Subros Limited

December 19, 2018

Subros Limited: Long-term rating upgraded to [ICRA]AA-(Stable) and short-term rating reaffirmed; rated amount enhanced for bank facilities

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based -Term Loan	105.23	108.15	Rating upgraded to [ICRA]AA-(Stable) from [ICRA]A+(Positive)
Fund-based - Working Capital Facilities	35.00	35.00	Rating upgraded to [ICRA]AA-(Stable) from [ICRA]A+(Positive)
Non-fund Based - Working Capital Facilities	15.00	15.00	Rating upgraded to [ICRA]AA-(Stable) from [ICRA]A+(Positive)
Fund-based - Working Capital Facilities	90.00	110.00	[ICRA]A1+; reaffirmed
Non-fund Based - Working Capital Facilities	130.00	140.00	[ICRA]A1+; reaffirmed
Unallocated Limits	4.34	0.00	-
Total Bank Facilities	**379.57**	**408.15**	
Commercial Paper Programme	120.00	120.00	[ICRA]A1+; reaffirmed
NCD Programme	150.00	150.00	Rating upgraded to [ICRA]AA-(Stable) from [ICRA]A+(positive)

**Instrument details are provided in Annexure-1*

Rationale

The rating upgrade takes into account an expected improvement in the financial risk profile of Subros Limited (Subros) following an infusion of Rs. 209.88 crore from the issue of equity shares on preferential basis to Denso Corporation, Japan, in December 2018. The company is expected to utilise the equity proceeds for part repayment of debt as well as invest in new technologies and upgrade its manufacturing capabilities to cater to export requirements. As the company's capex requirements are expected to remain at moderate levels, going forward, the equity infusion coupled with an expectation of improved cash accruals is likely to improve the company's credit profile considerably (with Total Debt/OPBDIT expected to reduce to ~0.6-0.7 time by FY2022).

The rating action also factors in Subros's continued strong operational performance as it maintains a strong market position in the domestic automotive air conditioner (AC) market. Despite intense competition in the segment, Subros continues to benefit from its integrated manufacturing operations and strong product development capabilities (supported by technical support from Denso Corporation), helping it maintain a market leadership in the passenger vehicle (PV) automotive AC industry. The company's revenue mix over the years remained skewed towards the PV segment; however, over the last few years, it has also expanded its product range to commercial vehicle (CV) original equipment manufacturers (OEMs)[1], besides other segments (such as the railways). While the PV segment is likely to

[1] *With the Ministry of Road Transport and Highways mandating air conditioned cabins (or ventilation systems) in trucks from January 1, 2018, Subros has been able to gain business with many leading OEMs in the industry for truck driver cabin AC/ blower systems.*

remain the mainstay of the company's business prospects, the dependence is expected to reduce over the medium term as supplies for the new business segments scale up. In addition to a healthy growth in the scale of operations, the company also reported improved profitability over the last two years, benefitting from an increased indigenisation of components.

Subros remains exposed to increased customer concentration risk with direct and indirect sales to Maruti Suzuki India Limited (MSIL) accounting for ~80% of the revenues in H1 FY2019. The client and segment customer concentration risk is, however, mitigated to an extent by Subros's strong share of business with MSIL and the OEM's market leadership in the PV segment. Over the medium term, business gains from new segments (such as CVs and railways) are also expected to lead to some moderation in the dependence on MSIL to an extent.

Over the last three to four years, Subros had made substantial debt-funded investments towards capacity expansions, new product development and backward integration. To cater to Suzuki Motor Corporation's (SMC's, Japan) capacity expansion plans in Gujarat, Subros is setting up an additional facility in the state to enhance its production capacity to 2.5 million units from 1.5 million units (in phases over a medium term). The company plans to incur a total capex of ~Rs. 120 crore in FY2019, out of which ~Rs. 75 crore would be incurred for the Gujarat plant set up. In view of the usage of its cash accruals towards funding the capex requirements, the company's dependence on short-term funds (including bank borrowings, creditors and advances from customers) has remained high. This was reflected in an asset liability mismatch and a current ratio of 0.7 time as on March 31, 2018. The funds received via the preferential share issue to Denso Corporation are, however, likely to help reduce the asset liability mismatch to a large extent and aid the company to maintain a comfortable liquidity profile.

ICRA notes that the proceeds from the rated commercial paper programme are intended to be utilised for funding the working capital requirements, as per the objects of the issue. Any deviation from the above, which has the effect of exerting pressure on the asset-liability position of the company, would be a rating sensitivity.

