CRISIL
Ratings

# Rating Rationale

February 01, 2022 | Mumbai

# Munjal Showa Limited

*Long-term rating downgraded to 'CRISIL AA- / Negative'; Commercial paper rating reaffirmed*

**Rating Action**

| | |
|---|---|
| **Total Bank Loan Facilities Rated** | **Rs.144.25 Crore** |
| **Long Term Rating** | **CRISIL AA-/Negative (Downgraded from 'CRISIL AA/Negative')** |

| | |
|---|---|
| **Rs.6 Crore Commercial Paper** | **CRISIL A1+ (Reaffirmed)** |

*1 crore = 10 million*
*Refer to Annexure for Details of Instruments & Bank Facilities*

**Detailed Rationale**

CRISIL Ratings has downgraded its rating on long term bank facilities of Munjal Showa Limited (MSL) to **'CRISIL AA-/Negative'** from 'CRISIL AA/Negative' while reaffirming the rating of 'CRISIL A1+' on the company's commercial paper programme.

The rating action follows the continued sluggish business performance due to weak two-wheeler sales, and rising competitive intensity, resulting in MSL's revenues stagnating at below Rs.1100 crore in fiscal 2022 (estimated) as well (Rs.1077 crore in fiscal 2021, a decline of 16% over fiscal 2020 levels). With domestic two-wheeler sales witnessing negative growth for third year in a row, MSL's revenues have also been impacted, after peaking at ~Rs.1650 crores in fiscal 2019. Rising competitive intensity, with addition of new suppliers to MSL's existing customers have added to pressure on fresh orders, impacting revenues. Lower operating leverage due to fall in production volume of shock absorbers, along with steep increase in input costs, which though are passed on with a lag, as well as higher employee costs, have impacted operating profitability since fiscal 2020. MSL's operating profitability is expected at under 2% in fiscal 2022 (2.4% in fiscal 2021 and 5% in fiscal 2020), impacting cash generation.

With the two-wheeler segment expected to fare better in fiscal 2023 and MSL's initiative to diversify its revenue base and add customers from the electric two-wheeler segment, its revenues are expected to register an increase of 5-10% over the medium term but remain below fiscal 2019 levels. Operating profitability too is expected to improve gradually to 4-7% over the medium term, but cash generation is expected to remain modest, given average scale of operations.

The ratings nevertheless benefit from MSL's almost debt free balance sheet, unutilised bank lines, and cash surplus of over Rs.240 crores. With limited capital spending, no significant debt raising is expected over the medium term, leading to continued healthy financial risk profile.

The ratings continue to reflect MSL's established business linkages with customers, average scale of operations, and healthy financial risk profile supported by almost debt free balance sheet. These strengths are partially offset by limited segmental and geographical diversification, leading to low bargaining power with, and pricing pressure from, original equipment manufacturers (OEMs), and modest operating efficiencies.

**Key Rating Drivers & Detailed Description**

**Strengths:**

- **Established business linkages with main customers; average scale of operations:** MSL is a key player in the domestic shock-absorber industry and one of the leading suppliers to Hero MotoCorp Ltd (HMCL, rated 'CRISIL AAA/FAAA/Stable/CRISIL A1+'), the largest player in the two-wheeler market in India. The company also earlier used to supply shock absorbers to Honda Motorcycle and Scooters India Ltd (HMSI), however this business has discontinued for the last three-four years due to change in the client's sourcing policy. Apart from shock absorbers to two-wheelers, MSL also supplies struts and window balances to Maruti Suzuki India Ltd (rated 'CRISIL AAA/Stable/CRISIL A1+'). HMCL accounts for over 85% of MSL's revenues.

  Scale of operations remains average. The company's revenues peaked at ~Rs.1650 crores in fiscal 2019, but due to demand sluggishness and increasing competition, have dropped to under Rs.1100 crores in last two fiscals. Better demand prospects and attempts to diversify customer base is expected to lead to modest increase in revenues over the medium term.

