February 23, 2023

HI-Q Electronics (P) Limited: Ratings upgraded to [ICRA]BBB+ (Stable)/[ICRA]A2

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long Term – Fund Based/TL	13.20	2.88	[ICRA]BBB+ (Stable); upgraded from [ICRA]BBB(Stable)
Long Term - Fund Based/ CC	5.50	5.50	[ICRA]BBB+ (Stable); upgraded from [ICRA]BBB(Stable)
Short Term – Non-fund Based	3.00	3.00	[ICRA]A2; upgraded from [ICRA]A3+
Long Term/Short Term - Unallocated	3.42	13.74	[ICRA]BBB+ (Stable)/[ICRA]A2; upgraded from [ICRA]BBB(Stable)/[ICRA]A3+
Total	**25.12**	**25.12**	

**Instrument details in Annexure I*

Rationale

The ratings upgrade factors in Hi-Q Electronics (P) Limited's (Hi-Q) significant deleveraging demonstrated since FY2021, leading to an improvement in the credit metrics. ICRA expects the company's borrowings to further decline in FY2023, which, along with healthy earnings, are expected to further strengthen its credit metrics. The ratings are also supported by the company's established track record in the printed circuit board (PCB) manufacturing business with focus on high-margin multi-layer PCBs used in research and development (R&D) in the information technology, defence and aerospace sectors. The ratings also factor in the company's reputed customer base and demonstrated technological capabilities along with vast experience of promoters, which enhance its competitiveness and act as an entry barrier for new players. Hi-Q's operating income increased at a healthy compounded annual growth rate (CAGR) of 15% between FY2017 and FY2022. In the current fiscal, the company is expected to grow in the range of 15-20% year-on-year (YoY). The rating also derives support from the company's healthy financial risk profile, characterised by attractive operating margins, comfortable gearing and adequate coverage indicators.

The ratings, however, remain constrained by the company's moderate scale of operations, given the niche nature of its business. Also, the working capital intensive nature of operations owing to the high inventory holding has constrained the business return indicators. However, ICRA notes that Hi-Q has been able to tighten the cash conversion cycle in FY2022 through timely realisation of receivables, which has helped bring down the working capital intensity to 39% in FY2022 from 47% in FY2021. The company is also exposed to foreign currency fluctuations owing to sizeable imports, which remain unhedged and can exert pressure on margins in case of depreciation of the INR. The said risk is mitigated to some extent by substantial export revenues. ICRA believes that the electronics industry demands constant innovation and adaption to latest technologies to restrict competitive pressure, which could necessitate regular capital investments. Therefore, the ability of the company to make prudent investments to meet its revenue growth expectations will remain a key factor from the credit perspective.

The Stable outlook on the long-term rating indicates that the company's financial risk profile is expected to remain comfortable, supported by its established position in the PCB manufacturing business, favourable demand outlook from end-user segments, and conservative growth plans.

Key rating drivers and their description

Credit strengths

Significant deleveraging; healthy financial profile characterised by prudent capital allocation and healthy RoCE – The company's operating profit margins remained healthy at 23.76% in FY2022 though declining somewhat from 24.78% in FY2021, led by depreciation in the INR against the USD in FY2022 and increased sale to aerospace and defence segment (which entailed a higher cost of material consumed). The company's capital structure remained comfortable with a gearing of 0.21 times as on March 31, 2022 on the back of repayment of long-term debt and modest accretion to reserves. Moreover, Hi-Q's debt coverage indicators remained healthy with an interest coverage of 19.85 times and DSCR[1] of 2.40 times in FY2022. The company has planned capex in the near future from internal accruals and its financial risk profile is likely to remain comfortable, driven by healthy margins and low borrowing levels. The total debt level stood at a comfortable level of Rs. 1.98 crore as on December 31, 2022, against Rs. 9.26 crore as on March 31, 2022, Rs. 11.35 crore as on March 31, 2021, and Rs. 16.41 crore as on March 31, 2020.

Established track record of operations in PCB manufacturing – The company started operations in 1978 and has an established track record of operations, spanning over four decades. It has ventured into the supply of complex PCBs that find application in the defence and aerospace segments. Such orders have low raw material component, need faster roll-out times, and are technologically more sophisticated, thereby enabling the company to fetch relatively better margins over the industry average.

Over the years, it has built relationships with reputed players in the IT, aerospace, and defence sectors. Hi-Q's customer base continues to be moderately diversified with more than 200 customers and consists of a large number of original equipment manufacturers (OEMs) and subcontractors for OEMs (engaged in assembly). The established relationship has aided Hi-Q to get repeat orders and supports stability in revenues and earnings.

Large investments in technologies provide competitive advantage; capital-intensive operations act as an entry barrier – The company continues to focus on high-margin complex prototype PCB manufacturing to meet the R&D requirements of clients in the IT, aerospace, and defence sectors. It is capable of manufacturing up to 40-layer PCBs. Due to this, the operations require continuous capital expenditure for the acquisition and upgradation of technology and fixed assets, which acts as an effective entry barrier for new players. Additionally, ICRA notes that the domestic demand growth for PCBs is expected to remain healthy with rapid urbanisation, rising living standards, and increasing disposable income of the majority of the population, which augers well for the non-defence business. Further, given the Government's focus on greater indigenisation in the defence segment, order visibility from the defence segment is expected to remain healthy.