Outlook: Stable

The Stable outlook reflects ICRA's expectation that Subros would record a healthy revenue growth over the medium term, following a ramp up in the supplies of AC cabins (or ventilation systems) in trucks, coupled with the continued business from its existing customers in the PV industry. An improved scale of operations and improved financial risk profile are also likely to expand the company's operating margins and improve the debt coverage indicators. The outlook may be revised to Positive if substantial growth in revenue and profitability leads to a significant improvement in Subros's return indicators. The outlook may be revised to a Negative if the ramp up in the scale of operations of new businesses is slower than expected, or if an increase in the working capital intensity leads to a deterioration in the company's debt coverage indicators.

Key rating drivers

Credit strengths

Strong market share in PV segment; supply initiation for truck cabin AC/blowers to aid segment diversification - Subros is a leading automotive AC manufacturer in the domestic market. Despite intense competition in the segment, it has successfully maintained a strong market position (an estimated market share of ~40% in the addressable product range in the PV industry). The company benefits from its integrated manufacturing operations and strong product development capabilities. Its revenue mix over the years remained skewed towards the PV segment; however, over the last few years, it has expanded its product range to cater to CV OEMs, besides other segments (such as the railways). Although the PV segment is likely to remain the mainstay of the company's business prospects, its dependence is expected to reduce over the medium term as supplies for the new business segments scale up.

Technical collaboration with Denso Corporation strengthens product development capabilities and competitive positioning - Subros has a technical collaboration with Denso Corporation, a leading automotive manufacturer in the global market. The company's strong product development capabilities, coupled with its considerable scale of operations and low cost structure, has enabled it to sustain a strong market position over the years. Its strong parentage (SMC and Denso Corporation hold ~12% and ~20% equity stakes, respectively) has also helped it to maintain strong business relations with its primary customer, MSIL, while aiding in establishing relationships with new customers.

Equity infusion through preferential share issue leads to financial risk profile improvement - Subros had a conservative capital structure, reflected in a gearing of 1.0 time as on March 31, 2018; however, the TOL/TNW remained at moderate levels of 2.2 times on account of the high creditors on the company's balance sheet. The debt coverage indicators remained at moderate to healthy levels, characterised by Total Debt/OPBDIT of 1.8 times, interest coverage of 5.1 times and NCA/Total Debt of 39.7% in FY2018.

The company's board of directors approved the preferential share issue to Denso Corporation, which led to an equity infusion of Rs. 209.88 crore. As capex requirements are expected to remain at moderate levels going forward, the equity infusion coupled with an expectation of improved cash accruals is likely to improve the company's credit profile considerably (with Total Debt/OPBDIT expected to reduce to levels of 0.6-0.7 time by FY2022).

Credit challenges

Increased client concentration risk - The company remains exposed to increased customer concentration risk with direct and indirect sales to MSIL accounting for ~80% of total revenues in H1 FY2019. The indirect sales to MSIL comprise engine cooling modules supplied to the OEM through Denso Corporation. The client and segment customer concentration risk is, however, mitigated to an extent by the strong share of Subros's business with MSIL and the OEM's market leadership in the PV segment. Subros also remains focussed on reducing its segment and client concentration risk through business gains from new segments, such as commercial vehicles and railways.

Significant reliance on short-term borrowings reflected in asset liability mismatch; equity infusion from preferential issue likely to reduce the same - The company's dependence on short-term funds (including bank borrowings, creditors and advances from customers) remains high. This was reflected in an asset liability mismatch and a current ratio of 0.7 time in March 2018. The funds received via the preferential share issue to Denso Corporation is, however, likely to help reduce the asset liability mismatch to a large extent.

Liquidity position

On account of a significant decline in the working capital intensity, the company reported a significant increase in cash flows from operations in FY2018 (Rs. 265.1 crore in FY2018 from Rs. 38.7 crore in FY2017). Consequently, despite an increased capex outgo, it recorded free cash flows of Rs. 86.3 crore in FY2018. The company's repayment obligations remain at moderate levels of ~Rs. 69.9 crore in FY2019 (~Rs. 89.9 crore in FY2020). However, the funds received from the preferential equity allocation, coupled with an expectation of healthy cash accruals, are likely to help it maintain a comfortable liquidity profile over the short to medium term, characterised by an expected buffer of ~Rs. 40-50 crore in the working capital utilisation limits.

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

	Subros Limited. As on March 31, 2018, the Company had 1 subsidiary and 1 JV, that are enlisted in Annexure-2.

About the company

Subros was promoted in 1985 by Mr. Ramesh Suri and his younger brother, the Late Mr. Lalit Suri, to manufacture automotive AC systems. The company began its operations from 1986 after signing a technological agreement with Denso Corporation, which acquired a 13% ownership interest in Subros. Subsequent to a preferential equity allocation in FY2019, the shareholding of Denso Corporation has increased to 20%. Suzuki Motor Corporation (SMC), Japan, also holds a 12% share in the company, with 37% being held by the Suri family in the listed entity.

