SUBROS LIMITED

Analyst Contacts

Subrata Ray
subrata@icraindia.com
+91-22-30470 027

Anupama Arora
anupama@icraindia.com
+91-124-4545 303

Shishir Kumar
shishir.kumar@icraindia.com
+91-124- 4545 822

Relationship Contacts

Vivek Mathur
vivek@icraindia.com
+91-124- 4545 310

Rating

ICRA has re-affirmed the rating for Rs 212.0 crore[1], revised long-term facilities of Subros Limited (Subros) at [ICRA]A+(pronounced ICRA A plus) with 'stable' outlook[†]. ICRA has also re-affirmed the ratings for enhanced Rs 335.0 crore short-term bank facilities and Rs 60.0 crore commercial paper (CP)/short-term-debt (STD) programme of the company at [ICRA]A1 (pronounced ICRA A one).

Key Financial Indicators (Standalone)

	2010-11	2011-12	2012-13
Net Sales	1,089.1	1,115.4	1,271.0
Operating Income	1,089.6	1,115.7	1,271.8
OPBDITA	87.9	106.4	131.9
Profit after Tax	28.6	48.5	21.2
Net Cash Accruals	63.6	93.8	88.9
Total Debt	217.9	342.3	349.4
Equity Capital	12.0	12.0	12.0
Net Worth	230.1	270.8	286.5
OPBDIT/Operating Income (%)	8.1%	9.5%	10.4%
PAT/Operating Income (%)	2.6%	4.3%	1.7%
PBIT/avg. (Total Debt + Net Worth + DTL – Capital work-in progress) (%)	14.6%	19.2%	11.2%
Total Debt/TNW (Times)	0.9	1.3	1.2
OPBDIT/Interest & Finance Charges (Times)	5.7	4.1	3.7
Net Cash Accruals/Total Debt (%)	29.2%	27.4%	25.4%
Total Debt/OPBDITA	2.5	3.2	2.6

Note: Amounts in Rs. Crore; OI: Operating Income; OPBDIT: Operating Profit before Depreciation, Interest and Tax; PAT: Profit after Tax; PBIT: Profit before Interest and Tax; DTL: Deferred Tax Liability
Source: Annual Reports, ICRA estimates

Website
www.icra.in

[1] *100 lakh = 1 crore = 10 million*
[†] *For complete rating definition please refer to the ICRA website www.icra.in or any of the ICRA Rating Publications*

Key Rating Considerations

Credit Strengths

- Technical collaboration with global leader in automotive air-conditioners (AC) i.e., Denso Corporation (Denso) which also holds 13% stake
- Suzuki Motor Corporation (SMC), Japan holds 13% equity stake that has allowed Subros enjoy strong relationship with Maruti Suzuki India Limited (MSIL) since inception.
- Figures amongst most integrated automotive AC systems manufacturer in the country, resulting in cost advantages.
- Initiatives of product and customer diversification to help reduce segment concentration risk.
- Presence in new model launches and strong business relations with well established OEMs.
- New plant at Chennai to aid geographic diversification, new client addition as well as support business growth

Credit Challenges

- Notwithstanding some improvement, financial risk profile continues to be weighed down by large debt funded capex; gradual recovery expected over medium term when investments start yielding returns.
- Re-financing risk on account of debt repayments falling due over the long term
- Large proportion of imported raw material purchases (>50%) exposes the company to forex fluctuation risk, though ongoing localisation initiatives has helped reduce import dependence to an extent; risk also partially mitigated by forex pass through arrangements with key customers.
- Ongoing weakness in automotive industry to put pressure on return indicators over the short-term especially related to newly added capacities.
- Ability to maintain its dominant position given the rising competition and capacity expansion in automotive AC market

Rating Rationale

The ratings continue to derive support from Subros' leading market share in the automotive AC market, strong business positioning with leading OEMs and presence in new product development, initiatives of product and customer diversification, technical support from Denso, as well as equity participation from SMC. Subros' rating is however constrained by the ongoing weakness in domestic automotive market; continued pressure on capital structure, notwithstanding containment of bank borrowings during last fiscal; as well as significant debt repayment burden over medium to long term. Notwithstanding efforts toward localisation, the company's import content still remains high thereby exposing Subros' profitability indicators to foreign currency fluctuations. The risk is, however, mitigated by forex pass through arrangement with principal/key customers and shifting sourcing to low cost countries with alternative currencies. The ratings also consider Subros' in-house design capabilities, competitive cost structure in light of backward integrated nature of operations as well as being capacity ready for the next phase of industry growth.

