

October 23, 2020

## Munjal Auto Industries Limited: Rating reaffirmed; rated amount enhanced

### Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
LT Fund based/ CC	15.00	35.00	[ICRA]AA- (Stable) reaffirmed; assigned to enhanced amount
LT Fund based TL	79.59	80.18	[ICRA]AA- (Stable) reaffirmed; assigned to enhanced amount
ST Fund based	15.00	18.00	[ICRA]A1+ reaffirmed; assigned to enhanced amount
ST Non-fund based	16.64	15.93	[ICRA]A1+ reaffirmed
LT/ ST Unallocated	3.77	30.89	[ICRA]AA- (Stable)/ [ICRA]A1+ reaffirmed; assigned to enhanced amount
<b>Total bank limits</b>	<b>130.00</b>	<b>180.00</b>	
<b>Commercial paper</b>	<b>15.00</b>	<b>15.00</b>	[ICRA]A1+ reaffirmed

\*Instrument details are provided in Annexure-1

### Rationale

The rating reaffirmation takes into consideration Munjal Auto Industries Limited's (MAIL's) stable business profile as characterised by its sole supplier status for key exhaust system components, such as mufflers, to Hero Moto Corp Limited (HMCL; rated [ICRA]AAA(Stable)/[ICRA]A1+). MAIL's extensive experience in manufacturing mufflers has helped it stay cost competitive and along with its ability to regularly invest in setting up units in proximity to HMCL's plants, this has helped the company in maintaining a healthy relationship with HMCL. Further, MAIL's technical collaboration with Lafranconi Italy S.p.A. for exhaust systems of two-wheelers helps the company to gain access to the latest technology in order to meet the changing industry requirements. Despite recent debt-funded capital investments by the company related to BS-VI transmission and customer diversification, the rating also takes comfort from the management's track record of committing to a conservative capital structure.

The rating, however, continues to be constrained by MAIL's exposure to a single client and significant segment concentration risk on account of high revenue dependence on HMCL as well as the Indian two-wheeler industry. Although the company has been working on diversifying its business profile, the same is unlikely to result in meaningful diversification over the medium term. ICRA notes that the company's recent efforts at diversification through supplying sheet metal components to a passenger vehicle (PV) original equipment manufacturer (OEM) did not materialise as per plans as the company decided to exit the business after incurring losses. On the other hand, MAIL's acquisition of Indutch Composites Technology Private Limited (Indutch), a windmill blade manufacturer for various renewable energy companies, was an attempt to inorganically diversify into the non-automotive sector. While the revenue from this business continues to scale-up, it is yet to contribute significantly to MAIL's consolidated earnings. Thus, going forward, the rating will remain dependent on MAIL's ability to profitably scale up its supplies to customers other than HMCL and reduce its dependence on a single customer. Further, MAIL's ability to diversify its product profile to reduce dependence on mufflers will gain greater prominence over the medium-term as two-wheeler electric vehicles (EVs) are expected to become more popular which would pose a threat to the company's muffler business.

ICRA also notes the deterioration in the financial risk profile of MAIL as a result of debt-funded capex related to BS-VI transition, entry into new business and Indutch's new moulding plants as well as a sharp contraction in operating profit in FY2020 on account of negative operating leverage in the automotive industry and losses incurred in the new sheet metal business. While two-wheeler volumes are expected to be subdued in FY2021 by pandemic related disruptions in the first quarter, ICRA expects the volumes to remain healthy for the remaining fiscal. This recovery in volumes along with exit from a loss-making business in the current fiscal is likely to result in healthy cash accruals and gradual improvement in the overall credit metrics over the medium term, albeit with a delay in FY2021.

The Stable outlook on the long-term rating reflects ICRA's view that MAIL will continue to benefit from its long track record of operations, established relationship with HMCL and commitment to conservative financial policies. The company's cash accruals will be supported by recovery in two-wheeler volumes and are likely to be sufficient to meet repayment obligations.

