India Ratings Affirms TVS Srichakra at 'IND AA-'/Stable

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- Auto & Ancillaries

India Ratings and Research (Ind-Ra) has affirmed TVS Srichakra Limited's (TVSSC) Long-Term Issuer Rating at 'IND AA-'. The Outlook is Stable. The instrument-wise rating actions are given below:

Instrument Type	Coupon Rate	Maturity Date	Size of Issue (million)	Rating/Outlook	Rating Action
Commercial Paper*	-	Up to 365 days	INR3,000	IND A1+	Affirmed
Fund-based working capital limits	-	-	INR3,750 (increased from INR3,700)	IND AA-/Stable/ IND A1+	Affirmed
Non-fund-based working capital limits	-	-	INR1,140	IND AA-/Stable/ IND A1+	Affirmed
Term loans	-	FY30	INR3,711.8 (increased from INR1,750)	IND AA-/Stable	Affirmed
Proposed term loans/working capital limits	-	-	INR598.2	IND AA-/Stable/ IND A1+	Assigned
Short-term loan	-	-	INR1,000	WD	Withdrawn (paid in full)

*Carved out of fund-based working capital limits

Analytical approach: Ind-Ra continues to take a consolidated view of TVSSC and its wholly-owned subsidiaries, TVS Srichakra Investments Limited and TVS Sensing Solutions Private Limited, to arrive at the ratings on account of commonality in management, similar lines of business activity and operational interlinkages.

Key Rating Drivers

Strong Market Position; Diversified Customer Base: TVSSC is a dominant two-wheeler (2W) tyre manufacturer for auto original equipment manufacturers (OEMs) and is improving its presence in the aftermarket 2W tyre segment. The company maintained its market share in the OEM segment at about 40% during FY21, aided by its longstanding relationships with the top OEMs. The company's OEM segment revenue is diversified with the top four customers contributing about 44% to the consolidated revenue during FY21 (FY20: 53%, FY19: 53%). During FY20 and FY21, the volumes in the OEM segment recorded a double-digit decline yoy, after growing at a CAGR of 7% during FY16-FY19, due to the overall fall in the 2W industry sales. However, a continued focus on the less volatile and higher-margin aftermarket segment has enabled the company in increasing its market position in the aftermarket segment which contributed about 35% to the revenue during FY21 (around 30% over FY19-FY20).

Capacity Enhancement Targets Further Diversification: The utilisation of TVSSC's facilities, which fell to about 80% in FY20 on account of the demand slowdown across OEMs and the aftermarket, recovered to the FY19 level of close to 90% over 3Q-4QFY21 .Hence, expansion capex for the available production facilities remains important for the company to retain its strong market position in the 2W tyre segment and to further entrench its position in the off-highway tyres (OHT) export segment, given many players in the tyre industry are also expanding their capacities. TVSSC's capex is aimed at achieving increased capacity, better product diversification and higher margins. The OHT expansion is scheduled over FY22-FY23 with the first phase becoming fully operational by June 2022 and the second phase by March 2023. With the additional capacities coming online, the company will be able to address the increased order book received for this segment over the past six months. The revenue contribution from the OHT segment will also double to about 20% once the facility is fully functional. Moreover, as OHT is a margin-accretive segment, its higher contribution is also likely to increase EBITDA margins gradually. The agency will monitor growth and diversification aided by the capex underway.

Revenue Decline in FY21; Recovery Likely from FY22: TVSSC's revenue decline was limited to 7.8% yoy to INR19,392 million in FY21 (FY20: decline of 13.5% yoy) due to a pick-up 2QFY21 onwards. During 1QFY22, the revenue (1QFY22: INR4,953 million, 4QFY21: INR6,020 million, 3QFY21: INR5,727 million) was adversely impacted by the second wave of COVID-19 and sluggish pace of 2W OEM sales. Nevertheless, Ind-Ra expects TVSSC to record a revenue of INR22 billion-INR24 billion in FY22, backed by a continued replacement demand, healthy export demand, as well as a 10%-14% yoy increase in 2W OEM volumes, led by preference for personal mobility and the gradual opening of educational institutes and workplaces. Ind-Ra also expects revenue growth to remain healthy in FY23, supported by the new OHT facility coming online by June 2022.