<u>Scale, Diversification and Competitive Position:</u> Subros is the largest automotive air conditioner manufacturer in India with an integrated facility and capability to provide complete air conditioning and heater systems. While Subros' sales remained concentrated to passenger vehicle (PV) air conditioners (AC) in the past, the company is gradually diversifying its product mix as well as segment mix. Over the last few years the company has added radiators in its product range besides extending its AC range to cater to commercial vehicle customers.

Subros has maintained its competitive position with its key customers through initiatives for backward integration and localization, investing in product development/testing and design capabilities as well as continuous capacity expansion. Further, the company also benefits from its technical collaboration with Denso, global leader in automobile air conditioners. Subros' strength over the years has been its strong presence in MSIL and TML. Moreover, the company has successfully added new customers like

Mahindra & Mahindra Limited (M&M), Force Motors Limited and VE Commercial Vehicles Limited that allows for diversification of revenue streams in the commercial vehicle (CV) AC market also. Although these OEMs currently account for less than 10% of Subros' revenues, its presence in the new product development programmes of new clients is likely to help it acquire significant business over the medium term.

The competitive intensity in the domestic automotive AC market has intensified with increased activity by foreign ancillaries that have entered the Indian market through JV's with Indian suppliers. Nevertheless, Subros' in-house R&D capabilities, technical collaboration with Denso, considerable scale of operations as well as low cost structure, has enabled it to sustain its market leadership. Subros association with Denso, Japan, which is amongst the leading players in the AC system worldwide along with considerable localised content give it an advantage when compared to other players. Subros' strong parentage (both Suzuki and Denso hold 13% equity stake in Subros) has also helped it maintain strong business relations with key customers like MSIL.

Revenue Growth: Subros largest customer – MSIL, reported modest 3.0% production volume growth, while, TML its second largest customer witnessed sharp volume decline of 17.6% in 2012-13. Subros however reported healthy 14.0% operating income growth to Rs 1271.8 crore in lieu of higher off-takes from M&M, that saw volumes expand by 26.7%; increase in sales to non-PV segment and replacement market; as well as favourable model mix in MSIL and TML. Volumes in the passenger car market continue to remain under pressure during YTD 2013-14, while growth in UVs has also lost pace with increase in excise duty and prices of diesel. Consequently short term revenue growth outlook for Subros appears dim. The company reported a 12.1% YoY decline in operating income growth during Q1 2013-14. Turnover growth is however expected to improve over medium term with demand recovery in the automotive market as well as growth in new business segments.

Cost and Profitability: Subros has considerable raw material import content (~55%), mostly JPY denominated and movement in INR and JPY exchange rate can have a bearing on the company's operating profitability. During 2012-13 the company benefitted from savings on the localisation front as well as some improvement in INR/JPY rate, enabling it to post a YoY improvement in operating margins to 10.4%. 2012-13 Net margins at 1.7% were however lower in comparison to 4.3% in 2011-12 (not strictly comparable to as there was non-operating income of ~29 crore from sale of land) in light of increase in depreciation and interest expense as a fallout of large debt funded expansion. Large scale capital investment and a lack of commensurate returns from the same also negatively impacted Subros' return Indicators. Benign commodity prices are expected to support the company's operating profitability, which shall otherwise face pressure from weak capacity utilisation. Subros' (standalone) operating margins expanded by 150bps to 10.5% in Q1 2013-14. Improvement in net margins was however restricted by higher depreciation and interest expense.

Financial Policy and Capital Structure***:*** Notwithstanding small improvement, Subros financial risk profile is characterised by moderate gearing and debt coverage indicators. During 2012-13 capex outgo of Rs 141.7 crore, led to increase in term borrowings. Increase in overall debt was however restricted by lower working capital borrowings as on March 31, 2013 vis-a-vis that on March 31, 2012. With accruals to networth Subros' financial leverage moderated to an extent to 1.2x as on March 2013 (1.3x as on March 2012). However, the company is exposed to re-financing risk on account debt repayments due over long term. While capital structure is expected to remain under pressure over the short to medium term it is expected to improve over the long term once investments done over the last two years start generating return.

