Press Release

Diffusion Engineers Limited

May 10, 2021

Rating Assigned

Total Bank Facilities Rated*	Rs.60.00 Cr.
Long Term Rating	ACUITE A- / Outlook: Stable (Assigned)
Short Term Rating	ACUITE A2+ (Assigned)

** Refer Annexure for details*

Rating Rationale

Acuité has assigned its long-term rating of **'ACUITE A-' (read as ACUITE A minus)** and short-term rating of **ACUITE A2+ (read as ACUITE A two plus)** on the Rs.60.00 crore bank facilities of Diffusion Engineers Limited. (DEL). The outlook is **'Stable.'**

The ratings assigned to DEL takes into account the company's long presence of over 3 decades supported by experienced management, healthy financial risk profile and improving scale of business with sustainable operating margin. The company's operating margin has improved to 14.39 per cent during April-December 2020 (provisional) as against 13.52per cent in FY2018. The improvement in margins is on account of higher order book, improved realization and cost cutting measures. Further, DEL's operating margin has remained above 11per cent during FY18 to FY20. The ratings, however, are partly constrained by working capital intensive nature of operations, although improving and susceptibility to fluctuation in key raw material prices. The working capital is intensive marked by GCA days of 213 for FY2020.

About the Company

Established in 1982, DEL is engaged in welding maintenance and repair solution services for industries like cement, power and steel, among others. The Nagpur-based company manufactures welding consumables like electrodes, flux cored wire, etc. and also offers solutions for reconditioning/repair. The company was promoted by Mr. N. K. Garg. However, after his demise in 2020, Mr. Prashant Garg was appointed as a managing director.

Analytical Approach

Acuite has considered the standalone financial and business risk profiles of DEL to arrive at the rating.

Key Rating Drivers

Strengths

- **Long track record of operations supported by experienced management**

  DEL has been in the business of welding consumables since past more than 3 decades. Besides manufacturing welding consumables like electrodes, flux cored wires, etc., the company also offers solutions for reconditioning/repair of critical equipment used in manufacturing plants of cement, power and steel, among others.

  Mr. N. K. Garg, promoter of the company, was a managing director of the company. However, after his demise in 2020, Mr. Prashant Garg was appointed as a managing director. Mr. N. K. Garg was having around 4 decades of industry experience, which has enabled DEL not only to maintain good relation with customers and suppliers, but also to diversify the product/service offerings. In addition to welding consumables, DEL also manufactures wear plates and some heavy machineries like plasma cutting machines, etc.

  The current managing director, Mr. Prashant, has around 14 years of experience and has shown his strong capability by developing a state-of-the-art production facility for DEL to manufacture sophisticated cement, power and steel plant equipment.

Acuite believes that DEL's established track record and experienced management would continue to support its growth going ahead.

- **Healthy financial risk profile**

DEL has healthy financial risk profile marked by healthy net worth, comfortable gearing and debt-protection matrix. The company's net worth, as on March 31, 2020 increased to Rs.95.48 crore from Rs.87.23 core as on March 31, 2019 and Rs.80.28 crore as on March 31, 2018.

DEL follows conservative leverage policy with its gearing level (debt to equity ratio) standing below unity in the past, despite rise in debt levels in the recent years. As on March 31, 2020, debt to equity ratio of the company stood at 0.33 times compared to 0.17 times as on March 31, 2019. The company's total debt as on March 31, 2020 was Rs.31.65 crore compared to Rs.14.80 crore as on March 31, 2019. Total debt as on March 31, 2020 comprised long-term debt of Rs.11.63 crore and short-term debt of Rs.20.02 crore. DEL had taken additional term loan in FY20 for its expansion project. In FY21, debt to equity ratio is expected to have improved to ~0.2 times. Acuite expects, debt to equity ratio to improve further to ~0.10 times by March 31, 2023, provided no significant deb-funded capex. Total outside liabilities to tangible net worth (TOL/TNW) ratio too has remained below unity during FY18 to FY20.

DEL's interest coverage ratio (ICR), in FY20, improved to 9.23 times from ~8.4 times in the preceding two years. Debt service coverage ratio (DSCR) too increased to 6.57 times for FY20 from ~6 times a year ago. Going ahead, with expected improvement in operating performance, DEL's ICR is expected to improve to 13-14 times by FY23. DSCR, however, would see some deterioration due to higher repayment of term loans, but would remain at a moderate level of 2-5 times during FY21-FY23.

- **Improving business scale along with sustainable operating margin**

The operating performance of DEL was impacted by Covid-19-led disruptions during the last few days of March 2020. The company, however, has registered good growth during FY18 to FY20. DEL's operating revenue grew at a CAGR of ~12per cent during the same period. This was on the back of higher work orders. The company has also maintained above 11per cent EBITDA margin during FY18 to FY20.