- **Healthy financial risk profile:** Net worth was large at Rs 628 crore and balance sheet was almost debt free at September 30, 2021. Debt metrics remain healthy despite low profitability, due to minimal debt. Cash accruals in fiscal 2022 will be negligible due to subdued performance, leading to some of the capex (Rs.10-15 crore annually), being funded from liquid surpluses (Rs.243 crore at September 30, 2021). However, cash accruals are expected to increase to ~Rs. 20-25 crore per fiscal from fiscal 2023 and cover modest capex and working capital requirement. Consequently, reliance on debt will remain minimal, thereby benefitting financial risk profile.

**Weaknesses:**

- **Modest operating efficiencies:** Due to a decline in orders across segments and customers, capacity utilisation is subdued and has led to increased overhead costs. Hence, operating profitability is expected at under 2% in fiscal 2022, and improve to 4-7% over the medium term, supported by better operating performance. MSL also benefits from the fact that its three large manufacturing facilities are close to key clients, which improves control on capex and working capital management.

- **Limited segmental and geographical diversification:** Despite increasing supplies to other OEMs, bulk of the revenue is derived from HMCL. MSL has negligible reach in the global market due to restrictions from its collaborator, and second largest shareholder, Showa Corporation and no direct presence in the after-market segment, which fetches a higher margin. Earlier, HMSIL accounted for a healthy share of business (20% of revenue in fiscal 2013), but this declined as Showa India Pvt Ltd (100% subsidiary of Showa Corporation) replaced MSL as HMSIL's largest supplier. Ability to diversify revenue base and increasing supplies to electric two-wheeler OEMs will be critical to grow revenues, as HMCL too has been inducting new suppliers of shock absorbers for motorcycles.

- **Low bargaining power against OEMs:** Though the company has the flexibility to pass on any change in input cost, pushing any increase in other manufacturing overheads to customers poses a challenge. Moreover, high dependence on OEMs and exposure to intense competition would also constrain operating profitability, as reflected in the last two fiscals.

**Liquidity: Strong**

Cash surplus was around Rs 243 crore as on September 30, 2021 and part of the same may be used to fund modest capex in fiscal 2022, due to low cash accruals. Fund-based limit of Rs 25 crore largely remained unutilised in the 12 months through December 2021. Annual cash accrual is expected at around Rs 20-25 crore from fiscal 2023 against absence of any term debt obligation. Better accruals, sizeable liquid surplus, and unutilised bank limit should be more than sufficient to meet capex (annually Rs.10-15 crore) and incremental working capital requirement over the medium term.

**Outlook: Negative**

CRISIL Ratings believes MSL's performance while improving, will remain modest over the medium term, given its high customer concentration, especially on OEMs. Financial risk profile will, however, continue to be healthy, supported by better accrual and modest capex needs.

**Rating Sensitivity factors**
**Upward factors:**
- Revenue growth in excess of 8-10% per annum, including through better customer diversity
- Significant improvement in operating profitability to over 7-8%, resulting in better cash generation
- Sustenance of strong financial risk profile and debt metrics, and maintenance of healthy liquid surplus .

**Downward factors:**
- Continuing stagnation in revenues due to loss of share in business from key customer, and slower than expected ramp up in supplies to new customers
- Weak operating leverage resulting in operating profitability sustaining at below 3-4% over medium term, impacting cash generation
- Moderation in key debt metrics due to large, debt-funded capex/acquisitions
- Material decline in liquid surplus

**About the Company**
MSL was established by the erstwhile Hero group in 1985 as part of a technical and financial collaboration with Showa Corporation. Following a family arrangement in May 2010, MSL continues to be vested with Mr. Yogesh Chander Munjal, within the late Mr. Satyanand Munjal faction. Mr Yogesh Chander Munjal and family, through Dayanand Munjal Investments Pvt Ltd and Showa Corporation, had equity holdings of 40.10% and 24.90%, respectively, as on December 31, 2021. The main products are front forks and shock absorbers for the two-wheeler segment, and struts and window balancers for four-wheelers.