## Key rating drivers and their description

### Credit strengths

**Strong business position** - MAIL is the sole supplier of mufflers to HMCL, which is the leader in the Indian two-wheeler industry. In addition, the company also supplies spoke rims and steel wheel rims to the two-wheeler OEM as well as fuel tanks to a PV OEM. It has been able to maintain its strong share of business with HMCL aided by its cost competitive manufacturing practices and ability to incur regular investments in setting up units in proximity to HMCL's plants. The company's expertise in manufacturing mufflers along with its established relationship with HMCL is likely to help it to maintain a majority share of business with the OEM, going forward.

**Technical collaboration supports product development capabilities** - MAIL enjoys technical collaborations with Lafranconi Italy S.p.A. for exhaust systems of two-wheelers as well as with Samsung Industries Ltd., South Korea, for fuel tanks of PVs. Such technical collaborations have helped MAIL to not only maintain a healthy share of business with its customers, but also to gain access to the latest technology in order to meet the evolving regulatory requirements.

**Criticality of product** – Mufflers, which drove ~81% of MAIL's consolidated revenues in FY2020, is a critical product for two-wheeler exhaust systems and has gained even greater importance following the BS-VI transition due to the increased complexity of the new technology. This has resulted in MAIL retaining its position as a preferred supplier to HMCL over the years, which is likely to continue further.

### Credit challenges

**High customer concentration risk** - HMCL accounted for ~83% of the total consolidated revenues of the company in FY2020. The contribution by new products segments and other OEMs remain negligible. However, the sole supplier status, its established track record and HMCL's market leadership position mitigates the client concentration risk to some extent. Taking cognizance of the high reliance on HMCL, the company has been working on a diversification strategy. As part of its initiatives, it acquired majority stake (68%) in Indutch, a company that develops and manufactures various composite products that find applications in sectors such as wind energy, railways, marine, industrial and aerospace. With a healthy order book position, Indutch is expected to grow at a fast pace over the medium term, allowing MAIL to diversify its earnings profile. MAIL had also begun supplying sheet metal components to a PV OEM; however, the same

did not materialise as per plans as the company decided to exit the business in the current fiscal after incurring losses. Going forward, the company's ability to profitably diversify its business profile will remain a key monitorable.

**Financial risk profile characterised by low operating margin** - With MAIL deriving ~81% of its consolidated revenues from the sale of mufflers, the operating margins remain low owing to the assembly type nature of operations. While the company had previously generated healthy core return on capital employed (core RoCE) in the range of 18-25% with optimal asset utilisation, the same declined to 4.8% in FY2020 because of volume moderation in the two-wheeler and PV segments. Further, with BS-VI compliant mufflers having a greater percentage of bought-out parts relative to previously manufactured mufflers, the company's operating margin (in percentage terms) is likely to remain lower over previous years. However, the operating profit (in absolute terms) is unlikely to be impacted by this transition.

**Pandemic related downturn in demand in the near term likely to delay improvement in credit metrics** - The national lockdown in April-May 2020 and local lockdowns thereafter have resulted in significant deterioration in the economic environment and consumer sentiments. While sequential recovery in two-wheeler wholesale volumes has been witnessed since the washout in Q1 FY2021 with monthly YoY sales growth turning positive since August 2020, the volumes for FY2021 are expected to remain subdued with ICRA expecting the wholesale dispatches to contract by 16-18% in FY2021 over the previous fiscal. This is likely to delay the expected improvement in the MAIL's capitalisation and coverage indicators, which witnessed some deterioration due to debt-funded capex during FY2019-FY2020.