Liquidity Indicator - Adequate: TVSSC had unencumbered cash and cash equivalent balance of INR47 million at FYE21 (FYE20: INR40 million). The average month-end utilisation of its INR3,750 million fund-based working capital facilities was around 24% during the 12 months ended September 2021. The company generated positive free cash flow of INR1,785 million in FY21 (FY20: INR707 million, FY19: negative INR1,267 million) supported by healthy profitability, rationalised capex spend (FY21: INR975 million, FY20: INR1,385 million) and favourable working capital movements. The company's growing focus on the aftermarket segment will require it to maintain large inventories in the channel, thus keeping the working capital cycle elongated (FY21: 132 days, FY20: 129 days; FY19:117 days).

Ind-Ra expects the company's free cash flow to turn negative in FY22 on account of its large capex plans of about INR3,500 million, which is likely to be partly debt-funded. The company has a debt sanction of INR2,400 million against the planned capex. TVSSC has long-term debt repayment obligations of INR608 million in FY22 and INR402 million in FY23, which are likely to be repaid using internal accruals. TVSSC enjoys financial flexibility on account of it being part of the TVS group and well-diversified funding sources.

Large Capex Plans to Increase Net Leverage in FY22-FY23: Ind-Ra expects TVSSC's net leverage (net debt/EBITDA) to moderate to around 2.5x in FYE22 (FYE21: 0.9x, FYE20: 1.6x) on the back of its debt-funded capex plans as well as subdued EBITDA margins. The company has significant capex plans of INR10,000 million over the next three-to-four years, aimed at doubling both the OHT and 2W tyre capacity, and funded through a mix of debt and internal accruals. Of this, almost a third of the capex (pertaining to the OHT facility) is scheduled for FY22, and is to be funded by a term loan of INR2,400 million. The company's interest coverage (EBITDA/interest expense) improved yoy to 6.9x in FY21 (FY20: 5.5x), backed by improved cash flow generation. The interest coverage is likely to remain in line with the rating category in FY22.

With the onset of the demand downcycle from 2HFY19, the company had deferred its capacity enhancement plans, awaiting visibility of a strong sustained recovery. With strong demand coming in from the export markets for the OHT segment, the management is proceeding with capex towards this facility in FY22. Over FY23-FY24, company plans to undertake the 2W expansion; however, the same could be extended/deferred in case the demand revival is not in line with the management's expectations, given its modular nature. The agency expects the deleveraging post capex to be gradual with the net leverage reducing below 2.0x only in FY24, as the benefits to scale and profitability are likely to start accruing partially FY23 onwards from the OHT facility and FY24 onwards from the 2W facility. Any cost overruns, delays in deriving the expected benefits and/or a further sharp rise in the raw material prices could lead to higher-than-expected deterioration in the credit metrics. Also, TVSSC remains exposed to the risks related to the timely execution of projects and favourable demand scenario for successfully operationalising the new facilities.

Raw Material Price Volatility Likely to Constrain Margins in FY22: TVSSC's EBITDA margin expanded to 11.9% in FY21 (FY20: 10.3%), due to the increased proportion of margin-accretive replacement and export market sales, the reduced cost of raw materials during 1HFY21, multiple cost-reduction initiatives, and improved operating leverage. The company was also able to partly offset the increase in raw material prices from 2HFY21 through price hikes in the replacement and export markets as well as pass through of price hikes to OEMs with a lag of three-to-six months. However, during 1QFY22, the EBITDA margin contracted to 5.3% (4QFY21: 13.2%, 3QFY21: 14.0%, 2QFY21: 15.7%) due to a rise in the raw material prices and a slowdown in demand on account of the second wave of COVID-19.

Ind-Ra expects TVSSC's EBITDA margin to moderate yoy to 8.5%-9.0% in FY22 due to higher input costs, though be partly supported by the phased price hikes and improved operating leverage. The EBITDA margin remains sensitive to any volatility in natural rubber (1HFY22: INR171/kg, FY21: INR142/kg, FY20: INR135/kg; source: Centre for Monitoring Indian Economy) and Brent crude (1HFY22: USD71.1/bbl, FY21: USD44.4/bbl, FY20: USD61.2/bbl; source: US Energy Information Administration), considering raw material costs represent about 60% of the revenue. The trend of the tyre industry margins reducing to single digits during times of elevated raw material prices has been witnessed in the past.

