

January 31, 2020 ^{Revised}

MSL Driveline Systems Limited: Rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term Loans	41.62	6.10	[ICRA]A+ (Stable); re-affirmed
Long-term / Short-term, Fund-based Bank Facilities	50.00	25.00	[ICRA]A+ (Stable) / [ICRA]A1+; re-affirmed
Long-term/ Short-term, Fund-based/Non-fund Based Bank Facilities	0.00	25.00	[ICRA]A+ (Stable) / [ICRA]A1+; re-affirmed
Short-term, Non-fund Based Bank Facilities	5.00	5.00	[ICRA]A1+; re-affirmed
Total	96.62	61.10	

*Instrument details are provided in Annexure-1

Rationale

The rating reaffirmation draws comfort from the established business relationship of MSL Driveline Systems Limited (MSL) with leading domestic original equipment manufacturers (OEMs) and the extensive experience of its promoters in the automotive (auto)/auto ancillary business, facilitating an expansion of its customer base. The ratings note the traction developed by MSL in the medium and heavy commercial vehicles (M&HCV) segment over the years, which has enabled diversification of its revenues, beyond the traditional utility vehicle (UV) segment. The company's financial profile continues to be robust, as evinced by the strong capital structure and coverage indicators.

The ratings, however, remain constrained by the high client concentration and dependence on the rear-wheel and 4X4 drive UV segment, which is at present witnessing a shift in preference towards front-wheel drives. The consequent risk of lower offtake is, however, mitigated to some extent by MSL's foray into the M&HCV segment. Nevertheless, its operations are exposed to the cyclicity associated with the UV and CV segments in both the domestic and export markets. ICRA notes the 18.3% YoY degrowth in revenues in H1 FY2020 owing to the ongoing slowdown in the domestic auto industry. However, MSL witnessed a marginal improvement of 10 bps YoY in its operating profit margin (OPM) in H1 FY2020 owing to higher after-market sales.

MSL has undertaken a series of share buyback amounting Rs. 98.2 crore (including taxes) over FY2018 to FY2020, including the recent one amounting to Rs. 36.8 crore (including taxes) in November 2019. This is in order to help the promoters fund their debt repayment obligation towards the Rs. 115-crore loan (current outstanding is Rs. 67 crore) taken in FY2017 for the purchase of 37.5% stake in MSL from Mahindra & Mahindra Limited (M&M). Despite this, MSL's coverage indicators remain comfortable, as reflected by OPBITDA/Interest of 17.1 times and NCA/Total Debt of 156.6% as on September 30, 2019. ICRA will continue to monitor the company's dividend payouts and share buyback.

The ratings factor in the company's exposure to foreign currency fluctuation risk, although the same is partially mitigated by the natural hedge through imports and forward covers. The ratings would remain sensitive to its ability to sustain the cyclicity inherent in the auto and auto components industry, increase its client as well as product base and hence maintain its profit margins.

Key rating drivers and their description

Credit strengths

Extensive experience of promoters in auto ancillary business – The promoters have more than 22 years of experience in the auto components industry. They have provided MSL with access to international clients and technical collaboration with the Korean auto ancillary manufacturer, Hyolim Industrial Co. Ltd., product innovation and thus an increase in share of business with OEMs.

Established business relationship with most major OEMs in domestic UV and CV markets – MSL is the tier-I supplier for most of the OEMs in India, which include among others, M&M, Ashok Leyland Limited (ALL), Tata Motors Limited (TML), VE Commercial Vehicles India Limited (VECV) and Force Motors Limited.

Strengthening position in CV segment offering diversification of product line – Till FY2015, the products manufactured by MSL were mainly catered to UV and light commercial vehicles (LCV) segments. However, in a bid to counter competition from other suppliers and fight the risk of obsolescence of its products, the company has been making greater inroads into the CV segment, particularly M&HCVs since FY2016, which currently contributes 30-35% to the total sales of the company. It witnessed an increase in after-market sales, which has been supporting its profit margins.

Strong capital structure and coverage indicators – The company's capital structure remains strong as evinced by gearing of 0.26 times as on March 31, 2019 and 0.14 times as on September 30, 2019, and TD/OPBDITA of 0.6 times and 0.5 times as of March 2019 and on September 30, 2019, respectively.

Credit challenges

Expected decline in revenues and profit margins in FY2020 due to slowdown in domestic auto industry – MSL witnessed a revenue decline of 18.3% YoY in H1 FY2020 owing to the ongoing slowdown in the domestic auto industry, and is expected to witness 20-25% decline in revenues for FY2020. However, supported by after-market sales, MSL witnessed a marginal YoY improvement of 10 bps in its OPM in H1 FY2020. Nonetheless, it is likely to witness a subdued H2, resulting in a decline in its OPM for FY2020.

High single client concentration at ~30% of total revenues in FY2019 – MSL faces high client concentration risk, with sales to M&M contributing to ~30% of its total sales in FY2019. MSL is the sole supplier of propeller shafts for most of the UV models of M&M. The consequent risk of high client concentration is, however, mitigated to some extent by its foray into the M&HCV segment, with sales to ALL, TML and VECV.

Relatively large dependence on rear-wheel and 4x4 drive UV segment; shift in preference towards front-wheel drives – MSL's products primarily cater to the rear-wheel and 4x4 drive UVs. However, the UV segment is witnessing a shift in preference towards the front-wheel drive, thereby jeopardising its growth prospects. Nonetheless, MSL had diversified into the CV segment from FY2015, sales to which have gained traction in FY2018 and FY2019. At present, ~30-35% of the total sales of MSL is driven by the CV segment, as against ~10% in FY2015.

