October 07, 2022

Sterling Tools 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	78.88	59.61	[ICRA]AA-(Stable); Reaffirmed
Long term Fund-based working capital	120.00	120.00	[ICRA]AA-(Stable); Reaffirmed
Non-fund Based Limits	2.09	2.84	[ICRA]A1+; Reaffirmed
Unallocated	4.70	23.22	[ICRA]A1+; Reaffirmed
Total Bank Lines	**205.67**	**205.67**	

**Instrument details are provided in Annexure-1*

Rationale

The ratings reaffirmation factors in the stable operating performance of Sterling Tools Limited (STL) over the past 12 months, aided by its established market position as the second largest automotive fastener manufacturer in India. The company enjoys a healthy share of business (SOB) with leading automotive original equipment manufacturers (OEMs), including Maruti Suzuki India Limited (MSIL), Honda Motorcycles and Scooters India Limited (HMSI), Tata Motors Limited (TML) and Ashok Leyland Limited (ALL), Mahindra & Mahindra among others. Benefitting from its expertise in developing value-added specialised, and critical fasteners including those used in engine and transmission systems, the company has become a key development partner for auto OEMs for their fastener requirements.

The company reported a healthy revival in revenues during FY2022, even outpacing the industry growth and closed the fiscal with revenue growth of ~43% YoY on a consolidated basis and ~32% YoY on a standalone basis. This was supported by the improvement in the economic environment and consequently higher demand from the automobile industry. The performance continued to improve in Q1 FY2023 with 53% YoY growth in revenue. Even though the company's margins have remained impacted to an extent by inflationary pressures, they continue to remain healthy (OPM of ~15% in FY2022). Aided by improved operating leverage and an easing in metal prices, STL's margins are expected to report an improvement, going forward.

To cater to the new business opportunities in the automotive industry, the company collaborated with a Chinese company, Jiangsu Gtake Electric, to form a joint venture (JV), Sterling Gtake E Mobility Ltd. (SGEM). However, considering the delay in obtaining FDI approvals by its Chinese partner, STL currently holds full stake in SGEM.

SGEM manufactures Motor Control Units (MCUs) for a wide range of electric vehicles (EVs) ranging from high-speed scooters (>40 kmph), cargo 3-wheelers (3Ws) and light commercial vehicles (LCVs). It imports the electronic parts from China, while the mechanical parts/assembly lines are localised. SGEM received its first order worth Rs. 60 crores in July 2021 from an electric two-wheeler (e-2W) OEM, which was followed up by an additional order of Rs. 100 crores from the same OEM. The subsidiary is working with multiple customers including some leading OEMs across various segments. A ramp up in revenues from the business would support the company's entry into the EV component space and diversify its revenue streams, going forward. Moreover, as the quantum of investments is likely to be limited, the company's credit metrics are not expected to be significantly impacted.

ICRA notes that over the past few quarters, the company's reliance on working capital borrowings has increased to some extent on account of raw material stocking to counter the volatilities in steel prices and supply as well as initial working capital investment required by the subsidiary. Accordingly, gross debt levels increased to Rs. 110.0 crore as on March 31, 2022 (Rs. 105.4 crore in FY2021, and Rs. 75.0 crore in FY2020). Nevertheless, the company continues to maintain adequate cash and liquid investments (Rs. 31 crores as on March 31, 2022) resulting in net debt levels of Rs. 70 crores. Coupled with healthy operating profitability, the credit metrics remain comfortable with gearing of 0.3x, interest cover of 10x and TOL/TNW of 0.5x in FY2022.

The Stable outlook on the long-term rating reflects ICRA's opinion that STL would continue to maintain healthy credit metrics going forward as well, aided by its established market position as a leading automotive fastener manufacturer.

Key rating drivers and their description

Credit strengths

Leading player in the automotive fastener segment – STL is positioned as the second largest automotive fastener manufacturer in India, trailing only behind Sundaram Fasteners in terms of revenue and market share. Aided by regular investments in product development (with focus on specialised fasteners), the company has been able to enhance its SOB with leading automobile OEMs in India. Accordingly, despite stiff competition from both organised and numerous unorganised players in the fastener segment, the company has maintained its market standing over the years.

Diversified revenue profile across automotive segments; diversified client profile with healthy SOB with key customers – STL's revenue profile is well-diversified, catering to all major automotive segments, as well as some non-automotive segments. Furthermore, its dependence on each segment is limited, with commercial vehicles accounting for only 28% of its OEM revenues (FY2022), followed by passenger vehicles (PVs) (~27%), two-wheelers (~21%), and tractors (~15%). STL's diversified presence protects its revenues and earnings to some extent from demand downturns that impact specific automotive segments. The company caters to multiple OEMs across the automotive spectrum, with healthy SOB with most leading OEMs and limited dependence on a single customer. Its largest customer accounted for ~19% of STL's FY2022 revenue, while its top five customers contributed ~52%. STL's well-diversified revenue profile, coupled with healthy market position with major automotive OEMs, augurs well for its business prospects over the medium term.

