March 03, 2023

Automotive Axles Limited: Long-term rating upgraded, short-term rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount	Current Rated Amount	Rating action
Fund-based – Term Loan	20.00	12.50	[ICRA]AA- (Stable); upgraded from [ICRA]A+ (Stable)
Fund-based – Working Capital Facilities	85.00	-	-
Non-fund Based Working Capital Facilities	13.00	-	-
Long-term/ Short-term – Fund-based/ Non-fund Based Limits	-	100.00	[ICRA]AA- (Stable)/[ICRA]A1+; long-term rating upgraded from [ICRA]A+ (Stable) and short-term rating Reaffirmed
Unallocated	27.00	32.50	[ICRA]AA- (Stable); upgraded from [ICRA]A+ (Stable)
Total	**145.00**	**145.00**	

**Instrument details are provided in Annexure-1*

Rationale

The revision in the long-term rating factors in the significant improvement in Automotive Axles Limited's (AAL's) operational performance in FY2022 and 9M FY2023, and expectations that this will sustain over the medium term. In line with the pick-up in demand in the domestic commercial vehicle (CV) industry, AAL reported YoY growth of 65% and 74% in revenues during FY2022 and 9M FY2023, respectively, with improvement in operating profitability to 9.2% in FY2022 and further to 11.0% in 9M FY2023 from 7.5% in FY2021 as a result of operating leverage benefits. The ratings also favourably factor in AAL's comfortable financial risk profile and robust balance sheet as evidenced by its sizeable net worth, low debt levels, and strong liquidity position.

The ratings continue to factor in the company's established position as one of the largest independent axle manufacturers in India, catering to several large medium and heavy commercial vehicle (M&HCV) original equipment manufacturers (OEMs), namely Ashok Leyland Limited (ALL), Daimler India Commercial Vehicles Private Limited (Daimler), Mahindra Vehicle Manufacturers Limited (M&M), Tata Motors Limited (TML), VE Commercial Vehicles Limited (VECV), Caterpillar India Private Limited (CAT), Vehicle Factory Jabalpur (VFJ), Swaraj Mazda Limited (SML), etc. The company enjoys healthy relationships with its established client base and a strong share of business with most of the major OEMs in the M&HCV industry. Further, the company benefits in terms of technology and operational support provided by its parent, Meritor Inc. ICRA has also factored in the change in ownership at the parent level, with Cummins Inc. acquiring complete ownership of Meritor Inc. in February 2022. ICRA expects operational synergies to accrue to AAL as a step-down subsidiary of one of the major global auto-component suppliers.

The rating strengths are partially offset by the customer concentration risk with AAL's top customer, ALL, driving 50-60% of its total revenues. The rating also considers the inherent cyclicality in the M&HCV industry. However, ICRA notes the company's efforts to diversify its revenue streams by scaling up its presence in other segments such as defence and off-highway applications, which are expected to yield benefits over the medium to long-term. Further, the company is exposed to the susceptibility of profitability to fluctuations in prices of key raw materials, although it is expected to pass on the impact of the same to its customers with some lag.

The Stable outlook on the long-term reflects ICRA's opinion that the company will continue to benefit from its strong parentage and the established track record of its operations and maintain its comfortable financial risk profile over the medium term.

Key rating drivers and their description

Credit strengths

Healthy financial profile characterised by low debt, healthy net worth base, comfortable credit metrics and sizeable cash balances – AAL's financial profile is healthy, supported by a healthy net worth base of Rs. 658.5 crore as on September 30, 2022, healthy cash flows and low debt levels. The company's liquidity position is strong with a balance of free cash and liquid investments of Rs. 86.9 crore as on September 30, 2022. This apart, its entire working capital facilities of Rs. 100.0 crore remain unutilised. Given the low debt levels, AAL enjoys a strong capital structure with low leveraging, and comfortable coverage indicators such as interest coverage of 55.4 times and DSCR of 17.1 times during FY2022. The company's credit metrics are expected to remain comfortable going forward on the back of expected healthy cash accruals and absence of any significant debt-funded capex.