For the first six months of fiscal 2022, profit after tax (PAT) was Rs 4 crore (Rs.3 crore in corresponding period of fiscal 2021) on revenue of Rs 498 crore (Rs.421 crore).

**Key Financial Indicators**

| Particulars | Unit | 2021 | 2020 |
|---|---|---|---|
| Revenue | Rs. cr. | 1085 | 1288 |
| Profit after tax (PAT) | Rs. cr. | 26 | 43 |
| PAT margin | % | 2.4 | 3.3 |
| Adjusted debt/adjusted networth | Times | 0.00 | 0.00 |
| Adjusted interest coverage | Times | 104.44 | 154.17 |

**Any other information**: Not applicable

**Note on complexity levels of the rated instrument:**
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**Annexure - Details of Instrument(s)**

| ISIN | Name of instrument | Date of allotment | Coupon rate (%) | Maturity Date | Issue size (Rs crore) | Complexity level | Rating assigned with outlook |
|---|---|---|---|---|---|---|---|
| NA | Cash Credit | NA | NA | NA | 10 | NA | CRISIL AA-/Negative |
| NA | Proposed Long Term Bank Loan Facility | NA | NA | NA | 80.75 | NA | CRISIL AA-/Negative |
| NA | Letter of Credit@ | NA | NA | NA | 53.5 | NA | CRISIL AA-/Negative |
| NA | Commercial Paper | NA | NA | 7-365 days | 6 | Simple | CRISIL A1+ |

*@ 20 Crore Sublimit to CC, 10 Crore Sublimit to BG*

**Annexure - Rating History for last 3 Years**

| | Current | | | 2022 (History) | | 2021 | | 2020 | | 2019 | | Start of 2019 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Instrument | Type | Outstanding Amount | Rating | Date | Rating | Date | Rating | Date | Rating | Date | Rating | Rating |
| **Fund Based Facilities** | LT | 90.75 | CRISIL AA-/Negative | | -- | 23-02-21 | CRISIL AA/Negative | 28-02-20 | CRISIL AA/Negative | 28-03-19 | CRISIL AA/Stable | CRISIL AA/Stable |
| **Non-Fund Based Facilities** | LT | 53.5 | CRISIL AA-/Negative | | -- | 23-02-21 | CRISIL A1+ | 28-02-20 | CRISIL A1+ | 28-03-19 | CRISIL A1+ | CRISIL A1+ |
| **Commercial Paper** | ST | 6.0 | CRISIL A1+ | | -- | 23-02-21 | CRISIL A1+ | 28-02-20 | CRISIL A1+ | 28-03-19 | CRISIL A1+ | CRISIL A1+ |

*All amounts are in Rs.Cr.*

**Annexure - Details of Bank Lenders & Facilities**

| Facility | Amount (Rs.Crore) | Name of Lender | Rating |
|---|---|---|---|
| **Cash Credit** | **10** | **State bank of India** | **CRISIL AA-/Negative** |
| **Letter of Credit&** | **53.5** | **Citibank N. A.** | **CRISIL AA-/Negative** |
| **Proposed Long Term Bank Loan Facility** | **80.75** | **Not Applicable** | **CRISIL AA-/Negative** |

*This Annexure has been updated on 01-Feb-2022 in line with the lender-wise facility details as on 01-Feb-2022 received from the rated entity.*

*& - 20 Crore Sublimit to CC 10 Crore Sublimit to BG*

## Criteria Details

| Links to related criteria |
|---|
| CRISILs Approach to Financial Ratios |
| Rating criteria for manufaturing and service sector companies |
| CRISILs Bank Loan Ratings - process, scale and default recognition |
| Rating Criteria for Auto Component Suppliers |
| CRISILs Criteria for rating short term debt |

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