Cash Flow Variability: Increase in operating profits coupled with release of working capital led to healthy fund flow from operations during 2012-13. Free cash flows were however negative in light of large capex investment as well as interest burden. Liquidity position of the company is otherwise comfortable with financial flexibility in terms of un-drawn bank limits.

Company Profile

Subros was promoted in 1985 by Mr. Ramesh Suri and his younger brother Late Mr. Lalit Suri to manufacture automotive air conditioning systems. The company began its operations in 1986 after signing a technological agreement with Denso, which also acquired a 13% ownership interest in Subros. SMC, Japan holds a 13% share in Subros while 40% is held by the Suri family and the public (34%). In return for its assistance to Subros, Denso gets annual royalty on Subros' sales and a lump sum as fee for development of any new product. Additionally Subros has a joint development agreement with Denso (renewed last in April 2006), whereby the company would also receive assistance for development of AC systems for Indian OEMs (other than MSIL). The company has long standing relationship with Denso and hence enjoys good technological capabilities in the auto air-conditioning space, which has also helped the company to maintain its competitive edge over its peers.

Business Risk Profile

Expanding portfolio through related diversification

Subros has the largest integrated manufacturing unit in India for automobile air conditioning and engine cooling systems. The company has the capability to manufacture compressors, condensers, heat exchangers, and all the connecting elements that are required to complete the AC loop. While the company was initially focused on providing cooling solutions for the passenger vehicle (PV) segment, it has gradually expanded its product portfolio to include air conditioners for buses, refrigerated containers for trucks and rail engine ACs. Subros has also introduced heat exchangers and engine cooling modules to cater to the need of Highway and Off-highway vehicles

Gradual client diversification underway; decline in exposure to TML with lower off-takes from the OEM

Table 1: Trend in OEM-wise sales mix

	Value Share				
	FY10	**FY11**	**FY12**	**FY13**	**Q1 FY14**
MSIL	73.6%	73.0%	71.2%	73.5%	73.3%
TML	16.4%	15.2%	17.1%	12.9%	11.2%
Other OE	7.5%	6.3%		7.3%	8.6%
After Market Sales	2.5%	0.6%	11.7%*	2.3%	1.3%
Spares, Heaters & Evaporators	0.0%	5.1%		4.0%	5.5%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Source: Company Data, ICRA Estimates; * consolidated share for last three rows

MSIL and TML, continue to be the major customers of Subros. Notwithstanding diversification towards other customers like Mahindra & Mahindra Limited, Force Motors Limited etc and entry into new sales channels like introduction of radiators in the replacement market; revenue exposure to MSIL and TML continues to be in excess of 84% (~94% in 2008-09). Proportion of revenues from TML, however, declined in 2012-13 and Q1 2013-14 with the OEM facing weak end-user demand. While sales to MSIL witnessed a reduction in FY12 in light of production constraints witnessed by the OEM, the volumes recovered during FY13 with the OEM reporting moderate production growth. Further, Subros maintains strong business positioning with the OEM through presence in most of its future model launches/refurbishments; helped by technical collaboration and equity participation from Denso. Apart from consolidating business position with existing players, the company has plans to target new customers and expand its client base, especially after expansion of product profile and setting up new unit at Chennai. Presence in the automotive hub of Chennai has enabled Subros to add customers like Bharat Benz, Ashok Leyland- Nissan and Renault Nissan.

Maintains foothold withstanding intensifying competition

Subros is the market leader in the domestic car AC market, enjoying more than 40% market share. Competitive intensity in the domestic automotive AC market has intensified in the last few years.

Nevertheless, Subros' in-house R&D capabilities (through design JV with Denso) and technical collaboration from Denso, along with competitive cost structure through backward integration and localisation; has enabled it to sustain its market share. Subros' strong parentage (both Suzuki and Denso hold 13% equity stake in Subros) has also helped it maintain strong business relations with key customers like MSIL.

In a bid to improve bargaining power against vendors, select OEMs assumed the role of system integrators and started procuring standalone AC components in place of the complete AC systems. Although the choice between sourcing complete systems/ individual components varies from model to model, in case of individual part sourcing there are challenges like managing multi-supplier base and warranty claims, as well as absence of basket pricing (making the AC assembly more expensive for the OEM). Also in case of purchase of complete AC system, vendors like Subros are able to optimize the AC loop, and deliver cost savings for the OEM. Thus expected shift in market towards procurement of complete systems is likely to benefit AC vendors like Subros.