Technological and operational support by virtue of its parentage – AAL is a 35.52% each JV between BFIL and Meritor Inc., a leading global supplier of drivetrain, mobility, braking and aftermarket solutions for the CV and industrial markets. Access to know-how from the global parent provides the company with technological leadership in India. Further, with the recent acquisition of Meritor by Cummins Inc. globally, the same enhances AAL's access to Cummins' technological prowess and well-established relationships with global OEMs. Accordingly, the change in ultimate parentage is expected to bring in operational synergies for AAL in terms of the new product segments, customers and geographies that it can cater to by leveraging Cummins' standing in the automobile industry.

Strong position in axle and brake manufacturing industry coupled with established relationships with major OEMs continues to support business prospects – The company is the largest independent manufacturer of rear drive axles for M&HCVs in India with an established position with the domestic OEMs. The company has a strong customer base in the domestic market catering to all the major OEMs in the Indian CV industry, namely ALL, TML, M&M, and VECV among others. This has supported AAL's business prospects over the years. The company supplies drive axles, TAG axles and brakes to these customers. Additionally, it supplies suspensions to ALL. AAL also supplies axles to CAT for its various construction equipment.

Credit challenges

Customer concentration risk – The company has high dependence on ALL, which has accounted for 50-60% of its revenues historically. However, the healthy share of business and its long-term association with ALL provide comfort. Further, the increasing share of business with other OEMs like M&M, TML and VECV, etc, along with the company's foray into the defence segment and plans to increase its presence in the off-highway segment, is expected to reduce the concentration, going forward.

Exposed to cyclicality inherent in M&HCV industry – AAL derives most of its revenues from CVs, especially the M&HCV segment, exposing its revenues to cyclicality in demand in these segments. However, the company is taking steps to mitigate this risk by increasing its presence in other segments such as defence and off-highway applications.

Susceptibility to fluctuations in steel prices – The company's margins are susceptible to volatility in steel prices, though the same is generally passed on to its customers with a lag.

Environmental and social risks

Environmental considerations: Even as AAL is not directly exposed to climate-transition risks from a likelihood of tightening emission-control requirements, with its products being used by different categories of OEMs, its automotive- manufacturing customers remain highly exposed to the same. Accordingly, the company's prospects are linked to the ability of its customers to meet tightening emission requirements. The company may need to invest materially to develop products to cater to electric vehicles, even as a transition towards the same in the segments catered to by AAL is likely to be only gradual. The company's exposure to litigation/ penalties from issues related to waste and water management remains relatively low.

Social considerations: AAL, like most automotive-component suppliers, has a healthy dependence on human capital; as such retaining human capital, maintaining healthy employee relations and supplier ecosystem remain essential for disruption-free operations for the entity. The company has been taking initiatives to impart training to its employees towards improvement of their capacity and capabilities. Another social risk that AAL faces pertains to product safety and quality, wherein instances of product recalls and high-warranty costs may not only lead to a financial implication, but could also harm the reputation and create a more long-lasting adverse impact. In this regard, AAL's strong track record in catering to leading automotive manufacturers underscore its ability to mitigate these risks to an extent. The company's strong technological capabilities are likely to help it align its products with any change in customer preferences.

Liquidity position: Strong

AAL's liquidity is strong with healthy cash flow from operations, sizeable cash balances of Rs. 86.9 crore as on September 30, 2022, and no major capex plan over the near to medium term. With the healthy cash flow generation from operations, AAL's dependence on working capital borrowings has been limited, resulting in further buffer of Rs. 100.0 crore from unutilised working capital lines as on January 31, 2023. On the outstanding long-term debt, AAL has debt repayments of Rs. 4 crore annually over the next three years, which can be comfortably met from the existing sources of funds, resulting in a strong liquidity profile for the company.

Rating sensitivities

Positive factors – The rating could be upgraded if the company is able to strengthen its business profile further through meaningful diversification of its customer base and products, which would aid the company to reduce its exposure to cyclicality on a sustained basis. The company's ability to maintain its profitability and return indicators at healthy levels over industry cycles would also remain critical.

