Press Release

Sree SGK Industries

August 20, 2018

Rating Assigned

Total Bank Facilities Rated	Rs. 7.50 crore
Long Term Rating	ACUITE B/ Stable (Assigned)

Rating Rationale

Acuité has assigned a long term rating of **'ACUITE B' (read as ACUITE B)** to the Rs.7.50 crore bank facilities of Sree SGK Industries. The outlook is **'Stable'**.

Established in 1989, by Mr. Nanjunda Setty BC, Sree SGK Industries (SGI) is a Shimoga (Karnataka) based proprietorship concern. The entity is engaged in manufacture of automobile and hydraulic components. The entity is also engaged in machining of steel and tubular components. The entity has an installed capacity to manufacture 170 tons of castings per month.

Key rating drivers:

Strengths:

- **Experienced management and established track record of operations**
  The promoter Mr. Nanjunda Setty BC has around five decades of experience in the automobile engineering space. The promoter holds degree in Bachelor of Engineering; he along with others have business interest in other firms which are into manufacture and supply of route valve seats, automobile parts for reputed OEM's in Auto Industry. SGI manufactures automobile and hydraulic components. It has an off-take arrangement with Wipro Infrastructure Engineering (WIE; group entity of Wipro Group), numero uno player in India in manufacturing of automobile engineering components for over a decade; SGI derives around 70 per cent of revenues from WIE for supplies across in India as well as to overseas units of WIE in Hindupur, Chennai, Bengaluru, Pune in India and Romania, Brazil among others in Overseas. Though the revenues are constrained over the last three years at around Rs.10.0 – 12.0 crores due to capacity issues, however with the proposed capex for increasing the machining capacity, the revenues are expected to improve to about Rs.18.0 – 24.0 crores over the medium term besides improving off-take from WIE as well as other clientele.

- **Average financial risk profile**
  The financial risk profile is marked by moderate gearing and net worth levels, though underpinned by weak debt protection metrics. The net worth stands at Rs.8.12 crore as on 31 March, 2018 (provisional) decreased by Rs.0.38 crores as compared to FY2017; it was mainly due to losses at net level in FY2018 (provisional). Gearing is moderate at 1.33 times (provisional) as of March 31, 2018 as compared to 1.13 times as on March 31, 2017. Gearing levels deteriorated due to increase in working capital borrowings in FY2018 (Provisional). Tangible net worth to total outside liabilities (TOL/TNW) also stands moderate at 1.60 times as on March 31, 2018 as compared to 1.32 times as on March 31, 2017. Debt protection metrics of interest coverage ratio (ICR) and net cash accruals to total debt (NCA/TD) are weak at 1.38 times and 0.05 times respectively for FY2018. Acuité believes that the financial risk profile is expected to improve over the medium term supported by expected increase in scale of operations and cash accruals despite marginal debt-funded capex proposed of about Rs.2.4 crores in FY2019.

Weaknesses:

- **Modest Scale of operations and losses at operating level**

SGI's operations are modest in the range of Rs.11.0 – 12.5 crores over the past three years through FY2018 with revenues at Rs.12.35 crores (provisional). The modest revenues are partly attributed to capacity constraints besides client concentration in revenues. SGI derives about 70 per cent of its revenues from WIE, though associated for more than a decade. Modest revenues and revenue concentration has limited the absorption of the fixed costs of depreciation and interest in full; resulted in SGI reporting losses for the last three years in the range of Rs.1.1 – 1.6 crores. This further resulted in SGI reporting cash accruals of below Rs.0.5 crore against its repayment obligations of about Rs.0.96 crores causing stretch in its financial flexibility. Acuite believes that SGI improving its revenue profile while maintaining its profitability at about 15 per cent are key rating sensitivity factors.

- **Intense working capital operations**

SGI has intense working capital operations as evident from gross current assets (GCA) days of 286 as on March 31, 2018 (provisional) as against 249 days as on March 31, 2017. The high GCA days was mainly due to high inventory and debtor levels. The inventory days are high at 205 in FY2018 due to huge number of components of more than 1000, to serve the customers on time. Its key customer, WIE demands supplies at short notice for its local as well as overseas locations which warrants SGI to maintain. The entity's debtor days stood at 125 days as on March 31 2018 (Provisional) due to low bargaining power with WIE. Intense working capital management has led to full utilization of working capital limits over the past six months ended July 2018. Creditor days were stretched to the extent of 240 days in FY2018 provisional. Acuité believes that the working capital operations of the firm will remain intense as evident from moderate collection mechanism and high inventory levels in the business.

Analytical Approach

Acuité has considered the standalone business and financial risk profiles of the SGI to arrive at this rating.

Outlook: Stable

Acuité believes that the outlook on SGI will remain stable over the medium term on account of the experience of the promoters in the automobile engineering industry and long track record of operations. The outlook may be revised to 'Positive' in case the firm registers significant growth in its revenues while improving its profitability at operating level. Conversely, the outlook may be revised to 'Negative' in case of any significant stretch in its working capital management leading to deterioration of its financial risk profile and liquidity.

About the Rated Entity - Key Financials

	Unit	FY18 (Prov.)	FY17 (Actual)	FY16 (Actual)
Operating Income	Rs. Cr.	12.35	12.49	10.97
EBITDA	Rs. Cr.	1.83	1.30	1.04
PAT	Rs. Cr.	-1.13	-1.59	-1.43
EBITDA Margin	(%)	14.83	10.45	9.50
PAT Margin	(%)	-9.16	-12.73	-13.05
ROCE	(%)	1.07	-1.57	-4.60
Total Debt/Tangible Net Worth	Times	1.33	1.13	0.83
PBDIT/Interest	Times	1.38	1.06	1.20
Total Debt/PBDIT	Times	5.91	6.95	6.55
Gross Current Assets (Days)	Days	286	249	259

Status of non-cooperation with previous CRA (if applicable)

None

Any other information

None

Applicable Criteria

- Default Recognition -https://www.acuite.in/criteria-default.htm
- Manufacturing Entities - https://www.acuite.in/view-rating-criteria-4.htm
- Financial Ratios And Adjustments - https://www.acuite.in/criteria-fin-ratios.htm

Note on complexity levels of the rated instrument
https://www.acuite.in/criteria-complexity-levels.htm

Rating History (Upto last three years)
None

***Annexure – Details of instruments rated**

Name of the Facilities	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. Crore)	Ratings/Outlook
Cash Credit	Not Applicable	Not Applicable	Not Applicable	4.50	ACUITE B / Stable (Assigned)
Term Loans	Not Applicable	Not Applicable	Not Applicable	1.50	ACUITE B / Stable (Assigned)
Proposed Term Loan	Not Applicable	Not Applicable	Not Applicable	1.50	ACUITE B / Stable (Assigned)

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About Acuité Ratings & Research:
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