Credit challenges

Small scale of operations – The company's scale of operations has been modest with an operating income of Rs. 66.27 crore in FY2022. The same stood at Rs 48.02 crore in FY2021, declining from Rs. 57.04 crore in FY2020 owing to weak demand from its key end-user industries following the pandemic. Major increase in demand for PCBs from domestic producers due to constructive steps taken by the Government of India including 'Made in India' and 'Digital India' provides impetus to domestic consumer electronics production units. This has helped the company book revenues of Rs. 56.3 crore in 9M FY2023 with an outstanding order book position of Rs. 11.65 crore. The company is poised to record revenues of Rs. 77 crore in FY2023, which would be an all-time high.

High working capital intensity owing to high inventory holding – The company's working capital intensity remains high and stood at 39% in FY2022 (moderating somewhat from 45.0% in FY2021) owing to the high receivable days and inventory levels. It maintains high levels of inventory to successfully fulfil customer orders, which require a fast turnaround time but involves a long lead time for procurement of critical imported input materials. Additionally, the company is required to order above a minimum order quantity for most of its raw materials, resulting in high inventory levels. The receivables position has also been high in the past with extended credit period provided to public sector undertakings (PSUs) and a few of its key customers. But the working capital intensity of the company reduced in FY2022 due to timely realisation from major customers due to availability of LC discounting facility, which supported its liquidity profile.

Exposure to foreign currency risks due to a significant proportion of imports – The company imports a major part of its raw material requirements, which exposes it to forex risks. However, such risks are partly mitigated due to a natural hedge arising from Hi-Q's export earnings.

[1] Debt service coverage ratio

Liquidity position: Adequate

Hi-Q's liquidity remains adequate with healthy net cash accruals and modest cash and bank balance. The free cash flow has been positive in four out of the past five fiscals (FY2018 – FY2022), aided by healthy profit margins and conservative growth plans. The company has a cash credit facility of Rs. 5.50 crore, with the average utilisation level standing at a modest of 44% between April 2021 and December 2022. In addition, the company maintains a positive balance in the Euro and USD account aggregating to Rs. 1.7 crore as on January 31, 2023. Going forward, the company has expansion plans in the pipeline, which are expected to be funded by internal accruals.

Rating sensitivities

Positive factors – ICRA could upgrade Hi-Q's rating if the company demonstrates a healthy revenue growth and significant strengthening in its net worth along with improvement in the liquidity position on a sustained basis.

Negative factors –Pressure on Hi-Q's rating could arise if there is a significant decline in the operating income and profitability or a higher-than-anticipated debt-funded capital expenditure, weakening the capital structure and debt protection metrics. Specific credit metrics that might trigger a rating downgrade include a total debt/OPBITDA of more than 1.5 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	Not Applicable
Consolidation/Standalone	Standalone

About the company

Hi-Q was initially founded as a partnership firm in 1978 by Dr. S. Venkatachalam and was converted into a private limited company in 1983. The company manufactures prototypes of printed circuit boards (PCBs) that are mainly used by IT hardware companies for their research and development requirements. It has also forayed into the manufacturing of complex multi-layer PCBs with specific design and testing requirements for the players in the defence and aerospace sectors. Hi-Q's manufacturing facility is located at Hosur, Tamil Nadu.

Key financial indicators (Audited/ Provisional)

Hi-Q Standalone	FY2020A	FY2021A	FY2022A	9MFY203P
Operating Income (Rs. crore)	57.04	48.02	66.27	56.3
PAT (Rs. crore)	7.97	3.05	6.91	-
OPBDIT/OI (%)	30.20%	24.78%	23.76%	-
PAT/OI (%)	13.97%	6.35%	10.43%	-
Total Outside Liabilities/Tangible Net Worth (times)	0.77	0.52	0.44	-
Total Debt/OPBDIT (times)	0.95	0.95	0.59	-
Interest Coverage (times)	12.02	9.17	19.85	-

PAT: Profit After Tax; OPBDITA: Operating Profit Before Depreciation, Interest, Taxes and Amortisation, A-Audited, P-Provisional
Source: Company, ICRA Research; All ratios as per ICRA's calculations

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three year

	Instrument	Current Rating (FY2023)				Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding as on Mar 31, 2022 (Rs. crore)	Date & Rating on	Date & Rating in FY2022	Date & Rating in FY2021	Date & Rating in FY2020
					23-Feb-2023	30-Nov-2021	31-August-2020	-
1	Cash Credit	Long Term	5.50	-	[ICRA]BBB+ (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	-
2	Term Loan	Long Term	2.88	2.35	[ICRA]BBB + (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	-
3	Bank Guarantee	Short Term	3.00	-	[ICRA]A2	[ICRA]A3+	[ICRA]A3+	-
4	Unallocated	Long Term/ Short Term	13.74	-	[ICRA]BBB + (Stable)/[ICRA]A2	[ICRA]BBB (Stable)/[ICRA]A3+	[ICRA]BBB (Stable)/[ICRA]A3+	-

Complexity level of the rated instrument

Instrument	Complexity Indicator
Cash Credit	Simple
Term Loan	Simple
Bank Guarantee	Very Simple
Unallocated	Not Applicable

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments, are available on ICRA's website: Click Here

Annexure I: Instrument details

ISIN No	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (RS Crore)	Current Rating and Outlook
NA	Cash Credit	NA	NA	NA	5.50	[ICRA]BBB+ (Stable)
NA	Term Loan	NA	NA	NA	2.88	[ICRA]BBB+ (Stable)
NA	Bank Guarantee	NA	NA	NA	3.00	[ICRA]A2
NA	Unallocated	NA	NA	NA	13.74	[ICRA]BBB+ (Stable)/[ICRA]A2

Source: Company Data

Please click here to view details of lender-wise facilities rated by ICRA

Annexure II: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Not Applicable		

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

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