The company has grown from a capacity of 15,000 AC units in 1985 (primarily comprising assembly operations) into a leading automotive AC system manufacturer with the capability to manufacture compressors, condensers, hoses and tubes. While the company was initially focused on providing cooling solutions for the PV segment, it has gradually expanded its product portfolio over the years to include ACs for homes, buses, truck cabins, railway driver cabins and refrigerated containers for trucks.

Subros has manufacturing plants at Noida (Uttar Pradesh), Manesar (Haryana), Pune (Maharashtra), Chennai and Sanand (Gujarat) with an annual capacity of 1.5 million AC kits. The company also has a well-equipped research and development (R&D) centre and tool room at Noida.

Key financial indicators (audited) - Consolidated

	FY2017	FY2018
Operating Income (Rs. crore)	1,534.9	1,912.9
PAT (Rs. crore)	13.2	60.6
OPBDIT/OI	10.9%	11.0%
RoCE	8.5%	18.7%
Total Debt/TNW (times)	1.2	1.0
Total Debt/OPBDIT (times)	2.4	1.8
Interest Coverage (times)	3.5	5.1

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

	Instrument	Current Rating (FY2019)				Chronology of Rating History for the Past 3 Years					
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating December 2018	Date & Rating in FY2018		Date & Rating in FY2017		Date & Rating in FY2016	
						December 2017	May 2017	December 2016	June 2016	October 2015	July 2015
1	Fund-based - Term Loan	Long Term	108.15	**108.15**	**[ICRA]AA- (Stable)**	**[ICRA]A+ (Positive)**	**[ICRA]A+ (Stable)**	**[ICRA]A+ (Stable)**	**[ICRA]A+&**	**[ICRA]A+ (Stable)**	**[ICRA]A+ (Stable)**
2	Fund-based - Working Capital Facilities	Long Term	35.00	**-**	**[ICRA]AA- (Stable)**	**[ICRA]A+ (Positive)**	**[ICRA]A+ (Stable)**	**[ICRA]A+ (Stable)**	**[ICRA]A+&**	**[ICRA]A+ (Stable)**	**[ICRA]A+ (Stable)**
3	Non-fund Based - Working Capital Facilities	Long Term	15.00	**-**	**[ICRA]AA- (Stable)**	**[ICRA]A+ (Positive)**	**[ICRA]A+ (Stable)**	**[ICRA]A+ (Stable)**	**[ICRA]A+&**	**[ICRA]A+ (Stable)**	**[ICRA]A+ (Stable)**
4	Fund-based - Working Capital Facilities	Short Term	110.00	**-**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**
5	Non-fund Based - Working Capital Facilities	Short Term	140.00	**-**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**
6	Unallocated Limits	Long Term/ Short Term	0.00	**-**	**-**	**[ICRA]A+ (Positive)/ [ICRA]A1+**	**[ICRA]A+ (Stable)/ [ICRA]A1+**	**[ICRA]A+ (Stable)/ [ICRA]A1+**	**[ICRA]A+&/ [ICRA]A1+ &**	**-**	**-**
7	Commercial Paper Program	Short Term	120.00	**-**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+ &**	**[ICRA]A1+**	**[ICRA]A1+**
8	NCD Program	Long Term	150.00	**40.0**	**[ICRA]AA- (Stable)**	**[ICRA]A+ (Positive)**	**[ICRA]A+ (Stable)**	**-**	**-**	**-**	**-**

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument Details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loan - 1	Oct 2014	-	Dec 2020	20.00	[ICRA]AA-(Stable)
NA	Term Loan - 2	Jan 2014	-	Mar 2020	18.75	[ICRA]AA-(Stable)
NA	Term Loan - 3	Feb 2016	-	Mar 2022	26.25	[ICRA]AA-(Stable)
NA	Term Loan - 4	Mar 2015	-	Mar 2020	13.15	[ICRA]AA-(Stable)
NA	Term Loan - 5	Jan 2018	-	Nov 2022	30.00	[ICRA]AA-(Stable)
NA	Fund-based - Working Capital Facilities	-	-	-	35.00	[ICRA]AA-(Stable)
NA	Non-fund Based - Working Capital Facilities	-	-	-	15.00	[ICRA]AA-(Stable)
NA	Fund-based - Working Capital Facilities	-	-	-	110.00	[ICRA]A1+
NA	Non-fund Based - Working Capital Facilities	-	-	-	140.00	[ICRA]A1+
-	Commercial Paper		Yet to be placed		120.00	[ICRA]A1+
INE287B07010	NCD Program	Aug 2017	-	April 2020	25.00	[ICRA]AA-(Stable)
INE287B07010	NCD Program	Aug 2017	-	April 2020	25.00	[ICRA]AA-(Stable)
-	NCD Program		Yet to be placed		100.00	[ICRA]AA-(Stable)

Source: Subros Limited

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Thai Subros Limited	100.00%	Full Consolidation
Denso Subros Thermal Engineering Centre India Limited	26.00%	Equity Method

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