Product development and business expansion capabilities to benefit from recent collaborations – During FY2018, STL entered into a business collaboration agreement with Meidoh Co. Ltd., Japan, to develop and sell high tensile fasteners in India. Further, the company formed a subsidiary, SGEM, in technical collaboration with a Chinese company for manufacturing MCUs for EVs, which has already started contributing to the top line (~Rs. 68 crores in H1 CY2023) and would support the company's entry into the EV component space and diversify its revenue streams, going forward.

Healthy financial risk profile with robust profitability, return indicators and comfortable credit metrics – During FY2018–FY2021, STL maintained healthy profitability indicators, with OPM in the range of 16–21%, supported by a high share of specialised fasteners, steady realisations, and strict control on cost overheads. The OPM, however, dropped to ~15% in FY2022 owing to the company's limited ability to pass on inflationary pressures. Even as it was largely able to pass on hikes in steel prices to its customers, it could not completely pass on the increase in other costs, viz., energy, chemicals, and conversion material costs due to the inflation. The margins are, however, expected to improve in FY2023 on account of some softening expected in the raw material costs during H2 FY2023 and other manufacturing costs, which escalated in FY2022 from the supply chain disruptions caused worldwide. Additionally, STL maintains a conservative capital structure with low gearing levels and comfortable coverage indicators. Its average working capital utilisation also remains low, with an average buffer of Rs. 68 crore as unutilised limits (over the past 12 months). Going forward, even as ICRA expects the funding of STL's future capex plans to be undertaken through a mix of internal accruals and external debt, the debt metrics will likely remain in the comfortable range.

Credit challenges

Exposed to inherent cyclicality of domestic automotive industry – With ~80% of STL's revenues derived from supplies to domestic automotive OEMs, it remains exposed to cyclicality in the domestic automobile market. As the domestic auto industry underwent a sharp downturn during FY2020 and FY2021, it had significant impact on STL as well, with revenues contracting by 29% and 2.5% YoY during this period, respectively. Though the pandemic impacted the company's prospects again in Q1 FY2022; the situation progressively improved as the domestic automotive market recovered, supported by the boost in economic activities; and the company was able to close FY2022 with 32% growth in revenues on a standalone basis. STL's revenue, particularly in the PV segment, however, was constrained by the semiconductor chip shortage, which hampered the overall automobile industry.

Slow ramp up at the Bengaluru facility to constrain return indicators in near term – STL has set up a greenfield facility in Karnataka, which commenced operations from September 2019 with an initial production capacity of 500 MT per month. Given the slowdown in the domestic automotive market, ramp-up at the plant was slower than envisaged, and it exerted some pressure on return indicators (ROCE reduced to 10% in FY2022 from 23% in FY2019). However, as per the management, the company has majorly completed the required capex at the Bengaluru plant, which is now running at improved capacity (800 MT per month) from FY2023 and is, consequently, generating improved revenues. The return indicators are expected to remain pressurised over the near term but will improve, going forward, as operations scale up to optimal levels.

Limited product diversification with fasteners constituting bulk of revenues – STL has historically operated in a single product category of fasteners, thereby limiting its product diversification and offerings. Nevertheless, the versatility of the product segment, along with STL's strong market position as the second largest player and its healthy presence with its key OEMs, offers comfort regarding the stability of the business. Additionally, the company has commenced supplies for MCUs in the EV space through its subsidiary, SGEM, from the start of CY2022, which is expected to augur well for its business prospects as well as product diversification, going forward.

Environmental and Social Risks

Environmental considerations – Even as STL is not directly exposed to climate-transition risks from a likelihood of tightening emission-control requirements, with its products being used across different fuel powertrains, its automotive-manufacturing customers remain highly exposed to the same; accordingly, STL's prospects are linked to the ability of its customers to meet tightening emission requirements. The company has been taking steps to reduce its carbon footprint, by enhancing its reliance on renewable sources and other energy saving efforts such as adoption of energy-efficient fixtures/equipment and extensive water recycling. The company's exposure to litigation/ penalties from issues related to waste and water management remains relatively low.

Social considerations – STL, like most automotive-component suppliers, has a healthy dependence on human capital; as such retaining human capital, maintaining healthy employee relations and supplier ecosystem remain essential for disruption-free operations for the entity. STL annual reports indicate that the entity has been taking initiatives to support its vendors in upgrading their operations, skills, quality, and technology. Another social risk that STL faces pertains to product safety and quality, wherein instances of product recalls and high-warranty costs may not only lead to a financial implication but could also harm the reputation and create a more long-lasting adverse impact. In this regard, STL's strong track record in catering to leading automotive manufacturers underscore its ability to mitigate these risks to an extent. The company's strong technological capabilities are likely to help it align its products with any change in customer preferences.