### Liquidity position: Adequate

Despite expectation of lower cash flow generation from operations during the current fiscal due to disruptions caused by the pandemic, MAIL's liquidity profile remains **adequate** supported by sufficient buffer in its undrawn working capital limits, gradually improving cash flows with recovery in two-wheeler sales and limited debt repayment requirements. Over the past 12-months, the company's working capital facilities were utilised to the extent of 9% of sanctioned limits. Furthermore, the company also had Rs. 36.3 crore in cash and liquid investments at the end of March 2020. While the same were liquidated during H1 FY2021 to meet working capital requirements, comfort is drawn from the company's low leverage. ICRA expects the company to adequately service its annual debt repayment, which vary between Rs. 14-22 crore on a consolidated basis, over the next five years.

### Rating sensitivities

**Positive triggers** – A sustained improvement in the operational profile of the company through material diversification of its customers and product segments, while maintaining a healthy financial risk profile, could trigger a rating upgrade.

**Negative triggers** – A rating downgrade could be triggered if there is a significant deterioration in the operational profile of the company because of reduced share of business. Moreover, a prolonged weakness in the two-wheeler industry could further delay improvement in the financial profile of MAIL, and a rating downgrade could also be triggered by Debt/OPBDITA on a net level exceeding 2.0 times on a sustained basis.

## Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	<a href="#">Corporate Credit Rating Methodology</a> <a href="#">Rating Methodology for Auto Component Manufacturers</a>
Parent/Group Support	Not applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has consolidated the financials of Indutch Composites Technology Private Limited, given the ownership and close managerial linkages between them.

## About the company

Munjal Auto Industries Limited is a leading auto component manufacturing company in India with presence in components such as exhaust systems, spoke rims, steel wheel rims, fuel tanks, body-in-white (BIW) parts and other automotive assemblies. The company generated ~83% of its consolidated sales from two-wheeler OEMs, followed by the PV segment (4.5%) in FY2020. The company's major customer is HMCL, which drove 82.2% of the company's consolidated revenues in FY2020.

In terms of technical capabilities, MAIL enjoys technical collaborations with Lafranconi, Italy, for manufacturing exhaust systems of two-wheelers, as well as with Samsung Industries Ltd., South Korea, for manufacturing fuel tanks for PVs. As per the company, it is among the largest manufacturers of two-wheeler exhaust systems in the world, with a manufacturing capacity of close to 94.5 lakh systems annually.

The company has four manufacturing units, one each at Baroda (Gujarat), Bawal (Haryana), Dharuhera (Haryana) and Haridwar (Uttarakhand). Over the last few years, MAIL has added significant capacities to meet HMCL's increasing demand, with the latest unit being the one at Dharuhera. Additionally, MAIL has invested in additional lines at some of its other facilities. Currently, MAIL is the sole supplier of mufflers for HMCL's two-wheelers.

The company also has a 68% stake in Indutch Composites Technology Private Limited, a company engaged in developing and manufacturing various composite products that find applications in sectors such as wind energy, railways, marine, industrial and aerospace. This stake was acquired during Q1 FY2019 as part of MAIL's broader diversification strategy to reduce its customer concentration risk. The company currently has three operational units, two in Vadodara city (Halol and Waghodia), Gujarat, and one at Chennai. It primarily derives its revenues from manufacturing windmill blades and ancillary products. Its operating income in FY2020 was Rs. 97.1 crore, which is expected to scale-up further.

MAIL is a Hero Group company with the Satyanand Munjal family holding almost 75% stake in the company and the remaining being held by public shareholders. The chairman of the company is Mr. Sudhir Munjal and he is supported by his son, Mr. Anuj Munjal. Mr. Anuj Munjal is responsible for managing the daily operations of the company.