Negative factors – Pressure on AAL's ratings could arise in case of sustained de-growth in revenues on account of the slowdown in industry demand or if deterioration in profit margins affects the debt coverage indicators on a sustained basis. Specific credit metrics that could lead to a rating downgrade include Total Debt/OPBITDA of more than 1.5 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Auto Component Suppliers
Parent/Group Support	Not Applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the standalone financials of AAL.

About the company

Incorporated in 1981, Automotive Axles Limited is a joint venture between BF Investment Limited, an investment holding company with investments in various Kalyani Group companies, and Meritor Inc., USA, a leading supplier of axles for CVs, with the JV partners holding 35.52% stake each. In February 2022, Cummins Inc. (rated Moody's A2) acquired 100% stake in Meritor, making AAL an indirect JV of Cummins Inc. The purchase consideration for the transaction was $3.7 billion.

AAL is currently the largest independent manufacturer of rear drive axle assemblies for CVs (primarily M&HCVs) in India. Its product portfolio includes a wide range of axles catering to haulage trucks, tippers, tractor trailers and other off highway vehicles used for special purposes. The company also supplies drum and disc brake assemblies for trucks, trailers, buses and coaches and is the second largest brake manufacturer in India after Brakes India Private Limited. With manufacturing plants at Mysore, Pantnagar, Jamshedpur and Hosur, the company supplies its components to customers across India as well as in international markets. AAL's domestic customers include Ashok Leyland Limited, Daimler India Commercial Vehicles Private Limited, Man Trucks India Private Limited, Mahindra Vehicle Manufacturers Limited, Tata Motors Limited, etc, while internationally its business is largely routed through the parent company.

Key financial indicators (audited)

AAL (Standalone)	FY2021	FY2022	H1 FY2023
Operating Income (Rs. crore)	905.6	1,490.6	974.9
PAT (Rs. crore)	22.7	74.4	60.5
OPBDIT/OI (%)	7.5%	9.2%	10.5%
RoCE (%)	5.9%	16.1%	25.2%
Total Outside Liabilities/Tangible Net Worth (times)	0.7	0.7	0.5
Total Debt/OPBDIT (times)	0.9	0.6	0.5
Interest Coverage (times)	23.0	55.4	68.4
DSCR (times)	8.9	17.1	23.1

Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation;
**acceptances included as part of creditors in audited financials have been classified as debt by ICRA*

Status of non-cooperation with previous CRA: Not Applicable

Any other information: None

Rating history for past three years

	Instrument	Type	Current Rating (FY2023)			Chronology of Rating History for the Past 3 Years		
			Amount Rated (Rs. crore)	Amount Outstanding as of Sep 30, 2022 (Rs. crore)	Date & Rating in FY2023	Date & Rating in FY2022	Date & Rating in FY2021	Date & Rating in FY2020
					Mar 03, 2023,	Feb 28, 2022 Oct 20, 2022	Dec 29, 2020	Sep 27, 2019
1	**Term Loan**	Long Term	12.50	12.50	[ICRA]AA- (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)
2	**Fund Based**	Long Term	-	-	-	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)
3	**Non-fund Based**	Short Term	-	-	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
4	**Fund based/Non-fund-based limits**	Long Term/ Short Term	100.00	-	[ICRA]AA- (Stable)/ [ICRA]A1+	-	-	-

5	**Unallocated**	Long Term	32.50	-	[ICRA]AA- (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)

Complexity level of the rated instrument

Instrument	Complexity Indicator
Fund Based – Term Loan	Simple
Fund based/Non-fund-based limits	Simple
Unallocated	Not Applicable

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments, is available on ICRA's website: www.icra.in

Annexure-1: Instrument details

ISIN No.	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	O/s Rating and Outlook
NA	Term Loans	FY2019	7.10% - 7.25%	FY2026	12.50	[ICRA]AA- (Stable)
NA	Fund based/Non-fund-based limits	NA	NA	NA	100.00	[ICRA]AA- (Stable)/ [ICRA]A1+
NA	Unallocated	NA	NA	NA	32.50	[ICRA]AA- (Stable)

Source: Company

Annexure-2: List of entities considered for consolidated analysis – Not Applicable

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

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