June 24, 2024

Sadhu Forging Limited: Ratings reaffirmed; rated amount enhanced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term – Fund-based/ Term Loan	1.76	27.27	[ICRA]BBB- (Stable); reaffirmed/ assigned for the enhanced amount
Short-term – Non-fund Based	4.50	4.50	[ICRA]A3; reaffirmed
Long-term/ Short term – Fund-based	110.00	120.00	[ICRA]BBB- (Stable)/[ICRA]A3; reaffirmed/ assigned for the enhanced amount
Long-term/ Short-term – Unallocated	6.74	0.23	[ICRA]BBB- (Stable)/[ICRA]A3; reaffirmed
Total	**123.00**	**152.0**	

**Instrument details are provided in Annexure-I*

Rationale

The ratings reaffirmation considers ICRA's expectation that Sadhu Forging Limited's (SFL) revenue will increase, going forward, on the back of its expanding product portfolio and client base. 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 SFL's strong association with its 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 SFL's long-term business prospects. While the company has witnessed volume growth in FY2024, subdued realisations resulted in an overall drop in revenue. Going forward, ICRA expects the top line of SFL to improve on account of its healthy rise in orders from new clients in the CV and railways segments. ICRA also notes the improvement in SFL's financial risk profile, which is reflected by a consistent improvement in coverage indicators and return metrics of the company.

However, the ratings are constrained by the relatively low profitability than its peers in the industry despite improvement witnessed in the last two fiscals. SFL's operating profit margins improved to 7.64% in FY2024 from 6.77% in FY2023 on the back of the company's focus on reducing costs, besides softening of input prices to some extent. In addition, the ratings factor in the impact of forex movements and 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 various raw material grades and finished goods. However, the company's working capital intensity has stabilised compared to earlier years. Besides, SFL's debt coverage metrics continue to remain moderate, though the same are exhibiting 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.

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

Key rating drivers and their description

Credit strengths

Status as a 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). Its exports accounted for ~20% of its sales in FY2024. The company has been associated with reputed clients for a long period.

SFL enjoys working relationships of more than a decade with its export clients such as Kubota and Meritor. It also has healthy relationships of 5-7 years with its domestic OEM clients. The company has been getting steady repeat business from its entire clientele.

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.

Diversified product and customer profile – The company manufactures products for diversified segments like CVs and tractors. Further, the company has limited product portfolio in the passenger vehicle (PV) and railways segments. Its customer profile is moderately diversified in the domestic and exports markets. Moreover, SFL has expanded its product portfolio with its existing clients, thereby gradually increasing its share of business with its clients. The company plans to focus on machined components and assemblies, which generate higher margins. Over the last couple of years, the company has developed several products for its existing set of clients in the domestic as well as export segments. The company has also added new clients in the recent past. The incremental sales are expected to improve the company's operating margins as these products are high value additive and are thus high-margin products.

Continued improvement in return indicators for the past two fiscals – The company's overall return indicators have been improving in the past two fiscals. The operating profit margins of the company improved to 8.1% in FY2024 from 7.32% in FY2023 and 7.04% in FY2022. The profitability improved on account of cost-effective measures undertaken by the management, higher sales of high-margin products and softening of input prices in FY2024. Despite the improvement in OPM, it remains marginally lower than other peers in the forging industry.

Credit challenges

Coverage indicators remain moderately stretched despite improvement in the recent past – While SFL's operating margins have improved in the past two fiscals supported by several cost-effective measures put in place by the management and softening of input prices to an extent, the debt metrics continue to be moderately stretched, as reflected by Total debt/OPBDIT of 3.76 times and DSCR of 1.61 times as on March 31, 2024. The same are expected to improve gradually.