In FY21, despite the pandemic-led challenges, DEL has registered higher revenue (~3per cent) vis-à-vis FY20 led by higher orders and improved realization. This along with some cost cutting measures is expected to have propelled the company's EBTIDA margin to ~14per cent in FY21. Further, DEL's initial order book for FY22 stood higher at ~Rs.90 crore compared to Rs.55 crore-Rs.60 crore a year ago.

Going ahead, the company's operating revenue is expected to grow at a CAGR of ~13.5per cent during FY22 to FY23 and EBITDA margin is likely to remain at 13-13.5per cent levels. Dominance of organized players (~65-70per cent market share) in the welding consumable segment would also support DEL's overall operating performance going ahead.

Weaknesses

- **Moderately intensive working capital operations, albeit improving**

DEL has moderately intensive working capital operations. The company's GCA days for FY20 stood at 213 compared to 172 for FY19 and 202 for FY18. The high working capital intensity is driven by high inventory days, which increased to 125 for FY20 from 91 days for FY19 and 100 days for FY18. Debtor days stood at 91 for FY20 compared to 82 for FY19. FY20 working capital cycle was impacted by Covid19-led nation-wide lockdown during the last few days of the fiscal. However, DEL's working capital intensity has seen improving looking at FY19 and FY18 GCA day figures. Acuite believes that DEL's GCA days would remain around 180-200 levels during FY21-FY23.

- **Susceptibility to fluctuation in raw material prices**

DEL's profitability is susceptible to fluctuations in prices of key raw material, i.e. steel (~70per cent of total raw material cost). DEL's inability to pass on sudden rise in steel prices to its consumers would impact the company's overall operating performance.

Liquidity Position - Adequate

DEL has adequate liquidity position marked by sufficient net cash accruals to its maturing debt obligations. The company generated cash accruals of Rs.12.12 crore for FY20 against maturing debt obligations of Rs.0.23 crore during the same period. In FY21 also, DEL's cash accruals are estimated at Rs.14.92 crore against maturing debt obligations of Rs.3.53 crore. Going ahead, during FY22 and FY23, the company's cash accruals are expected to be around Rs.16 crore to Rs.18 core against maturing debt obligations of Rs.2 crore to Rs.6.2 crore.

Further, despite operating in high working capital intensive business, DEL's fund-based bank limit utilization stood lower at ~15per cent level during April '20 to January '21. Current ratio stood moderate at 1.41 times as on March 31, 2020.

Acuite believes, DEL's liquidity position would remain adequate going ahead with sufficient cash accruals to its maturing debt and lower bank limit utilization.

Rating Sensitivities

- Inability to sustain operating margin
- Elongation of working capital cycle

Material Covenants

No

Outlook: Stable

Acuité believes that DEL would maintain 'Stable' outlook on the back of established presence in the welding consumables segment and experienced management and improving scale of business while maintaining healthy operating margin. The outlook may be revised to 'Positive' in case the company reports higher than expected growth in revenue and improvement in profitability. Conversely, the outlook may be revised to 'Negative' in case of lower-than-expected revenue and inability to sustain operating margin, thereby hurting operating performance and resulting in deterioration in financial risk profile.

About the Rated Entity - Key Financials

	Unit	FY20 (Actual)	FY19 (Actual)
Operating Income	Rs. Cr.	147.04	152.34
PAT	Rs. Cr.	9.06	9.81
PAT Margin	(%)	6.16	6.44
Total Debt/Tangible Net Worth	Times	0.33	0.17
PBDIT/Interest	Times	9.23	8.43

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

None

Any other information

Not Applicable

Applicable Criteria

- Default Recognition - https://www.acuite.in/view-rating-criteria-52.htm
- Manufacturing Entities – https://www.acuite.in/view-rating-criteria-59.htm
- Entities in Service Sector - https://www.acuite.in/view-rating-criteria-50.htm
- Financial Ratios And Adjustments -https://www.acuite.in/view-rating-criteria-53.htm

Note on complexity levels of the rated instrument

https://www.acuite.in/view-rating-criteria-55.htm

Rating History (Upto last three years)

Not Applicable

***Annexure – Details of instruments rated**

Name of the Facilities	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. Cr.)	Ratings/Outlook
Cash Credit	Not Applicable	Not Applicable	Not Applicable	20.00	ACUITE A-/Stable (Assigned)
Term Loan	29-Nov-2019	7.75%	29-Mar-2024	4.91	ACUITE A-/Stable (Assigned)
Term Loan	29-Feb-2020	7.75%	29-Nov-2024	3.05	ACUITE A-/Stable (Assigned)
Cash Credit	Not Applicable	Not Applicable	Not Applicable	5.00	ACUITE A-/Stable (Assigned)
Bank Guarantee	Not Applicable	Not Applicable	Not Applicable	10.00	ACUITE A2+ (Assigned)
Bank Guarantee	Not Applicable	Not Applicable	Not Applicable	2.50	ACUITE A2+ (Assigned)
Proposed Bank Facility/ies	Not Applicable	Not Applicable	Not Applicable	14.54	ACUITE A-/Stable (Assigned)

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About Acuité Ratings & Research:
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