March 20, 2023

Sadhu Forging Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term – Fund-based/ Term Loan	14.55	1.76	[ICRA]BBB-(Stable); reaffirmed
Short-term – Non-fund Based	4.50	4.50	[ICRA]A3; reaffirmed
Long-term/ Short term – Fund-based	103.50	110.00	[ICRA]BBB-(Stable)/[ICRA]A3; reaffirmed
Long-term/ Short-term – Unallocated	0.45	6.74	[ICRA]BBB-(Stable)/[ICRA]A3; reaffirmed
Total	**123.00**	**123.00**	

**Instrument details are provided in Annexure-I*

Rationale

The rating reaffirmation takes into account ICRA's expectation that Sadhu Forging Limited's (SFL) healthy revenue growth would continue on account of stable demand from end-user industries, in the near to medium term, supported by its recent capacity addition. ICRA's ratings further continue to draw comfort from the extensive experience of SFL's promoters and management in the forging and machining industry. The ratings also consider its strong association with a reputed clientele as reflected by repeat orders and its status as a tier-I supplier to various tractors and commercial vehicle (CV) Original Equipment Manufacturers (OEMs) in the domestic and export markets, which support its long-term business sustainability and growth prospects.

However, the ratings are constrained by the pressure on SFL's operating profitability in FY2022 and current fiscal largely on account of increase in raw material prices, which have witnessed corrections since Q1 FY2023. The corresponding price escalations from clients are expected to be realised with a lag. In addition, the ratings factor in the impact of forex movements and the intense competition in the industry. SFL's operations are working capital intensive owing to the long debtor cycle and its need to maintain high inventory levels for a variety of raw material grades and finished goods. However, both the debtors and inventory cycles have moderated in FY2022 and the current fiscal as compared to earlier levels, which have supported its cash flow position. Moreover, SFL's debt coverage metrics continue to be moderate though on an improving trend. The ratings are also tempered by sectoral concentration risks as the company generates a major share of its revenues from the automobile sector. ICRA also notes that SFL has extended corporate guarantee to one of its group companies. Any further funding support will remain a key rating sensitivity.

The Stable outlook on the [ICRA]BBB- rating reflects ICRA's belief that SFL will continue to benefit from its established association with reputed brands such as Tata Motors Limited (TML) and Mahindra & Mahindra (M&M). Further, the company is expected to scale up its new segments and register growth in its revenues.

Key rating drivers and their description

Credit strengths

Tier-I supplier to major OEMs – SFL supplies forging and casting auto components to established OEMs including TML, M&M, Volvo Eicher Commercial Vehicles (VECV), Tractors and Farm Equipment (TAFE), and Escorts Limited (EL), which are leading players in the industry. SFL also exports to players like Kubota and Meritor with exports generating around 19% of its sales in

9M FY2023. The company has been associated with such reputed clients for a long period now. SFL enjoys working relationships of more than a decade with its exports clients such as Kubota and Meritor; as well as healthy relationships of more than 5-7 years with its domestic OEM clients. The company has been getting steady repeat business across its clientele.

Diversified product and customer profile – The company manufactures products for diversified segments like CV and tractors. Further, the company also has limited product portfolio in the passenger vehicle (PV) and railways segments. As such, its customer profile is moderately diversified in the domestic and exports markets. Moreover, SFL has expand its product portfolio with its existing clients, thereby gradually increasing its share of business. The company plans to focus on machined components and assemblies, which are higher margin segments.

Extensive experience of promoters – The company's promoters have close to four decades of experience in the auto ancillary industry and are actively involved in its day-to-day operations.

Continued healthy growth in revenues– The company's revenues increased substantially in FY2022 with growth of ~41% to Rs. 520 crore on the back of increased capacity achieved through the recently concluded capex. The growth is expected to continue in the current fiscal as well, as the company has already achieved Rs. 433 crore in revenues during 9M FY2023. The growth in top line is largely on the back of stable demand from the end-user industries, which is expected to drive revenues in the near to medium term.

Credit challenges

Moderation in profitability exerting pressure on return metrics; exposure to fluctuations in raw material prices and forex rates – The company faces raw material price risk, to some extent, due to its arrangement with OEMs to pass on the increase in costs only partially, with a lag of one month. Further, with limited hedging policy in place, SFL's profitability remains exposed to adverse fluctuations in foreign currency. Although, some portion of risk is offset by it availing post shipment facilities and scheduled repayment of long-term liabilities in foreign currency. SFL's operating margins moderated in FY2022 on account of inflationary pressures witnessed across the cost structure but thereafter improved marginally in 9M FY2023 with some moderation in the input prices. Subsequently, the profit margins and return metrics are expected to improve but still remain under pressure in the near term. SFL's operating margins have been more modest than the industry average. Its debt metrics are also moderate as reflected by Total debt/OPBDIT of 5.07 times and DSCR of 1.47 times as on March 31, 2022 and are expected to improve gradually. ICRA notes that SFL has extended corporate guarantee to one of its group companies, Sadhu Overseas, to the tune of Rs. 14.69 crore. Any further funding support will remain a key rating sensitivity.

