December 27, 2019

Mahindra Logistics Limited: Rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term, Fund-based Facilities	50.0	50.0	[ICRA]AA (Stable); Reaffirmed
Short-term, Non-fund Based Facilities	15.0	15.0	[ICRA]A1+; Reaffirmed
Total	**65.0**	**65.0**	

**Instrument details are provided in Annexure-1*

Rationale

The rating reaffirmation takes into account the strong parentage of Mahindra Logistics Limited (MLL) as a subsidiary of Mahindra & Mahindra Limited (M&M, rated [ICRA]AAA (Stable) / [ICRA]A1+), MLL's established presence in the supply chain management (SCM) segment with M&M being a key customer, the increasing client diversification in its SCM business, and the respectable position it enjoys in the people logistics (people transport solutions or PTS) business. Despite a 5.6% YoY decline in revenues and 60 bps dip in operating profit margin (OPM) in H1 FY2020 due to the slowdown in the domestic automotive industry, the company's financial risk profile remains strong as characterised by its healthy return on capital employed (ROCE) of 28.2% in FY2019, capital structure of 0.1 time as on March 31, 2019 and debt coverage indicators and strong liquidity position. MLL continues to primarily follow an asset-light business model (asset-light model on a standalone basis, while its subsidiary company, 2X2 Logistics Private Limited has an asset-heavy model), which is positive, especially in a declining business environment.

MLL is positioned as a key intermediary in M&M's automotive and farm equipment business by providing end-to-end supply chain solutions. The strong business linkage with the Mahindra Group, particularly M&M, in the SCM segment, provides MLL with the requisite experience, volume and a stable business avenue. MLL's SCM business is at present primarily focussed on the automotive segment, in line with its large dependence on the parent entity for business. While MLL has also developed a strong client base outside the Group in other segments such as e-commerce, consumer and pharmaceutical verticals, its current dependence on the Group remains high at ~53% of the total revenues in H1 FY2020 (~56% in FY2019).

The rating is, however, constrained by MLL's concentration of revenues on the automotive industry (~69% of its total SCM revenues in FY2019) exposing it to high industry cyclicality. The impact of the same is reflected during H1 FY2020, when MLL's automotive segment revenues witnessed 12% YoY degrowth due to the overall slowdown in the domestic automotive industry. This decline was, however, partly compensated by the 8% YoY growth in its non-automotive segment revenues (contributed by e-commerce, consumer and pharmaceutical verticals). Due to the under-absorption of fixed costs due to lower revenues, MLL's OPM declined to 3.4%[1] in H1 FY2020 from 4.0% in H1 FY2019. MLL's business also remains vulnerable to stiff competition from many unorganised players and technology driven start-ups.

[1] *Adjusted OPM on pre-Ind AS 116 basis and before employee stock options (ESOP) / restricted stock units (RSU) charge*

The Stable outlook reflects ICRA expectations that MLL will continue to enjoy strong financial flexibility as part of the Mahindra Group and its strong linkages with the Group. ICRA believes that MLL will maintain its current comfortable capital structure and profitability, while aiming to grow the top line through industry and customer diversification.

Key rating drivers

Credit strengths

Strong financial flexibility as part of the Mahindra Group; strong business linkages with the Group in the SCM segment provide requisite volume and stable business avenue – While MLL was initially focussed on meeting the SCM requirements of the Mahindra Group, it subsequently diversified its client base beyond the Group. It continues to cater to almost the entire supply chain requirements of M&M. The Mahindra Group drove ~56% and ~53% of its total revenues in FY2019 and H1 FY2020, respectively. In addition to the business linkages and strong business volume, MLL, being a subsidiary of M&M, derives flexibility in tapping the banking and financial markets in case of funding requirements.

Asset-light business model provides operational flexibility, especially in declining business environment – MLL primarily follows an asset-light strategy (asset-light model on a standalone basis, while its subsidiary company, 2X2 Logistics, follows an asset-heavy model). While the vehicles are hired from transport companies on a contractual basis, all its warehousing requirements are on a lease basis. Such a policy results in very low capital expenditure (capex) requirements and, hence, low fixed costs. While the policy affects the profit margins negatively due to higher operating costs, it provides flexibility during industry down cycles and helps in reducing the volatility in ROCE. MLL's ROCE remained healthy at 28.2% in FY2019.

Broad customer base with presence among established companies – Though MLL derived ~56% of its FY2019 revenues and ~53% of its H1 FY2020 revenues from the Group, the revenue concentration on the Group has reduced over the years, from ~70% in FY2015. MLL has been focussing on strengthening its presence with other original equipment manufacturers (OEMs) in the automotive industry and also diversifying into other industry verticals (like pharmaceuticals, fast moving consumer goods or FMCG, telecom and e-commerce industries). MLL has, over the past couple of years, added several new customers in the non-automotive segment, resulting in diversification of its customer profile. Hence, the revenue share from non-Mahindra Group companies increased to ~47% of MLL's total revenues in H1 FY2020 from ~30% in FY2015.

Healthy capital structure and liquidity – Supported by strong accruals and moderate capex requirements (~Rs. 45 crore annually), MLL's capital structure remains strong—debt-free on a standalone basis since FY2013 and low debt levels on a consolidated basis (gearing of 0.1 time (excluding lease liabilities) as on September 30, 2019). The debt coverage indicators also remain healthy as reflected by Total debt/OPBDITA of 0.2x and interest coverage of 43.6x in FY2019. MLL continues to enjoy strong liquidity, as reflected by sizeable cash and bank balance as well as liquid investments aggregating to
Rs. 98.6 crore as on September 30, 2019 and largely unutilised bank lines of Rs. 48.0 crore.