Liquidity position: Adequate

The company has an adequate liquidity position with funds parked in liquid investments (Rs. 25.2 crore as on June 30, 2022) and sufficient buffer from undrawn working capital limits (Rs. 62 crores as on June 30, 2022). Repayment obligations remain moderate at Rs. 20–22 crore annually and are expected to be comfortably serviced from internal accruals. The company has moderate capex plans (~Rs. 25–30 crore for FY2023), which are likely to be met through a mix of debt and internal accruals.

Rating sensitivities

Positive factors – For a rating upgrade, sustained improvement in business risk profile, characterized by expansion in product portfolio and significant scale up in operations, while maintaining profitability indicators, credit metrics and liquidity profile at current healthy levels would be critical.

Negative factors – Sustained pressure on revenues and earnings is likely to cause a rating downgrade. Slower-than-expected ramp up at the greenfield facility with increased reliance on external borrowings, leading to sustained deterioration in profitability and credit metrics with Total Debt/OPBITDA above 1.5 times, could also cause a downward rating movement.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Auto Component Suppliers
Parent/Group Support	Not applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of STL. As on March 31, 2022, the company had two subsidiaries, which are enlisted in Annexure-2.

About the company

Established in 1979, STL manufactures and markets high tensile cold forged fasteners, primarily for the automobile industry. At present, it is positioned as the second largest fastener manufacturer in India, after Sundaram Fasteners. The company caters to leading automotive companies in India and tier-I auto component manufacturers in Europe. STL's product portfolio includes fasteners, which find application in both automotive and non-automotive segments.

STL has three manufacturing plants at Faridabad, Ballabhgarh and Palwal (all in Haryana), with a fourth manufacturing plant near Bengaluru. The company has a total manufacturing capacity of approximately 38,000 MT per annum at its existing plants, with an additional ~10,000 MTPA capacity at its new facility in Karnataka.

STL was founded by the first-generation entrepreneur, Mr. Manohar Lal Aggarwal, and has thereafter been managed by his two sons, Mr. Anil Aggarwal and Mr. Atul Aggarwal. The company is listed on the Bombay Stock Exchange and National Stock Exchange. Other group companies operated by the promoters are involved in automobile dealerships of Honda Cars India Limited (HCIL) and Harley Davidson.

Key financial indicators (audited)

STL Consolidated	FY2021	FY2022	Q1 FY2023
Operating Income (Rs. crore)	353.1	509.6	173.9
PAT (Rs. crore)	24.0	26.2	9.6
OPBDIT/OI (%)	17.1%	13.1%	13%
PAT/OI (%)	6.8%	5.1%	6%
Total Outside Liabilities/Tangible Net Worth (times)	0.6	0.5	NA*
Total Debt/OPBDIT (times)	1.7	1.6	NA*
Interest Coverage (times)	8.0	9.8	NA*

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation **Balance sheet figures not available for Q1 FY2023*

Note: Amount in Rs. crore; All calculations are as per ICRA research

Source: Company Annual Reports, ICRA research

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 as of Jun 30, 2022 (Rs. crore)	Date & Rating in	Date & Rating in FY2022	Date & Rating in FY2021		Date & Rating in FY2020
					Oct 7, 2022	Aug 25, 2021	Jan 7, 2021	May 21, 2020	Sep 24, 2019
1	Term Loan	Long Term	59.61	59.11	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Negative)	[ICRA]AA- (Negative)	[ICRA]AA- (Stable)
2	Cash Credit	Long Term	120.00	58.43	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Negative)	[ICRA]AA- (Negative)	[ICRA]AA- (Stable)
3	Non-fund Based Limits	Short Term	2.84	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
4	Unallocated	Short Term	23.22	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	-	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Term Loan	Simple
Cash Credit	Simple
Unallocated	Not Applicable
Non-fund Based Limits	Simple

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, is available on ICRA's website: www.icra.in

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. Crore)	Current Rating and Outlook
NA	Term Loan- I	FY2022*	MCLR linked	FY2025	4.01	[ICRA]AA- (Stable)
NA	Term Loan-II	FY2022*	MCLR linked	FY2024	4.60	[ICRA]AA- (Stable)
NA	Term Loan-III	FY2019	MCLR linked	FY2025	21.00	[ICRA]AA- (Stable)
NA	Term Loan-IV	FY2021	MCLR linked	FY2026	4.06	[ICRA]AA- (Stable)
NA	Term Loan-V	FY2022	MCLR linked	FY2027	25.94	[ICRA]AA- (Stable)
NA	Fund based working capital limits	NA	NA	NA	120.00	[ICRA]AA- (Stable)
NA	Non-fund based working capital limits	NA	NA	NA	2.84	[ICRA]A1+
NA	Unallocated	NA	NA	NA	23.22	[ICRA]A1+

Source: *Company* ** as per latest renewal done*

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

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Haryana Ispat Private Limited	100.00%	Full Consolidation
Sterling Gtake E-Mobility Limited	100.00%	Full Consolidation

Source: *Sterling Tools Limited*

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