October 16, 2020

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Term Loans	6.10	-	[ICRA]A+ (Stable); reaffirmed and withdrawn
Long-term / Short-term, Fund-based Bank Facilities	25.00	25.00	[ICRA]A+ (Stable) / [ICRA]A1+; reaffirmed
Long-term / Short-term, Fund-based /Non-fund Based Bank Facilities	25.00	25.00	[ICRA]A+ (Stable) / [ICRA]A1+; reaffirmed
Short-term, Non-fund Based Bank Facilities	5.00	5.00	[ICRA]A1+; reaffirmed
Total	**61.10**	**55.00**	

**Instrument details are provided in Annexure-1*

Rationale

The rating reaffirmation takes into account the strong liquidity position of MSL Driveline Systems Limited (MSL) with minimal debt repayment obligations, its established business relationship 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 vehicles (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 cyclicality associated with the UV and CV segments in both the domestic and export markets. ICRA also notes the 20.6% YoY degrowth in MSL's revenues in FY2020 (as per provisional financials) owing to the ongoing slowdown in the domestic auto industry, further accentuated by the Covid-19 pandemic in Q4 FY2020. The widespread lockdown initiated by the Government to contain the virus led to disruptions in the operations of the company, resulting in a significant YoY decline of 74.5% in its revenues in Q1 FY2021 (as per provisional financials). However, sales improved in Q2 FY2021, reverting to the monthly run rate of the company's pre-Covid levels from August 2020 onwards. ICRA notes that MSL witnessed 450 bps decline in its operating profit margin (OPM) to 8.7% in FY2020 (as per provisional financials), primarily due to a one-time write-off of Rs. 11.9 crore undertaken towards doubtful receivables and the decline in scale. However, despite the significant decline in sales in Q1 FY2021, MSL reported operating profits in Q1 FY2021, supported by implementation of cost saving measures and only a marginal decline in after-market sales.

MSL has undertaken a series of share buybacks amounting to Rs. 98.2 crore (including taxes) over FY2018 to FY2020. The company also undertook a dividend pay-out of Rs. 24 crore (including taxes) in March 2020. This was undertaken to help the promoters fund their debt repayment obligation towards the Rs. 115-crore loan (current outstanding of Rs. 60 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 11.7 times and net debt/OPBDITA of 0.9

time as on March 31, 2020 (as per provisional financials). The company's liquidity remains strong, with free cash and cash equivalents of Rs. 23.1 crore as on June 30, 2020, against gross debt of Rs. 27.4 crore. ICRA will continue to monitor the company's dividend pay-outs and share buybacks.

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 cyclicality inherent in the auto and auto components industry, increase its client as well as product base and hence improve its profit margins.

The [ICRA]A+ (Stable) rating on the Rs. 6.1-crore term loan of MSL has been reaffirmed and withdrawn at the request of the company and upon receipt of no dues certificate from the banker, in accordance with ICRA's policy on withdrawal and suspension of rating of bank facilities.

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, product innovation and technical collaboration with the Korean auto ancillary manufacturer, Hyolim Industrial Co. Ltd., 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 for the 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 at present drives 30-35% of its total sales. The company has also been witnessing robust growth in after-market sales, which has been supporting its profit margins.

Strong capital structure, coverage indicators and liquidity position – The company's capital structure remains strong as evinced by gearing of 0.3 time, interest coverage of 11.7 times and net debt/OPBDITA of 0.9 time as on March 31, 2020 (as per provisional financials). The company's liquidity remains strong, with free cash and cash equivalents of Rs. 23.1 crore as on June 30,2020, against a gross debt of Rs. 27.4 crore.

Credit challenges

Expected decline in revenues and profit margins in FY2021 due to slowdown in domestic auto industry and the impact of Covid-19 – MSL witnessed a 20.6% YoY decline in revenues in FY2020 (as per provisional financials) owing to the ongoing slowdown in the domestic auto industry, further accentuated by the ongoing global pandemic in Q4 FY2020. Coupled with the decline in scale, the write-off of Rs. 11.9 crore doubtful receivables in FY2020 resulted in 450 bps decline in its OPM to 8.7% in FY2020 (as per provisional financials). The widespread lockdown initiated by the Government to contain the infections had led to disruptions in the operations of the company, resulting in a significant YoY decline of 74.5% in its revenues in Q1 FY2021 (as per provisional financials). However, the operations of the company improved in Q2 FY2021 and have reverted to the monthly run rate of the pre-Covid levels from August 2020 onwards. Despite the significant decline in sales in Q1 FY2021, MSL reported operating profits in Q1 FY2021, supported by implementation of cost saving measures and only a marginal decline in after-market sales. Overall, for FY2021, the company is expected to witness a revenue decline of ~35-40% and OPM in the range of 9-10%.