Profitability susceptible to raw material price fluctuations and foreign currency movements – MSL has relatively low bargaining power with its customers as evident from its inability to pass on the increase in raw material prices to its customers with immediate effect. The company can pass-on the price increase with a time lag of two to three months, thereby impacting its profitability. It derived ~22% of its revenues from exports in FY2019 and thus carries exchange rate risk. The risk is, however, partially mitigated by a natural hedge through imports, which contributed to ~23% of its total purchases in FY2019. The company undertakes forward covers to mitigate the risks arising from fluctuations in foreign currency.

Liquidity position: Strong

The company's liquidity is **strong**, with expected annual cash accruals of ~Rs. 45-50 crore and minimal debt repayment obligations. Furthermore, while MSL has a sanctioned fund-based working capital limit of Rs. 50 crore, it has significant buffer on drawing power, with average utilisation of 26% on drawing power over the last 12 months that ended in October 2019. Thus, despite, the series of share buyback undertaken by the company, MSL's liquidity remains strong. It reported cash and cash equivalents of Rs. 8.7 crore as on September 30, 2019.

Rating sensitivities

Positive triggers – ICRA could upgrade MSL's rating if there is a significant improvement in scale, along with profitability.

Negative triggers – ICRA could downgrade MSL's rating if TD/OPBDITA weakens above 1.5 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Methodology for Auto Component Manufacturers
Parent/Group Support	Not applicable
Consolidation / Standalone	The ratings are based on the company's standalone financial profile.

About the company:

MSL, erstwhile Mahindra Sona Limited, began operations in 1979 from a Nashik-based facility (Maharashtra), as a part of the joint venture (JV) between M&M and Dana Corporation USA, as Mahindra Spicer Limited. In 1984, Mahindra Spicer Limited was merged with M&M and was known as the automotive component unit of M&M. In March 1995, M&M and Sona Koyo Steering Systems Limited (Sona Koyo) formed the JV, Mahindra Sona Limited (Mahindra Sona). The assets of the automotive component unit of M&M were transferred to Mahindra Sona for a consideration of Rs. 14.0 crore. Until December 2016, M&M group and Sona group held 37.5% stake each, with the balance 25% remaining with the strategic investors. On December 16, 2016, MSona Automotive Components Private Limited (MSona) acquired 37.5% stake of M&M in Mahindra Sona, and subsequently the company was renamed as MSL Driveline Systems Limited in March 2017. At present, the promoters hold 75.3% stake in MSL, with the rest being held by strategic investors.

The company is involved in designing and manufacturing a wide range of auto ancillary products, such as propeller shafts, clutches, universal joint kits, steering joints, and axle shafts for CVs and UVs.

For the six months that ended in September 30, 2019, as per provisional financials, MSL reported a profit after tax (PAT) of Rs. 18.0 crore on an operating income of Rs. 267.9 crore.

Key financial indicators (Audited)

	FY2018	FY2019
Operating Income (Rs. crore)	550.7	656.4
PAT (Rs. crore)	37.0	49.4
OPBDIT/OI (%)	12.2%	13.2%
RoCE (%)	26.4%	32.1%
Total Outside Liabilities/Tangible Net Worth (times)	1.0	0.9
Total Debt/OPBDIT (times)	0.5	0.6
Interest Coverage (times)	26.7	27.2
DSCR	9.1	4.0

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

	Instrument	Current Rating (FY2020)			Rating History for the Past 3 Years				
		Type	Amount Rated	Amount Outstanding*	Rating	FY2019	FY2018	FY2017	
					31-Jan-20	1-Feb-19	5-Feb-18	13-Jan-17	31-Dec-16
1	Term Loan	Long-term	6.1	6.1	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)
2	Fund-based Bank Facilities	Long-term/ Short-term	25.0	-	[ICRA]A+ (Stable) / [ICRA]A1+	[ICRA]A+ (Stable) / [ICRA]A1+	[ICRA]A+ (Stable) / [ICRA]A1+	-	-
3	Fund-based Bank Facilities	Long-term	-	-	-	-	-	[ICRA]A+(Stable)	[ICRA]A+ (Stable)
4	Fund-based / Non-fund Based Bank Facilities	Long-term/ Short-term	25.0	-	[ICRA]A+ (Stable) / [ICRA]A1+	-	-	-	-
5	Non-Fund Based Bank Facilities	Short-term	5.0	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+

Amount in Rs. crore

*As on December 31, 2019

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 (Rs. crore)	Current Rating and Outlook
-	Term Loan	FY2017	9.85%	FY2021	6.1	[ICRA]A+ (Stable)
-	Long-term / Short-term, Fund-based Bank Facilities	NA	NA	NA	25.0	[ICRA]A+ (Stable) / [ICRA]A1+
-	Long-term/ Short-term, Fund-based/Non-fund Based Bank facilities	NA	NA	NA	25.0	[ICRA]A+ (Stable)/ [ICRA]A1+
-	Short-term, Non-fund Based Bank Facilities	NA	NA	NA	5.0	[ICRA]A1+

Source: MSL Driveline Systems Limited

Corrigendum:

Rationale dated January 31, 2020 has been revised with changes as below:

Revision on Page 1 – In the third paragraph on share buyback, the amount has been revised to Rs. 98.2 crore (including taxes) over FY2018 to FY2020 from Rs. 106 crore (including taxes) over FY2018 to FY2020. Also, the recent amount of buyback has been revised to Rs. 36.8 crore (including taxes) in November 2019 from Rs. 36.0 crore (including taxes) in November 2019.

Revision on Page 3 – In the about the company section, the date when MSona Automotive Components Private Limited (MSona) acquired 37.5% stake of M&M in Mahindra Sona has been revised to December 16, 2016 from January 5, 2017.

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