ICRA

January 06, 2017

Ashok Leyland Limited

Instruments*	Amount Rated (Rs. crore)	Rating Action
Non Convertible Debentures	400.0	[ICRA]AA (stable) / upgraded from [ICRA]AA- (stable)
Non Convertible Debentures	675.0	Rating withdrawn
Commercial Paper / Short term debt	900.0 (enhanced from 600.0)	[ICRA]A1+ / reaffirmed
Long term: Fund based limits (Note)	900.0	[ICRA]AA (stable) / upgraded from [ICRA]AA- (stable)
Long term: Loans (proposed)	55.0	[ICRA]AA (stable) / upgraded from [ICRA]AA- (stable)
Short term: Non-fund based limits (Note)	750.0	[ICRA]A1+ / reaffirmed
Short term: fund based limits (proposed)	200.0	[ICRA]A1+ / reaffirmed

**Instrument details are provided in Annexure-1*

Note: The ratings of [ICRA]AA (stable)/ [ICRA]A1+ shall be applicable depending on the usage of the facilities

Rating action

ICRA has upgraded the long term rating outstanding on the Rs. 400.0 crore non-convertible debenture (NCD) programme, Rs. 900.0 crore[1] fund based limits and Rs. 55.0 crore long term loans of Ashok Leyland Limited ("ALL" / "the company") from [ICRA]AA- (pronounced ICRA double A minus) to [ICRA]AA (pronounced ICRA double A)[2]. ICRA has also reaffirmed the short term rating of [ICRA]A1+ (pronounced ICRA A one plus) outstanding on the Rs. 900.0 crore (enhanced from Rs. 600.0 crore) Commercial Paper / Short term debt, Rs. 750.0 crore short term non-fund based limits and Rs. 200.0 crore proposed short term fund based limits of ALL. The outlook on long term rating is stable. ICRA has also withdrawn the [ICRA]AA- rating outstanding on Rs. 675 crore NCD programme, as the same has been redeemed by ALL.

Rationale

The upgrade in long term rating considers ALL's strong operational and financial performance (standalone) during FY2016 and H1 FY2017. Aided by its widening network and favourable replacement demand, ALL's standalone financial risk profile remains strong characterized by robust growth in operating income (up 38% YoY in FY2016, even though H1 FY2017 growth was muted-in line with the industry), healthy operating margins (at 11.5% during FY2016 and H1 FY2017), and comfortable capital structure and coverage indicators as on September 30, 2016. Improving demand outlook for Light commercial vehicles (LCV) segment, ALL's continued thrust on network expansion, cost rationalization initiatives undertaken, strong financial flexibility, and monetization of non-core assets and investments in recent years further underpin the ratings.

However, the ratings remain constrained by the inherently cyclical nature of the commercial vehicles (CV) industry, and heightened competition in the CV industry from both existing and new players. The ratings also factor in the weak performance of some of the investee companies, impacting ALL's consolidated credit profile. Going forward, ALL's ability to sustain its market share and standalone credit profile, limit its funding support to investee companies, monetize non-core assets and achieve early turnaround of operations at Hinduja Foundries Limited (which is being merged with ALL) are key rating sensitivities.

[1] 100 lakh = 1 crore = 10 million

[2] For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications

Key rating drivers

Credit Strengths

- Strong brand equity and market position as the second largest player in M&HCV segment
- Improvement in profitability and key debt metrics supported by volumes, fall in raw material costs, cost reduction measures and control over working capital
- Spend on capex and investments scaled down; divestments / write-offs in non-profitable ventures (JVs, associates, subsidiaries) are expected to augment consolidated credit profile
- Focus on exports and new product introduction to aid revenue growth

Credit Weakness

- High dependence on the inherently cyclical M&HCV industry; unsuccessful diversification into non-core segments
- Continued investment requirement in subsidiaries / JVs; ability to make them self-sustaining will be crucial
- Likely peaking of M&HCV demand, which could affects sales volumes in near term

Description of key rating drivers highlighted above:

ALL is the second largest player in the Medium and Heavy Commercial Vehicle (M&HCV) segment. The company's sales volumes (domestic + exports) in the M&HCV segment grew by 41.3% in FY2016 (ahead of the industry growth rate of 28.2%); however sluggish freight demand and uncertainty regarding implementation of Goods and Sales tax is affecting volume growth in current fiscal (1.6% in 8m FY2017 against muted industry growth of 2.5%). Pre-buying ahead of the proposed implementation of BS-IV emission norms from April 2017 is expected to support volumes during Q4FY2017 although the impact of demonetization may moderate the growth to an extent. Aided by strong improvement in volumes, ALL's market share in the M&HCV segment witnessed an improvement from 28.5% in FY2015 to over 32% in 8m FY2017. With higher volumes, ALL's operating margins also expanded sharply from 7.6% in FY2015 to 11.5% in FY2016; also supported by cost rationalization efforts and lower commodity prices.

