

September 13, 2019

Elgi Rubber Company Limited: Ratings downgraded to [ICRA]BB+(Negative)/[ICRA]A4+

Summary of rating action

Instrument*	Previous Rated Amount	Current Rated Amount	Rating Action
LT-Foreign Currency Term Loan	USD 4.20 million	USD 4.20 million	
LT-Term Loan	Rs. 49.00 crore	Rs. 49.00 crore	
LT- Fund Based Facility	Rs. 50.00 crore	Rs. 50.00 crore	[ICRA]BB+ (Negative); revised from [ICRA]BBB- (Negative)
LT- Non-Fund Based Facility	Rs. 62.68 crore	Rs. 62.68 crore	
LT- Non-Fund Based Facility	USD 4.21 million	USD 4.21 million	
LT- Non-Fund Based Facility	EUR 5.90 million	EUR 5.90 million	
ST-Fund Based Facility	Rs. 15.00 crore	Rs. 15.00 crore	
ST-Fund Based sub limits	Rs. (15.00) crore	Rs. (15.00) crore	[ICRA]A4+; revised from [ICRA]A3
ST-Non-Fund Based Facility	Rs. 18.00 crore	Rs. 18.00 crore	
LT/ST- Unallocated Facilities	Rs.0.60 crore	Rs.0.60 crore	[ICRA]BB+ (Negative) / [ICRA]A4+; revised from [ICRA]BBB- (Negative)/ [ICRA]A3

*Instrument details are provided in Annexure-1

Rationale

The rating action considers the sustained weakness in the consolidated financial performance of Elgi Rubber Company Limited (ERCL) till Q1 FY2020. Ongoing demand slowdown in the domestic/export automotive industry, sharp spike in prices of raw material (rubber) had impacted the consolidated earnings of the company in Q1 FY2020. With negative outlook on domestic auto demand over the near-term, ERCL's earnings is expected to be subdued with consequent impact on the debt indicators and cash flows.

The ratings consider ERCL's strong track record of operations and the promoters vast experience in the tyre re-treading and rubber products business. The company has a well-diversified clientele in the reclaim rubber segment (50.4% of consolidated revenues in FY2019) which includes major tyre manufacturers like CEAT Limited, MRF Limited, TVS Sri Chakra Limited etc. and also has a wide spread franchisee network in the re-treading segment (49.6% of consolidated revenues). While the ongoing automotive slowdown is likely to impact the performance in FY2020, replacement demand stemming from the retreading division could be supportive to an extent.

The performance of the company's subsidiaries remains subdued, which coupled with the capital expenditure undertaken over the years had resulted in high debt levels and further stretch in debt coverage metrics as of March 2019. Ability of the company to correct its cost structure in key subsidiaries as witnessed during Q1 FY2020 and timely monetisation of its non-core assets will be critical for improvement in the credit profile. The company has a debt repayment obligation of Rs. 16.8 crore in FY2020, Rs. 28.4 crore in FY2021 and Rs. 30.2 crore I FY2022.

The negative outlook on the [ICRA]BB+ rating reflects ICRA's opinion that ERCL's financial profile will remain weak in FY2020 given the slowdown in domestic automotive demand and under-performance (albeit improving) of subsidiaries.

Key rating drivers and their description

Credit strengths

Strong promoter profile and franchise network – Mr. Sudarsan Varadaraj, the Chairman and Managing Director of the company has vast experience in the tyre re-treading and rubber products business. The Company operates its re-treading business through a well-established franchise model. ERCL operates 197 franchises and generates almost 50% of its domestic revenues and ~25% of its consolidated revenues from the same.

Established and well diversified clientele – The strong track record of the company and more than 35 years of promoter's experience in the re-treading business have aided in establishing a strong customer network. Some of the top customers include major tyre manufacturers such as CEAT, MRF and TVS. The company sells reclaim rubber to these companies; this segment accounts for 50.4% of revenues on consolidated level.

Favourable growth prospects for re-treading business – Volatile tyre prices and higher radialisation supports increased re-treading there by providing incremental business opportunities for the entity. Revenues from the re-treading business has had accounted for 49.6% of revenues during FY2019.

Credit challenges

Subdued financial profile - Weak financial performance of the foreign subsidiaries of ERCL had resulted in net losses for the company in recent years (till FY2019). The consolidated losses stood at Rs. 16.1 crore (-3.9% NPM) in FY2019 as against net profit of Rs. 0.5 crore (0.2% NPM) by the standalone entity for FY2019. During Q1 FY2020, the company's operating margins for the consolidated entity declined sharply by 530 bps to 0.6% on account of increase in raw material prices and other overhead expenses.