Credit challenges

Concentration of SCM business on automotive industry exposes MLL to high industry cyclicality – The automotive segment drove ~69% of MLL's total SCM revenues in FY2019, thereby exposing the business to cyclicality inherent in the industry. The impact of the same is reflected in 12% YoY degrowth in its automotive segment revenues during H1 FY2020 due to overall slowdown in the domestic automotive industry. However, with increasing business from the non-automotive industry, the concentration has reduced over the years.

Stiff competition from large number of unorganised players and technology driven start-ups – MLL faces intense competition from the unorganised logistics service providers and technology driven start-ups in the SCM business. In the PTS business, it faces competition from local travel operators as well as from application-based transportation service providers.

Liquidity position: Strong

MLL, on a standalone basis, does not have any debt. On a consolidated basis, MLL had a total debt of Rs. 28 crore as on September 30, 2019 (excluding lease liabilities and current portion of long-term debt) consisting of working capital loans and term loans in subsidiaries. The company's liquidity is **strong** due to healthy cash accruals and sizeable cash and bank balance as well as liquid investments of Rs. 98.6 crore as on September 30, 2019 and largely unutilised bank lines of Rs. 48.0 crore.

Rating sensitivities

Positive triggers: The rating is unlikely to be upgraded unless there is a substantial scale-up in revenues of MLL, along with greater sector and client diversification, with sustained improvement in ROCE.

Negative triggers: MLL's rating may be downgraded if there is any weakening in the credit profile of M&M and/or weakening in the operating performance of MLL. Any debt-funded capex / inorganic acquisition or investments in subsidiaries / joint ventures (JVs) undertaken by the company, which may adversely impact MLL's credit profile will be a negative trigger. Sustained fall in ROCE below 20% will also be a negative trigger.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent / Group Support	Not applicable
Consolidation / Standalone	For arriving at the rating, ICRA has considered the consolidated financials of MLL. As on September 30, 2019, the company had two subsidiaries and a joint venture that are all listed in Annexure-2.

About the company

MLL, a 58.52% subsidiary[2] of M&M, is a third-party logistics (3PL) provider, operating in the SCM and PTS businesses. MLL's SCM business includes supply chain consultancy, warehousing, stores and line feeding, transportation and freight forwarding. In its PTS business, MLL provides customisable and technology-enabled employee transportation services to corporate enterprises. The SCM business drove ~90% of MLL's revenues in FY2019, while the remaining (~10%) was generated by the PTS division.

[2] *As on September 30, 2019*

The company commenced operations from December 2000 as a division of M&M to handle the captive logistics and supply chain needs of the Group. Subsequently, the division began operating for external clients across the country. MLL was spun off as a 100% subsidiary of M&M, with effect from April 01, 2008. MLL concluded its initial public offering (IPO) in November 2017 and was listed on the Bombay Stock Exchange and the National Stock Exchange.

MLL has two subsidiary companies—LORDS Freight (India) Private Limited (LORDS) and 2X2 Logistics Private Limited (2X2 Logistics). LORDS is an international freight forwarder and 2X2 Logistics is a business associate of MLL providing transportation services to MLL through its fleet of owned trucks (152 as on September 30, 2019).

During H1 FY2020, MLL, on a consolidated basis, reported a profit after tax (PAT)[3] of Rs. 30.0 crore on an operating income (OI) of Rs. 1,751.5 crore, as against a PAT Rs. 43.4 crore on an OI of Rs. 1,855.5 crore during H1 FY2019.

Key financial indicators (audited, consolidated)

	FY2018	FY2019
Operating Income (Rs. crore)	3,416.1	3,851.3
PAT (Rs. crore)*	65.3	86.7
OPBDITA/OI (%)	3.5%	3.9%
RoCE (%)	25.4%	28.2%
Total Outside Liabilities/Tangible Net Worth (times)	1.3	1.4
Total Debt/OPBDITA (times)	0.3	0.2
Interest Coverage (times)	31.8	43.6
DSCR	8.7	8.8

Source: Company data, ICRA research
OPBDITA: Operating Profit before Depreciation, Interest, Taxes and Amortisation; ROCE: Return on Capital Employed; DSCR: Debt Service Coverage Ratio
**excluding share of profits from JVs / Associates*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

[3] *Excluding share of profits from JVs / Associates*

Rating history for last three years

	Instrument	Current Rating (FY2020) Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating 27-Dec-2019	Chronology of Rating History for the Past 3 Years: Date & Rating in FY2019 29-Nov-2018	Date & Rating in FY2018 16-Mar-2018	Date & Rating in FY2017 6-Dec-2016
1	Fund-based Limits	Long-term	50.00	-	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)
2	Non-fund Based Limits	Short-term	15.00	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+

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 click here

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Fund-based – Cash Credit	NA	NA	NA	50.00	[ICRA]AA (Stable)
NA	Non-Fund Based – Bank Guarantee / Letter of Credit	NA	NA	NA	15.00	[ICRA]A1+

Source: Mahindra Logistics Limited

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Subsidiaries		
LORDS Freight (India) Private Limited	82.92%	Full Consolidation
2X2 Logistics Private Limited	55.0%	Full Consolidation
Joint Ventures		
Transtech Logistics Private Limited (effective October 5, 2018)	39.79%	Equity Method

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About ICRA Limited:

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