May 23, 2019

V.S.T. Tillers Tractors Limited: Long-term rating downgraded to [ICRA]AA-; outlook revised to Stable; short-term rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount(Rs. crore)	Rating Action
Long term – Fund Based/CC	5.00	5.00	[ICRA]AA- (Stable); downgraded from [ICRA]AA, outlook revised from Negative
Short term – Non-fund Based	5.00	5.00	[ICRA]A1+; reaffirmed
Total	**10.00**	**10.00**	

**Instrument details are provided in Annexure-1*

Rationale

The revision in the long-term rating considers the weaker-than-expected performance of VST in FY2019 with a ~19.5% YoY de-growth in revenues because of a sharp 25% decline in power tiller volumes (~39% of revenues). This was largely on account of the subdued demand in key markets owing to the delayed subsidy releases in Karnataka, Andhra Pradesh and Maharashtra and the drought in Maharashtra and Gujarat. While VST's entry in the higher HP tractor segment was expected to support its overall revenue growth, the tractor volumes contracted by ~28% YoY (~49% of revenues) in FY2019 due to subdued demand in key markets and teething problems faced by the newly launched 17 HP and 27 HP tractor models. VST's operating and net margins contracted by 820 bps and 720 bps, respectively, in FY2019 with a sharp fall in revenues, increase in raw material prices and other fixed expenses, and one-time expenses. While the expected receipt of subsidies post-Union elections is likely to provide a fillip to the company's tractor and tiller volumes, ICRA will continue to monitor the impact of the same on VST's performance going forward. The dependence of the power tiller segment on Government subsidies exposes VST's revenues and margins to any changes in Government policies. The ratings also continue to factor in the cyclical nature of the tractor and tiller industry in addition to the competitive intensity, which limits the company's pricing flexibility to a certain extent and makes its profitability susceptible to fluctuations in input costs.

The ratings, however, remain supported by VST's long-standing presence and dominant market position in the domestic power tiller industry, its financial profile characterised by strong debt protection metrics with gearing and Total Debt/OPBDITA of 0.1 times and 1.0 times, respectively, as on March 31, 2019 and healthy interest coverage of 20.4 times in FY2019. With the relaunch of the 17 HP and 27 HP tractors in Q3 FY2019, ICRA expects the tractor volumes to increase in FY2020. Further, VST's technological transfer agreement with Kukje Machinery Co., Korea for the manufacturing of 4-wheel drive 47 HP Branson tractors is a key positive. VST's performance in the higher HP segment would be a key monitorable, given the competitive intensity marked by the presence of much larger and established players like Mahindra & Mahindra Limited (M&M), Tractors & Farm Equipment Limited (TAFE), Escorts Limited, International Tractors Limited (ITL), John Deere India Private Limited, etc. The long-term demand drivers remain favourable, given the Government's sustained focus on income insurance, farm mechanisation and the currently low level of farm equipment penetration. VST plans to incur ~Rs. 90 crore towards capital expenditure (capex) during FY2020-FY2021, with the same expected to be funded entirely through internal accruals and existing cash and liquid investments.

Outlook: Stable

ICRA believes VST's long-standing presence and dominant market position in the domestic power tiller industry and its increasing presence in the tractor segment will continue to support its business prospects. The outlook may be revised to Positive if higher-than-expected revenue growth and profitability strengthen the company's financial risk profile. The outlook may be revised to Negative if the performance remains weaker than expected on account of a delayed recovery in the volumes of tillers and tractors or if higher-than-expected capex, any adverse changes in the Government's policy or volatility in raw material prices results in weakened liquidity and accruals.

Key rating drivers

Credit strengths

Established position in domestic tiller market; widespread dealer network enhances business prospects – VST has an established market position and a well-reputed brand presence in the power tiller segment in India with a share of ~60% in H1 FY2019. This, coupled with its widespread dealer network, continues to support the company's business operations.

Testing and validation of higher HP tractor segments completed; ramp up in volumes expected to support revenue growth and margins, going forward – In FY2019, the company completed the testing and validation of tractors in the 39-50 HP segment (2-wheel drive) and of the 47-HP Branson tractor (4-wheel drive). ICRA expects the volumes in this segment to support the revenue growth, going forward. However, the performance of this segment would be a key credit monitorable, given the intense competition marked by the presence of well-established players like M&M, TAFE, Escorts, ITL, John Deere, etc.

Financial profile characterised by strong debt protection metrics – VST's financial profile is characterised by strong capitalisation and coverage indicators with a gearing and Total Debt/OPBITDA of 0.1 times and 1.0 times, respectively, as on March 31, 2019, and healthy interest coverage of 20.4 times in FY2019. The company also had sizeable cash and liquid investments of Rs. 154.7 crore, as on March 31, 2019, which is expected to be sufficient to meet its capex and incremental working capital requirements going forward.

Long-term business prospects remain favourable with increasing Government focus on income insurance, farm mechanisation – VST, being one of the leading farm mechanisation players, would be a key beneficiary of the Government's focus on increasing farm income and the farmer's propensity to purchase quality mechanisation products.