The continuous funding to foreign subsidiaries via. external borrowings coupled with debt funded capital expenditure over the years resulted in high debt levels of Rs.284.9 crore as on March 31,2019. Although, the same had declined marginally from Rs. 296.9 crore as on March 31, 2018, it continues to remain high. This along with thin accruals for the company had resulted in stretched coverage indicators with TD/OPBITDA of 23.3 times, interest coverage ratio of 0.7 times and DSCR of 0.6 times for FY2019. Although, interest coverage stood at 0.1 times during Q1 FY2020, Rs. 7.4 crore funds generated from sale of non-core asset during Q1 FY2020 had partly supported cash flows. Ability of the company to monetise its non-core assets in a timely manner, reduce the debt levels and improve the profitability remains a key rating monitorable.

Slowdown in the domestic automobile industry to impact the reclaim rubber division sales– Muted auto demand had impacted ERCL's revenues during Q1 FY2020 where consolidated revenues witnessed a de-growth of 6%. ERCL derived ~50% of its Q1 FY2020 revenues from the overseas markets, primarily from Europe and North America and the remaining from the Indian market (standalone operations). Thus, the company's revenues would be vulnerable to the ongoing muted demand scenario in the domestic and global auto industry. However, ~50% of the revenues from the aftermarket re-trading business provide support to an extent.

Fragmented industry structure – The domestic re-treading industry is dominated by the unorganised sector. This is primarily due to the pricing disparity that exist between the organised and unorganised players on account of tax evasion. However, with the introduction of GST and increasing radialisation of tyres the organized share is expected to increase going forward.

Liquidity position: Stretched

ERCL has a consolidated debt repayment of Rs.16.8 crore in FY2020, Rs. 28.4 crore in FY2021 and Rs. 30.2 crore in FY2022. The company has deferred the capital expenditure plan of Rs. 25 crore to be incurred in FY2020 and is focusing on reducing debt levels by monetizing its non-core assets (land). The management has plans to monetize land worth ~Rs.37 crore by Q3 FY2020 of which the company has realized Rs.7.4 crore as on Q1 FY2020. Timely monetization of the non-core assets will be a key monitorable.

Rating sensitivities

Positive triggers –An upgrade in the ratings is currently restricted. ICRA could upgrade ERCL’s rating if the company demonstrates a sustained improvement in its financial profile. Specific credit metrics that could lead to an upgrade of ERCL’s rating include sustained improvement in operating margin to 4 – 6% thus leading to improvement in debt coverage metrics.

Negative triggers – Negative pressure on ERCL’s rating could arise with further weakening of credit profile and delay in monetisation of its non-core assets in next few months.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Auto Component Manufacturers
Parent/Group Support	Not Applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of ERCL

About the company

Elgi Rubber Company Limited (ERCL) is engaged in manufacturing of re-treading products and providing re-treading solutions through franchisee network and a reclaim rubber manufacturing for tyre manufacturers. The Company had one domestic subsidiary –Titan Tyre care Products LLP, India and ten foreign subsidiaries in various countries including Netherlands, Australia, Brazil, Kenya, USA, Sri Lanka, Bangladesh. The company is listed in National Stock Exchange (NSE).

The standalone entity is engaged in the manufacturing of reclaim rubber, tread rubber and bonding gum and other rubber products. ERCL has other rubber, machinery and accessories manufacturing facilities at Annur and Kovilpalayam; tread rubber and bonding gum manufacturing facility at Kuruchi, Coimbatore and Kottayi, Palakkad with a capacity of 1000 tpm. The reclaim rubber is manufactured at manufacturing facilities in Chengalpet and Kanjikode, Palakkad district with a total capacity of ~1000 tpm. Elgi's products are sold under the brands Jet, Pincott, Carbrasive, Midwest Rubber, RCH, CRS, Armonas, Westernweld and Ecorr. The Company also has captive windmills of 5MW capacity and an aircraft tyre re-treading facility in Coimbatore.

Key financial indicators (audited)

Consolidated	FY2018	FY2019
Operating Income (Rs. crore)	376.5	409.9
PAT (Rs. crore)	(5.6)	(16.1)
OPBDIT/OI (%)	5.5%	3.0%
RoCE (%)	2.6%	0.3%
Total Outside Liabilities/Tangible Net Worth (times)	1.3	1.4
Total Debt/OPBDIT (times)	14.3	23.3
Interest Coverage (times)	1.2	0.7
DSCR	0.8	0.6