## Key financial indicators (audited)

	FY2019	FY2020*
Operating Income (Rs. crore)	1,216.9	1,240.3
PAT (Rs. crore)	37.3	3.7
OPBDIT/OI (%)	6.0%	4.0%
PAT/OI (%)	3.1%	0.3%
Total Outside Liabilities/Tangible Net Worth (times)	0.8	1.6
Total Debt/OPBDIT (times)	0.6	3.3
Interest Coverage (times)	17.2	4.1

\*In line with Ind AS-116 accounting, debt for FY2020 includes operating lease liabilities as well

## 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	FY2020		FY2019		FY2018
					23-Oct-2020	27-Sep-2019	17-May-2019	3-Aug-2018	20-Jun-2018	10-Jul-2017
1	Fund based/CC	Long Term	35.00	-	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)
2	Fund based TL	Long Term	80.18	80.20	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)
3	Fund based	Short Term	18.00	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
4	Non-fund based	Short Term	15.93	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
5	Unallocated	Long Term/Short Term	30.89	-	[ICRA]AA-(Stable)/[ICRA]A1+	[ICRA]AA-(Stable)/[ICRA]A1+	[ICRA]AA-(Stable)/[ICRA]A1+	[ICRA]AA-(Stable)/[ICRA]A1+	[ICRA]AA-(Stable)/[ICRA]A1+	[ICRA]AA-(Stable)/[ICRA]A1+
6	Commercial paper	Short Term	15.00	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+

Amount in Rs. crore; \*Outstanding as on 31-Mar-2020; standalone amount

## 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](http://www.icra.in)

### Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Cash Credit	NA	NA	NA	35.00	[ICRA]AA- (Stable)
NA	Term loan – 1	Apr-2014	NA	Dec-2021	2.92	[ICRA]AA- (Stable)
NA	Term loan – 2	Jan-2019	NA	Jun-2025	20.83	[ICRA]AA- (Stable)
NA	Term loan – 3	Nov-2013	NA	Dec-2020	3.44	[ICRA]AA- (Stable)
NA	Term loan – 4	Jun-2014	NA	Sep-2020	0.97	[ICRA]AA- (Stable)
NA	Term loan – 5	Jan-2019	NA	Jun-2025	29.54	[ICRA]AA- (Stable)
NA	Term loan – 6	Sep-2017	NA	Dec-2023	5.62	[ICRA]AA- (Stable)
NA	Term loan – 7	Sep-2019	NA	Dec-2025	16.86	[ICRA]AA- (Stable)
NA	Fund based	NA	NA	NA	18.00	[ICRA]A1+
NA	Non-fund based	NA	NA	NA	15.93	[ICRA]A1+
NA	Unallocated	NA	NA	NA	30.89	[ICRA]AA- (Stable)/ [ICRA]A1+
NA	Commercial Paper	Yet to be placed			15.00	[ICRA]A1+

Source: MAIL

### Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Indutch Composites Technology Private Limited	68.00%	Full Consolidation

## Analyst Contacts

### Subrata Ray

+91 22 6114 3408

[subrata@icraindia.com](mailto:subrata@icraindia.com)

### Shamsher Dewan

+91 124 4545 328

[shamsherd@icraindia.com](mailto:shamsherd@icraindia.com)

### Rohan Kanwar Gupta

+91 124 4545 808

[rohan.kanwar@icraindia.com](mailto:rohan.kanwar@icraindia.com)

### Pradyumna Choudhary

+91 124 4545 342

[pradyumna.choudhary@icraindia.com](mailto:pradyumna.choudhary@icraindia.com)

## Relationship Contact

### L. Shivakumar

+91 22 6114 3406

[shivakumar@icraindia.com](mailto:shivakumar@icraindia.com)

## MEDIA AND PUBLIC RELATIONS CONTACT

### Ms. Naznin Prodhani

Tel: +91 124 4545 860

[communications@icraindia.com](mailto:communications@icraindia.com)

## Helpline for business queries:

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

[info@icraindia.com](mailto:info@icraindia.com)

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## 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](mailto:info@icraindia.com)

Website: [www.icra.in](http://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,

Kolkata + (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008,

Bangalore + (91 80) 2559 7401/4049

Ahmedabad+ (91 79) 2658 4924/5049/2008

Hyderabad + (91 40) 2373 5061/7251

Pune + (91 20) 2556 0194/ 6606 9999

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