Credit challenges

Subdued performance in FY2019 – VST's revenues de-grew by 19.5% on a YoY basis in FY2019 due to a sharp decline of ~25% in its power tiller volumes. This was largely on account of the subdued demand in key markets because of delayed subsidy releases and the drought in Maharashtra and Gujarat. Power tiller sales were also impacted by a delay in subsidy allocation in various states because of the Central elections. While the company's entry into the higher HP tractor segment was expected to support its overall revenue growth, the tractor volumes also de-grew by ~28% (YoY) in FY2019. The decline was on account of the subdued demand in key markets and teething problems faced by the company for its newly launched 17 HP and 27 HP tractor models. VST's operating margins contracted by 820 bps to 7.5% in FY2019 (15.7% in FY2018) on account of a scale impact, a rise in raw materials costs and other one-time expenses. The fall in accruals, amid sustained capex, in recent years has resulted in lower RoCE levels. Following a cumulative spend of Rs. 103.4 crore during FY2018-19, VST is investing ~Rs. 90 crore in FY2020-FY2021, a major portion of which is for the expansion of the product mix into higher HP tractors. While the capex is expected to be funded entirely through internal accruals and cash reserves, the company's RoCE levels is expected to remain low. A sharp improvement in revenues and operating margins will be critical for improving VST's RoCE over the next two years.

Limited pricing flexibility for end products – The tractor and power tiller industries are characterised by competitive intensity, thus limiting VST's pricing flexibility amid fluctuating input costs.

Exposed to cyclicality in industry; continued dependence of power tiller segment on government subsides – VST derived ~38.6% and 49.5% of its revenues from the power tiller and tractor segments, respectively, in FY2019. The company remains exposed to the cyclicality inherent in these industries owing to the dependence on monsoon and crop production in the country. Also, the bulk of VST's power tiller sales are driven by the states, which exposes its revenues and margins to any adverse changes in government policies.

Liquidity position

VST's liquidity profile is comfortable with healthy cash and liquid investments of Rs. 154.7 crore and undrawn lines of cash credit of Rs. 5.0 crore as on March 31, 2019. The company does not have term loans in its books. The estimated capex of Rs. 90 crore for FY2020-FY2021 is expected to be funded entirely through internal accruals and cash reserves. With no repayment obligations, healthy accruals and relatively lower capex compared to its cash and liquid investments, ICRA expects VST's liquidity position to remain healthy over the medium term.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology ICRA's Rating methodology for Tractor industry
Parent/Group Support	NA
Consolidation/Standalone	The ratings are based on the standalone financial profile of the company

About the company

V.S.T. Tillers Tractors Limited was promoted in 1967 as a 60:20:20 joint venture between (1) Mr. V.T. Velu along with his two brothers in technical and financial collaboration, (2) Mitsubishi, Japan (Mitsubishi Heavy Industries Limited)[1] and Mitsubishi Corporation)[2] and (3) Mysore State Industrial Investment Corporation Limited, for the manufacture of power tillers and diesel engines. The commercial production of tillers commenced in 1970. Later, in 1984, an additional technical and financial collaboration was entered into with Mitsubishi Agricultural Machinery Company Limited, Japan for the manufacture of 18.5 horse power (HP) 4-wheel drive tractors. However, the collaborations with all the above entities have expired. The current shareholding of the Indian promoters in VST is 51.06% while Mitsubishi's stake is 2.93%.

VST manufactures farm equipment, namely power tillers, tractors, diesel engines and other precision agricultural and automotive components. It also trades in certain other farm equipment (mainly rice transplanters), which are sourced from China. Headquartered in Bangalore, VST derives over 96% of its revenues from the domestic market and has a nationwide network of about 250 dealers to support sales and provide after-sales services.

[1] *Mitsubishi Heavy Industries Limited: Rated A-/Negative by S&P, AA- (Stable)/ J-1+ by Japanese Credit Rating Agency*

[2] *Mitsubishi Corporation: Rated A (Stable)/A1 by S&P; A2 (Negative)/P1 by Moody's*

Key financial indicators (audited)

	FY2018	FY2019
Operating Income (Rs. crore)	764.0	614.8
PAT (Rs. crore)	112.0	46.0
OPBDIT/OI (%)	15.7%	7.5%
RoCE (%)	27.8%	12.4%
Total Debt/TNW (times)	0.1x	0.1x
Total Debt/OPBDIT (times)	0.3x	1.0x
Interest Coverage (times)	70.8x	20.4x

Source: VST

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

		Current Rating (FY2020)				Chronology of Rating History for the Past 3 Years			
	Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating in FY2020 May 2019	Date & Rating in FY2019 December 2018	Date & Rating in FY2019 April 2018	Date & Rating in FY2017 January 2017	Date & Rating in FY2016 January 2016
1	Fund Based – CC	Long Term	5.00	**NA**	[ICRA]AA- (Stable)	[ICRA]AA (Negative)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)
2	Non-fund Based – LC/BG	Short Term	5.00	**NA**	[ICRA]A1+	[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 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
NA	Cash Credit	NA	NA	NA	5.00	[ICRA]AA- (Stable)
NA	LC/BG	NA	NA	NA	5.00	[ICRA]A1+

Source: VST

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

ANALYST CONTACTS

Subrata Ray
+91 22 6114 3408
subrata@icraindia.com

Pavethra P
+91 44 4596 4314
pavethrap@icraindia.com

Mythri Macherla
+91 80 4332 6407
mythri.macherla@icraindia.com

Mithun
+91 80 4332 6411
mithun@icraindia.com

RELATIONSHIP CONTACT

Jayanta Chatterjee
+91 80 4332 6401
jayantac@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries:

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

About ICRA Limited:

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For more information, visit www.icra.in

ICRA Limited

Corporate Office
Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002
Tel: +91 124 4545300
Email: info@icraindia.com
Website: www.icra.in

Registered Office
1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001
Tel: +91 11 23357940-50

Branches

Mumbai	+ (91 22) 24331046/53/62/74/86/87
Chennai	+ (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,
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