Chennai Plant commences operations; manufacturing capacity enhanced at existing plants

Subros has continued to enhance manufacturing capacity over the last few years based on future projections shared by OEM clients besides its plan to enter new clients and diversify into related business segments like ACs for buses and refrigerated trucks, radiators etc.

Currently, Subros operates from its manufacturing locations at Noida (Uttar Pradesh), Manesar (Haryana) and Pune (Maharashtra) and Sanand (Gujarat). Subros also has an assembly plant at Thailand to (through its 100% subsidiary Thai Subros Limited) to cater to TML's requirements. During 2012-13, Subros invested in to new manufacturing set-up at Chennai; which has recently commenced operations. The plant shall help Subros augment market share in Southern India, which has already started receiving business from clients like Renault-Nissan, Ashok Leyland- Nissan and Bharat Benz.

Import content remains high; gradual import substitution expected over long term

Most Indian AC vendors have significant import content subjecting them to fluctuation in exchange rates as well as production disruptions in foreign countries. Over the last three years Subros has localized certain high value components like RS Evaporator and Heater Core, benefits of which have started accruing. In 2012-13, the company continued to invest in localisation of further critical components as well as increasing manufacturing capacity for the same. Nevertheless imports continue to form a considerable proportion of the company's raw material purchases, at-least over the foreseeable future, given that certain other high value components may not be localised due to intellectual property right concerns or very high investments. Higher localized content benefits the company in terms of reduced variability to foreign currency movement, improved cost structure as well as leaner component souring cycle. Apart from reducing import content, Subros risk is also mitigated by sourcing of parts from low cost destinations in an effort to optimise the landed cost of components

Financial Risk Profile

Table 2: Trend in Revenue and Profitability

Rs Crore	2008-09	2009-10	2010-11	2011-12	2012-13
Operating Income	694.4	905.5	1,089.6	1,115.7	1,271.8
OPBDITA	63.2	92.8	87.9	106.4	131.9
PAT	13.6	28.8	28.6	48.5	21.2
NCA	41.7	62.3	63.6	93.8	88.9
OPBDITA/OI	9.1%	10.3%	8.1%	9.5%	10.4%
PAT/OI	2.0%	3.2%	2.6%	4.3%	1.7%
ROCE	12.2%	18.7%	14.6%	19.2%	11.2%

Note: Amounts in Rs. crore, OPM: Operating Profit Margin; NPM: Net Profit Margin
Source: Annual reports of Subros and ICRA's Estimates

After reporting strong growth during 2009-10 and 2010-11 on the back of buoyant demand in the domestic automotive industry, Subros' operating income saw only marginal 2.4% YoY growth during 2011-12. Further, while macro-economic headwinds continued to impact OEM customers, Subros managed to report a 14.0% growth in 2012-13 on back of favourable model mix, increase in sales to customers like M&M as well as growth in non-PV segment, albeit on a small base.

After improving during 2011-12, helped by savings from localisation of high value components like RS evaporators and heater core, Subros operating margins continued their uptrend in 2012-13. Apart from other factors, savings from localisation, and improving INR/JPY rate for most of 2012-13 helped in the improvement in operating profitability in the previous fiscal year. The company has raw material price indexation and forex pass through arrangement with key customers. The operating margins have however fluctuated in the past since the price settlement (related to raw material prices and forex rate) with MSIL takes places with lag of a quarter and is based on average quarterly rates as against actual costs incurred by Subros. Moreover with certain customers like M&M and TML, price indexation happens after a longer duration-6 months and 12 months respectively. The variability in OPM can also be partly attributed to denominator effect from movement in raw material prices.

Table 3: Gearing and Coverage Indicators

Rs Crore	2008-09	2009-10	2010-11	2011-12	2012-13
Total Debt	135.0	154.1	217.9	342.3	349.4
Networth	183.9	207.1	230.1	270.8	286.5
Total Debt/TNW	0.7	0.7	0.9	1.3	1.2
OPBDITA / Int and FinCharges	4.3	5.8	5.7	4.1	3.7
Total Debt/OPDIT	2.1	1.7	2.5	3.2	2.6
NCA/Total Debt	30.9%	40.5%	29.2%	27.4%	25.4%

Note: Amounts in Rs. crore,NCA: Net Cash Accruals
Source: Annual Reports of Subros and ICRA's Estimates

