada. About 90% of all axle shafts manufactured by TEL are used by Original Equipment Manufacturers (OEMs) or Tier 1 suppliers.

Moderate capital structure and debt coverage indicators

The capital structure of the company is moderate as marked by an overall gearing of 0.79x as on March 31, 2020 (PY: 1.23x as on March 31, 2019). The improvement in the overall gearing is on account of the repayment of long term debt along with the lower utilization of working capital limits. Further, the debt coverage indicators also stood moderate. The interest coverage ratio and total debt to GCA stood at 2.79x and 4.60x during FY20 (PY: 3.62x and 5.46x respectively).

Key Rating Weaknesses

Stable and moderate profitability though decline in Total operating income

The total operating income of the company has reported a decline of around 20% to Rs.217.35 crores during FY20 (PY: Rs.270.03 crores). The decline has been primarily on account of slow-down in the auto sector along with the shut-down of the manufacturing facilities of the company during March, 2020 due to the nation-wide lockdowns announced by the GOI to control the spread of Coronavirus (Covid-19) pandemic led to the non-conversion of orders into dispatches.

The profitability margins of the company remained relatively stable. The PBILDT margin of the company stood moderate at 9.24% during FY20 (PY: 9.13%). However, the PAT margin moderated by 82 bps and stood at 1.85% during FY20 (PY: 2.67%) on account of increase in the depreciation & interest expenses during the year.

Q1FY21 Performance: The Company reported TOI of Rs.16 crores during Q1FY21 as against Rs.61.14 crores during Q1FY20. The decline is on account of the shut-down of the company's manufacturing facilities from April, 2020 to mid of May, 2020 due to the nation-wide lockdowns imposed by the GOI in lieu of the Covid-19 outbreak. Consequently, the company reported losses of Rs.0.94 crores. However, the PBILDT margin of the company improved and stood at 12.75% (PY: 9.03%). The same has been on account of rationalization of costs and improvement in operational efficiencies leading to reduction in cost of production.

Low bargaining power with customers and susceptibility of margins to volatility in raw material prices

Though there exists limited bargaining power with the customers, since the major customers are auto companies/OEMs, however, the company does have a mechanism wherein any revision in the raw material prices is reset by the OEMs on monthly basis and the change in the raw material prices are accommodated subsequently. The major raw material (Steel) cost accounts for around 50% of total operating income, furthermore, global prices for Steel are volatile which exposes TEL to price risk.

Cyclical 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.

The auto industry was already facing slowdown in India as well as globally which was further aggravated by the advent of Coronavirus pandemic which led to the nation-wide lockdowns, thereby leading to breaks in the production activity at various locations around the world. This led to subdued volumes in Q4FY20 which continued in Q1FY21 as well as there was lockdown for large part of this quarter combined with supply chain issues. The consumer demand which could not be met in April, May 2020 and initial days of June 2020 due to the nation-wide and various state lockdowns is expected to be spread across the next 6 months - from July to December 2020. The festive season is a crucial period for automobiles sector, as this is the time of the year when consumers usually make purchases of large ticket items, which are discretionary in nature. The festive season of this year will be even more pivotal for the automobile sector, as it is has long been affected by bloomy consumer sentiments even before the pandemic started in the nation. Also macroeconomic numbers continue to disappoint, reaching pre-Covid level is unlikely in FY21. While volume pickup is expected from H2-FY21, full demand recovery is expected only in FY22. It is expected that the 2-wheelers, passenger vehicles and tractor segments shall witness faster recovery than the rest.

Liquidity: Adequate

The company has adequate liquidity as characterized by sufficient cushion in cash accruals vis-à-vis repayment obligations during FY21. Going forward, its capex requirements are low and also the company has sufficient headroom to raise debt going forward with very comfortable capital structure with an overall gearing below 1x. Its bank limits are utilized to the extent of 65.1% for the past twelve months ending August, 2020 and has sought enhancement in bank lines, supported by above unity current ratio.

Being an auto ancillary player, the company has working capital intensive nature of operations as characterized by its operating cycle of 101 days in FY2020 (PY: 86 days). This is primarily because the company has to provide credit period of 2 to 2.5 months to its customers as majority of them are OEMs and large-sized players and possess higher bargaining power than TEL. Also, the company is required to maintain adequate inventory of raw materials for the smooth running of its production processes. The company has to maintain the minimum levels of inventory to meet delivery schedules which requires the company to stock up the requisite inventory. Therefore, the company has to maintain inventory of around 2.75 months on an average. However, the payable days of the company remain around 2 months.

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

Talbros Engineering Ltd (TEL), originally a part of Talbros Automotive Components Ltd. was separated into another company in 1996. TEL is engaged in the manufacturing of automotive rear axle shafts and other splined shafts and forgings used in commercial vehicles, utility vehicles and tractors. TEL has total five manufacturing plants with total manufacturing capacity of 21 lakhs axle shafts per annum as on March 31, 2020. The company manufactures and sells 90% of its products to domestic Original Equipment Manufacturers (OEMs) and Tier-1 suppliers of auto components.

Brief Financials (Rs. crore)	FY19 (A)	FY20 (A)
Total operating income	270.03	217.35
PBILDT	24.67	20.09
PAT	7.20	4.02
Overall gearing (times)	1.23	0.79
Interest coverage (times)	3.62	2.79

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	-	-	April, 2022	5.59	CARE BBB+; Negative
Fund-based - LT/ ST-Cash Credit	-	-	-	62.80	CARE BBB+; Negative / CARE A2

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	5.59	CARE BBB+; Negative	-	1)CARE BBB+; Stable (11-Dec-19) 2)CARE A-; Negative (02-Aug-19)	1)CARE A-; Stable (04-Jan-19)	1)CARE A-; Stable (09-Feb-18)
2.	Fund-based - LT/ ST-Cash Credit	LT/ST	62.80	CARE BBB+; Negative / CARE A2	-	1)CARE BBB+; Stable / CARE A2 (11-Dec-19) 2)CARE A-; Negative / CARE A2+ (02-Aug-19)	1)CARE A-; Stable / CARE A2+ (04-Jan-19)	1)CARE A-; Stable / CARE A2+ (09-Feb-18)

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

Name of the Instrument	Detailed explanation
Financial covenants	
As per sanction letter of the bank, 'all unsecured loans/ deposits from promoters and related parties as on 31 March, 2020 to the extent of Rs. 12 crore shall stay subordinated to bank loans and to remain invested in business during the tenure of facilities'.	Unsecured loans from promoters as on 31-March-2020 have been treated as quasi-equity and considered in the net worth of the company as per CARE's policy.

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.	Fund-based - LT/ ST-Cash Credit	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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