High single client concentration at ~32% of total revenues in FY2020 – MSL faces high client concentration risk, with sales to M&M driving ~32% of its total sales in FY2020. It 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 high 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, leading to increasing sales contribution from this segment. At present, ~30-35% of its total sales are driven by the CV segment, against ~10% in FY2015.

Profitability susceptible to raw material price fluctuations and foreign currency movements – MSL has a 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, which impacts its profitability. It derived ~21% of its revenues from exports in FY2020 and thus faces the exchange rate risk. The risk is, however, partially mitigated by a natural hedge through imports, which contributed to ~35% of its total purchases in FY2020. The company undertakes forward covers to mitigate the risks arising from fluctuations in foreign currency rates.

Liquidity position: Strong

MSL's liquidity is **strong**, with cash and cash equivalents of Rs. 23.1 crore as on June 30, 2020. It has a sanctioned fund-based working capital limit of Rs. 50 crore, of which Rs. 29.6 crore remained unutilised as on June 30, 2020. In addition, it has a high drawing power, resulting in an average utilisation of ~20% on its drawing power over the last 12 months that ended in June 2020. Moreover, during H1 FY2021, the company has repaid its term loan of Rs. 3.5 crore outstanding as on March 31, 2020, and currently does not have any scheduled term loan repayments. Also, the company has minimal maintenance capital expenditure requirement of Rs. 6-8 crore in FY2021, which is to be funded through internal cash flows.

Rating sensitivities

Positive triggers – An upgrade in ratings is unlikely in the current environment due to the impact of Covid-19 on the company's operations. Nevertheless, 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 in case of a prolonged impact on the company's operations triggered by Covid-19, resulting in any deterioration in its debt coverage indicators and liquidity profile. Specific credit metrics that could lead to a downgrade of MSL's rating include Total Debt/ OPBITDA exceeding 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, the M&M Group and the Sona Group held 37.5% stake each, with the balance 25% remaining with 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 three months that ended in June 30, 2020, as per provisional financials, MSL reported a net loss of Rs. 1.5 crore on an operating income of Rs. 36.2 crore.

Key financial indicators

	FY2019 (Audited)	FY2020 (Provisional)
Operating Income (Rs. crore)	656.4	521.0
PAT (Rs. crore)	49.4	26.3
OPBDIT/OI (%)	13.2%	8.7%
PAT/OI (%)	7.5%	5.0%
Total Outside Liabilities/Tangible Net Worth (times)	0.9	0.9
Total Debt/OPBDIT (times)	0.6	1.2
Interest Coverage (times)	27.2	11.7

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2021)					Rating History for the Past 3 Years		
		Type	Amount Rated	Amount Outstanding*	Rating	Rating	FY2020	FY2019	FY2018
					16-Oct-20	4-May-20	31-Jan-20	1-Feb-19	5-Feb-18
1	Term Loan	Long-term	6.1	0.0	[ICRA]A+ (Stable) withdrawn	[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+	[ICRA]A+ (Stable) / [ICRA]A1+	[ICRA]A+ (Stable) / [ICRA]A1+
3	Fund-based / Non-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+	-	-
4	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 October 08, 2020*

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); reaffirmed and withdrawn
-	Long-term / Short-term, Fund-based Bank Facilities	NA	NA	NA	25.0	[ICRA]A+ (Stable) / [ICRA]A1+; reaffirmed
-	Long-term / Short-term, Fund-based / Non-fund Based Bank facilities	NA	NA	NA	25.0	[ICRA]A+ (Stable) / [ICRA]A1+; reaffirmed
-	Short-term, Non-fund Based Bank Facilities	NA	NA	NA	5.0	[ICRA]A1+; reaffirmed

Source: MSL Driveline Systems Limited

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