Subros has continued to invest in technology upgardation, new product development, setting up new manufacturing locations and increasing capacity at existing plants over the last few years (Rs 126.5 crore during 2010-11, Rs 159.2 crore in 2011-12 and Rs 141.7 crore in 2012-13). Although a part of it has been funded through internal accruals, the company's term borrowings have increased over the years putting pressure on the financial risk profile. Subros' financial leverage increased gradually from 0.6x as on March 2008 to 1.3x as on March 2012, but declined marginally to 1.2x as on March 2013. The improvement in leverage was a result of containment of overall debt levels with decline in working capital borrowings during year end. Still, large debt repayment burden along with high interest outgo is expected to weigh on the company's coverage indicators, going forward.

Table 4: Trend in Working Capital Intensity

Rs Crore	2008-09	2009-10	2010-11	2011-12	2012-13
NWC/OI	9.5%	7.6%	6.4%	12.9%	7.7%
Debtors & Bills Disc.	26	18	16	23	11
Days Payables	54	44	44	62	48
Days Inventory	53	47	52	69	65

Note: Amounts in Rs. crore, NWC: Net Working Capital
Source: Annual Reports of Subros and ICRA's estimates

Subros maintains high inventory levels since a considerable portion of raw material purchase (~55% currently) is imported. The working capital intensity is however not high given the favourable credit period it enjoys with its suppliers. The working capital intensity declined during 2012-13 with a decline in debtor position and advances given for purchase of goods as on year end. The company's miscellaneous current liabilities also increased during 2012-13.

Table 5: Trend in Cash Flows

Rs Crore	2008-09	2009-10	2010-11	2011-12	2012-13
Fund Flow from Operations	78.1	78.3	37.9	78.7	178.2
Gross Cash Flows	65.8	63.8	72.3	8.2	144.1
Less: Dividends paid	(5.6)	(3.5)	(4.9)	(5.6)	(7.6)
Cash Flows for Project Capex	(79.8)	(77.2)	(123.8)	(161.8)	(141.7)
Free Cash Flows	(19.6)	(17.0)	(56.4)	(159.1)	(5.3)

Note: Amounts in Rs. crore; Capex: Capital expenditure
Source: Annual Report, ICRA Estimates

Healthy increase in operating profits on back of increase in scale of operations and an improvement in operating margin, coupled with release of working capital on account of lower working capital intensity led to healthy increase in Subros' fund flow from operations during 2012-13. Nevertheless with large capex investments, free cash flows were in deficit, though to a limited extent. Subros large capex programme in the previous fiscal was directed towards capacity augmentation to meet future demand of customer OEMs, localisation projects, new product development as well as investments in technology upgardation.

September 2013

Annexure II: Rating Table

Instrument	Amount	Rating Action
	In Crore	As on Sep'13
Commercial Paper/Short Term Debt	60.0 (reduced from 120.0)	[ICRA]A1 reaffirmed
Term loans	137.0 (reduced from 155.0)	[ICRA]A+(stable) assigned
Cash Credit	65.0	[ICRA]A+(stable) assigned
Non Fund Based Limits	10.0	[ICRA]A+(stable) assigned
Fund Based and Non Fund based Limits	335.0 (increased from 295.0)	[ICRA]A1 reaffirmed

ICRA Limited

An Associate of Moody's Investors Service

CORPORATE OFFICE
Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002
Tel: +91 124 4545300; Fax: +91 124 4545350
Email: info@icraindia.com, Website: www.icra.in

REGISTERED OFFICE
1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001
Tel: +91 11 23357940-50; Fax: +91 11 23357014

Branches: **Mumbai**: Tel.: + (91 22) 24331046/53/62/74/86/87, Fax: + (91 22) 2433 1390 **Chennai**: Tel + (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294, Fax + (91 44) 2434 3663 **Kolkata**: Tel + (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008, Fax + (91 33) 2287 0728 **Bangalore**: Tel + (91 80) 2559 7401/4049 Fax + (91 80) 559 4065 **Ahmedabad**: Tel + (91 79) 2658 4924/5049/2008, Fax + (91 79) 2658 4924 **Hyderabad**: Tel +(91 40) 2373 5061/7251, Fax + (91 40) 2373 5152 **Pune**: Tel + (91 20) 2552 0194/95/96, Fax + (91 20) 553 9231