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Type	Current Rating (FY2020)		Rating 13-Sep-2019	Rating History for the Past 3 Years					26-Jul 2016
			Amount Rated	Amount O/s		FY2019 18-Feb 2019	FY2018 23-Feb 2018	24-Oct 2017	05-Sep 2017	FY2017 23-Mar 2017	
1	Term Loan Foreign Currency	Long term	USD 4.20 Million	USD 3.75 Million	[ICRA]BB+ (Negative)	[ICRA]BBB- (Negative)	[ICRA]BBB (Negative)	[ICRA]BBB+ (Negative)	[ICRA]BBB+ (Negative)	[ICRA]BBB+ (Stable)	[ICRA]A- (Negative)
2	Term Loan	Long term	Rs.49.0 crore	Rs.21.75 crore	[ICRA]BB+ (Negative)	[ICRA]BBB- (Negative)	-	-	-	-	-
3	Cash Credit/WCDL	Long term	Rs. 50.0 crore	-	[ICRA]BB+ (Negative)	[ICRA]BBB- (Negative)	[ICRA]BBB (Negative)	[ICRA]BBB+ (Negative)	[ICRA]BBB+ (Negative)	[ICRA]BBB+ (Stable)	[ICRA]A- (Negative)
4	Bank Guarantee	Long term	Rs. 62.70 crore	-	[ICRA]BB+ (Negative)	[ICRA]BBB- (Negative)	[ICRA]BBB (Negative)	[ICRA]BBB+ (Negative)	[ICRA]BBB+ (Negative)	[ICRA]BBB+ (Stable)	[ICRA]A- (Negative)
5	Bank Guarantee	Long term	USD 4.21 Million	-	[ICRA]BB+ (Negative)	[ICRA]BBB- (Negative)	[ICRA]BBB (Negative)	[ICRA]BBB+ (Negative)	[ICRA]BBB+ (Negative)	[ICRA]BBB+ (Stable)	[ICRA]A- (Negative)
6	Bank Guarantee	Long term	Euro 5.90 Million	-	[ICRA]BB+ (Negative)	[ICRA]BBB- (Negative)	[ICRA]BBB (Negative)	[ICRA]BBB+ (Negative)	[ICRA]BBB+ (Negative)	[ICRA]BBB+ (Stable)	[ICRA]A- (Negative)
7	Export Packing Credit	Short term	Rs. 15.0 crore	-	[ICRA]A4+	[ICRA]A3	[ICRA]A3	[ICRA]A2	[ICRA]A2	[ICRA]A2	[ICRA]A2+
8	Letter of Credit/BG	Short term	Rs. 18.0 crore	-	[ICRA]A4+	[ICRA]A3	[ICRA]A3	[ICRA]A2	[ICRA]A2	[ICRA]A2	[ICRA]A2+
9	Sublimit	Short term	Rs. 15.0 crore	-	[ICRA]A4+	[ICRA]A3	[ICRA]A3	[ICRA]A2	[ICRA]A2	[ICRA]A2	[ICRA]A2+

10	Unallocated	Long/ Short term	Rs. 0.60 crore	-	[ICRA]BB+ (Negative)/ [ICRA]A4+	[ICRA]BBB- (Negative)/ [ICRA]A3	[ICRA]BBB (Negative)/ [ICRA]A3	ICRA]BBB+ Negative)/ ICRA]A2	ICRA]BBB+ Negative)/ ICRA]A2	[ICRA]BBB+ (Stable)/ [ICRA]A2	[ICRA]A- (Negative)/ [ICRA]A2+
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Amount in Rs. crore

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	Current Rating and Outlook
NA	Term Loan	Feb 2016	-	Oct 2022	USD 4.20 Million	[ICRA]BB+(Negative)
NA	Term Loan	Apr 2018	-	Mar 2025	Rs.49.00 crore	[ICRA]BB+(Negative)
NA	Cash Credit	-	-	-	Rs. 50.00 crore	[ICRA]BB+(Negative)
NA	Bank Guarantee	-	-	-	Rs. 62.70 crore	[ICRA]BB+(Negative)
NA	Bank Guarantee	-	-	-	USD 4.21 Million	[ICRA]BB+(Negative)
NA	Bank Guarantee	-	-	-	Euro 5.90 Million	[ICRA]BB+(Negative)
NA	Export Packing Credit	-	-	-	Rs. 15.00 crore	[ICRA]A4+
NA	Letter of Credit/BG	-	-	-	Rs. 18.00 crore	[ICRA]A4+
NA	Sub-limit	-	-	-	Rs. 15.00 crore	[ICRA]A4+
NA	Unallocated	-	-	-	Rs. 0.60 crore	[ICRA]BB+(Negative)/ [ICRA]A4+

Source: Elgi Rubber Company Limited

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Elgi Rubber Company LLC, USA	100.00%	Full Consolidation
Elgi Rubber Company Limited, Kenya	99.99%	Full Consolidation
Elgi Rubber Company Limited, Sri Lanka	99.99%	Full Consolidation
Treadsdirect Limited, Bangladesh	100.00%	Full Consolidation
Borrachas e Equipamentos Elgi Ltda, Brasil	99.99%	Full Consolidation
Pincott International Pty Limited, Australia	100.00%	Full Consolidation
Titan Tyrecare Products LLP, India	99.99%	Full Consolidation
Elgi Rubber Company Holding BV, Netherlands	100.00%	Full Consolidation

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