Lower Scale than Market Leaders: While TVSSC's revenue grew in double-digits historically, excluding over FY20-FY21, it has been lower than that of peers in the 2W tyre segment. MRF Ltd and CEAT Limited ('IND AA'/Stable), which have a larger share of the 2W aftermarket, largely driven by their entrenched market position in the aftermarket segment. The company's ability to gain a meaningful market share in the 2W aftermarket segment depends on the success of its brand-building strategies and efficient channel management.

Standalone Performance: TVSSC's standalone operations continue to account for a major share (FY21: over 96%) of the consolidated revenue, EBITDA and debt. TVSSC recorded a revenue of INR18,758 million (FY20: INR20,522 million), EBITDA of INR2,249 million (INR2,153 million), interest coverage of 6.9x (5.8x) and net leverage of 0.9x (1.6x) in FY21.

Rating Sensitivities

Positive: Maintaining strong cash flows, which will enable the company to meet a substantial portion of its capex requirements, even while input costs continue to rise, indicating significant strengthening of the business profile in terms of a substantially higher proportion of revenue from the aftermarket segment and lower volatility in EBITDA margins, on a consolidated basis, could result in a positive rating action.

Negative: A substantial erosion of the profitability margins due to an increase in the price of inputs, prolonged periods of demand slowdown or increased competition, leading to the consolidated net leverage exceeding 2x, on a sustained basis, could be negative for the ratings.

Company Profile

TVSSC belongs to the TVS group of companies. The company is a leading manufacturer of 2W tyres in India and caters to both OEMs and aftermarket segments, and also manufactures OHT for the domestic and export markets. The company has two manufacturing plants, one each in Madurai in Tamil Nadu and Rudrapur in Uttarakhand.

CONSOLIDATED FINANCIAL SUMMARY

Particulars	FY21	FY20
Revenue (INR million)	19,392	21,037
EBITDA (INR million)	2,300	2,168
EBITDA margins (%)	11.9	10.3
Interest coverage (x)	6.9	5.5
Net leverage (x)	0.9	1.6
Source: TVSSC, Ind-Ra		

Solicitation Disclosures

Additional information is available at www.indiaratings.co.in. The ratings above were solicited by, or on behalf of, the issuer, and therefore, India Ratings has been compensated for the provision of the ratings.

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Rating History

Instrument Type	Current Rating/Outlook			Historical Rating/Outlook			
	Rating Type	Rated Limits (million)	Rating	12 November 2020	18 December 2019	8 August 2019	18 April 2018
Issuer rating	Long-term	-	IND AA-/Stable	IND AA-/Stable	IND AA-/Stable	IND AA-/Stable	IND AA-/Stable
Fund-based limits	Long-term/ Short-term	INR3,750	IND AA-/Stable/IND A1+	IND AA-/Stable/IND A1+	IND AA-/Stable/IND A1+	IND AA-/Stable/IND A1+	IND AA-/Stable/IND A1+
Non-fund based limits	Long-term/Short-term	INR1,140	IND AA-/Stable/IND A1+	IND AA-/Stable/IND A1+	IND AA-/Stable/IND A1+	IND AA-/Stable/IND A1+	IND AA-/Stable/IND A1+
Term loan limits	Long-term	INR3,711.8	IND AA-/Stable	IND AA-/Stable	IND AA-/Stable	IND AA-/Stable	IND AA-/Stable
Proposed term loans/working capital limits	Long-term/Short-term	INR598.2	IND AA-/Stable/IND A1+	-	-	-	-

CP	Short-term	INR3,000	IND A1+	IND A1+	IND A1+	-	-

Bank wise Facilities Details

Click here to see the details

Complexity Level of Instruments

Instrument Type	Complexity Indicator
Term loan	Low
CP	Low
Fund-based limits	Low
Non-fund based limits	Low

For details on the complexity levels of the instruments, please visit https://www.indiaratings.co.in/complexity-indicators.

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