Moderately high working capital intensity– SFL's operations remained working capital intensive with NWC/OI of ~28% as on March 31, 2022, with improvement witnessed as compared to March 31, 2021. The same is expected to be on similar lines in the current fiscal. While the company has to offer credit of up to 90 days and 180 days to its domestic and export clients, respectively, it also keeps stock of around 75-90 days. The company, however, has flexibility to avail additional funding from its creditors when needed, and also has access to vendor financing for raw material purchase from Tata Steel as well as bill discounting limits for specific clients.

Exposed to cyclicality in automotive industry amid intense competition from peers; limited presence in EV segment poses threat to demand– SFL is exposed to industry cyclicality due to significant revenue dependence on the CV and tractor segments. However, as of now, both these industries are experiencing stable demand. Moreover, limited presence in the EV segment poses a threat to demand in the long-term.

Liquidity position: Adequate

SFL's liquidity position is **adequate** on account of stable operating cash flows aided by increasing scale of operations following the recently concluded capex. The liquidity is also aided by substantial amount of liquid investments, which the company intends to use to support liquidity in case required. Also, the company has flexibility to avail more invoice discounting limits, if needed, given adequate associated receivables available. There is limited cushion available in its working capital limits along with limited free cash availability on its books. This apart, there are sizeable repayments (Rs. 13.75 crore in FY2024 and Rs. 13.65 crore in FY2025). The same is expected to be met by the internal accruals.

Rating sensitivities

Positive factors – The rating could be upgraded if there is healthy ramp up of operations leading to improvement in the company's revenues and coverage indicators. Specific credit metrics that could lead to an upgrade in ratings include TD/OPBIDTA of less than 3.0 times on a sustained basis.

Negative factors – Negative pressure on the ratings could arise in case of any significant reduction in the company's revenues and profitability resulting in deterioration in liquidity and weakening of the debt coverage indicators on a sustained basis. Specific credit metrics that could lead to a downgrade in ratings include DSCR of less than 1.4 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Methodology on Auto Component Suppliers
Parent/Group support	Not Applicable
Consolidation/Standalone	Standalone

About the company

Incorporated in 1976, SFL has four manufacturing units with facilities for forging and machining of automotive components. The company manufactures transmission and differential parts for CVs and tractors. Its major manufactured components include gears, shafts, axles, engine components and steering assemblies. It supplies components to several reputed OEMs, including M&M, TML, TAFE, Kubota, Meritor and Escorts Limited. The promoter group also operates another auto ancillary, Sadhu Autoparts Private Limited (SAPL), which is primarily involved in machining operations and derives most of its revenues from exports.

Key financial indicators (audited/provisional)

Consolidated	FY2021	FY2022	9M FY2023*
Operating income	369.5	519.8	433.3
PAT	3.2	8.8	10.1
OPBDIT/OI	6.9%	6.2%	6.7%
PAT/OI	0.9%	1.7%	2.3%
Total outside liabilities/Tangible net worth (times)	2.4	2.5	-
Total debt/OPBDIT (times)	6.2	5.1	-
Interest coverage (times)	2.8	2.8	-

*PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs. Crore, *Based on provisional numbers*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument		Current rating (FY2023)				Chronology of rating history for the past 3 years				
		Type	Amount rated (Rs. crore)	Amount outstanding (Rs. crore)	Date & rating in FY2023	Date & rating in FY2022		Date & rating in FY2021		Date & rating in FY2020
					Mar 20, 2023	Mar 17, 2022	Aug 02, 2021	Nov 19, 2020	Sep 03, 2020	Jul 29, 2019
1	Term loan	Long Term	1.76	1.76	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Negative)	[ICRA]BBB (Negative)	[ICRA]BBB (Negative)	[ICRA]BBB (Stable)
2	Non-fund Based	Short Term	4.50	4.50	[ICRA]A3	[ICRA]A3	[ICRA]A3	[ICRA]A3+	[ICRA]A3+	[ICRA]A3+
3	Fund Based	Long Term/ Short Term	110.00	110.00	[ICRA]BBB- (Stable)/ [ICRA]A3	[ICRA]BBB- (Stable)/ [ICRA]A3	[ICRA]BBB- (Negative)/ [ICRA]A3	[ICRA]BBB (Negative)/ [ICRA]A3+	[ICRA]BBB (Negative)/ [ICRA]A3+	[ICRA]BBB (Stable)/ [ICRA]A3+
4	Unallocated	Long Term/ Short Term	6.74	6.74	[ICRA]BBB- (Stable)/ [ICRA]A3	[ICRA]BBB- (Stable)/ [ICRA]A3	[ICRA]BBB- (Negative)/ [ICRA]A3	[ICRA]BBB (Negative)/ [ICRA]A3+	[ICRA]BBB (Negative)/ [ICRA]A3+	[ICRA]BBB (Stable)/ [ICRA]A3+

Source: Company

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long Term - Fund Based TL	Simple
Short Term - Non-Fund Based	Very Simple
Long Term / Short Term - Fund Based	Simple
Long Term / Short Term – Unallocated	NA

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	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loan	2014	NA	2026	1.76	[ICRA]BBB-(Stable)
NA	LC/BG	-	NA	-	4.50	[ICRA]A3
NA	Cash Credit	-	NA	-	110.00	[ICRA]BBB-(Stable)/ [ICRA]A3
NA	Unallocated	-	NA	-	6.74	[ICRA]BBB-(Stable)/ [ICRA]A3

Source: Company

Annexure II: List of entities considered for consolidated analysis – 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.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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