Moderately high working capital intensity – SFL's operations remained working capital intensive with NWC/OI of ~28% as on March 31, 2024 at a consolidated level, with improvement witnessed over earlier levels (prior to FY2021). The same is expected to be on the similar line in the current fiscal. While the company offers credit of up to 90 days and 180 days to its domestic and export clients, respectively, it also keeps stock of 75-90 days. The company, however, has flexibility to avail additional funding from its creditors when needed, and has access to vendor financing for raw material purchases from Tata Steel as well as bill discounting limits for specific clients.

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

Liquidity position: Adequate

SFL's liquidity position is adequate on account of its stable operating cash flows, aided by its increasing scale of operations following the recently concluded capex. Besides, there are liquid investments, which the company intends to use, if required. Also, SFL 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 low free cash availability on its books. There are sizeable repayments to be made in the range of Rs. 15-16 crore in the next 2-3 years at a consolidated level. The same is expected to be met by internal accruals. The average utilisation level of working capital limits for the company stood at ~85% in the past 12 months. The company's liquid investments, which stood at ~Rs. 17 crore as on March 31, 2024, provide comfort.

Rating sensitivities

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

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

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Auto Components
Parent/Group support	Not Applicable
Consolidation/Standalone	Consolidated For arriving at the ratings, ICRA has considered the consolidated financials of SFL along with the partnership firm, Sadhu Overseas (SO), after netting off the inter-company transactions. Earlier, ICRA used to review the standalone financials of the company. However, from the current exercise, the company's consolidated financials along with inclusion of the guaranteed debt will reflect the credit risk profile more accurately. As a result, ICRA has revised its rating approach and is analysing the company's consolidated business and financial profiles, as the same are now more representative of SFL's credit profile

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 Overseas (SO), which is a partnership firm and is primarily involved in machining and forging operations in the domestic market.

Key financial indicators (audited)

Consolidated	FY2023	FY2024*
Operating income	608.54	580.91
PAT	14.45	18.68
OPBDIT/OI	7.32%	8.10%
PAT/OI	2.37%	3.22%
Total outside liabilities/Tangible net worth (times)	2.47	2.14
Total debt/OPBDIT (times)	4.21	3.76
Interest coverage (times)	3.17	2.99

*Source: Company, ICRA Research; * Provisional numbers; All ratios as per ICRA's calculations; Amount in Rs. Crore, PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument		Current rating (FY2025)				Chronology of rating history for the past 3 years			
		Type	Amount rated (Rs. crore)	Amount outstanding (Rs. crore)	Date & rating in FY2025	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022	
					Jun 24, 2024	-	Mar 20, 2023	Mar 17, 2022	Aug 02, 2021
1	Term loan	Long Term	27.27		[ICRA]BBB- (Stable)	-	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Negative)
2	Non-fund Based	Short Term	4.50	--	[ICRA]A3	-	[ICRA]A3	[ICRA]A3	[ICRA]A3
3	Fund Based	Long Term/ Short Term	120.00	--	[ICRA]BBB- (Stable)/ [ICRA]A3	-	[ICRA]BBB- (Stable)/ [ICRA]A3	[ICRA]BBB- (Stable)/ [ICRA]A3	[ICRA]BBB- (Negative)/ [ICRA]A3
4	Unallocated	Long Term/ Short Term	0.23	--	[ICRA]BBB- (Stable)/ [ICRA]A3	-	[ICRA]BBB- (Stable)/ [ICRA]A3	[ICRA]BBB- (Stable)/ [ICRA]A3	[ICRA]BBB- (Negative)/ [ICRA]A3

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	27.27	[ICRA]BBB-(Stable)
NA	Non-fund Based	-	NA	-	4.50	[ICRA]A3
NA	Fund Based	-	NA	-	120.00	[ICRA]BBB-(Stable)/ [ICRA]A3
NA	Unallocated	-	NA	-	0.23	[ICRA]BBB-(Stable)/ [ICRA]A3

Source: Company

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

Annexure II: List of entities considered for consolidated analysis – Not Applicable

Company Name	Ownership	Consolidation Approach
Sadhu Forging Limited	-	Full consolidation
Sadhu Overseas	100.00%	Full consolidation

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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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