Over 10% of ALL's total sales volumes in the M&HCV segment are exported, key destinations being Sri Lanka, Bangladesh, Middle East and Africa. ALL is also looking for newer markets in Latin America and increasing penetration in existing markets with a targeted double digit growth on exports over the medium term. While the higher revenue share from the M&HCV segment exposes ALL to risks of inherent cyclicality in the industry, the company's revenue diversification initiatives with defence and exports is expected to insulate the impact to an extent; that said, ALL's ability to record meaningful growth will be crucial to diversification of its revenue streams.

In the past few years, ALL stepped up efforts towards product diversification through investment in joint ventures and associates; major portion of the investments were debt funded. These investments were aimed at - a) strengthening financing and technological capabilities in CVs, b) increasing ALL's penetration in LCVs, and c) achieving business diversification. Accordingly, ALL made significant investments in recent years in an attempt to de-risk its product portfolio and attain geographical diversity. However, performance of some of the key investee entities was weak due to demand slowdown leading to delay in achieving break-even volumes and increasing funding requirements from ALL. Cumulatively, ALL had wrote-off / provided for investment write-down of over Rs. 1.0 billion in FY2015 and FY2016; the key investee entities being: (i) Ashok Leyland John Deere Construction Equipment Company P Ltd, (ii) Ashok Leyland Nissan Vehicles Ltd, (iii) Nissan Ashok Leyland Powertrain P Ltd, (iv) Nissan Ashok Leyland Technologies P Ltd, (v) Albonair GmbH, and (vi) Optare Plc. In view of market conditions and the requirement to fund the ailing group concerns, ALL prudently scaled down its capex and investments.

In the current fiscal, ALL bought out the stake held by Nissan Motor Co. Limited in three JVs projects, namely Ashok Leyland Nissan Vehicles Limited, Nissan Ashok Leyland Powertrain P Limited, and Nissan Ashok Leyland Technologies P Limited (at a price of Re.1/- for the entire stake in each Company). ALL also announced merger of its group company, Hinduja Foundries Limited {*HFL, rated [ICRA]BBB(SO) / rating watch with positive implications*}, with itself with effect from October 1, 2016 through a share swap arrangement (subject of regulatory and shareholders' approval). While both the transactions are targeted at providing long term operational synergies, HFL is expected to require support from ALL towards loss funding, potential payout towards voluntary retirement scheme, and any capex related spend.

Going forward, ALL’s ability to sustain its market share and standalone credit profile, restrict its funding support to investee companies and achieve early turnaround of operations in Hinduja Foundries Limited (which is being merged with ALL) are the key rating sensitivities.

Analytical approach:

Links to applicable Criteria
Corporate Credit Rating - A Note on Methodology
Rating Methodology for Commercial Vehicle Industry

About the Company:
Ashok Leyland Limited (“ALL” / “the company”) is the second-largest manufacturer in the Medium and Heavy Commercial Vehicles segment in India. The Company is the flagship entity of Hinduja Group. ALL operates from six manufacturing locations with a total capacity of 150,500 units and its key products include buses, trucks, engines, and defence & special vehicles. ALL operates from six locations – one at Ennore (Chennai), two at Hosur, assembly plants at Alwar (Rajasthan) and Bhandara (Maharashtra) and one at Pantnagar (Uttarakhand). ALL's product range constitutes a range of commercial vehicles, buses, defence and special application vehicles including fire-fighters at international airports and diesel engines for industrial, genset and marine applications.

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating History for last three years:
Table: Rating History

S. No.	Name of Instrument	Current Rating			Chronology of Rating History for the past 3 years				
		Type	**Rated amount (Rs. Crores)**	**Month - year & rating**	**Month - year & Rating in FY2016**	**Month - year & Rating in FY2015**	**Month - year & Rating in FY2014**		
				Jan 2017	**May 2015**	**July 2014**	**Sep 2013**	**Jun 2013**	**Jan 2013**
1	NCD	Long term	400 (reduced from 1075)	[ICRA]AA (Stable)	[ICRA]AA- (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]AA- (negative)	[ICRA]AA- (negative)
2	CP	Short term	900 (enhanced from 600)	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
3	Fund based	Long term	900	[ICRA]AA (Stable)	[ICRA]AA- (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]AA- (negative)	[ICRA]AA- (negative)
4	Term loans (proposed)	Long term	55	[ICRA]AA (Stable)	[ICRA]AA- (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]AA- (negative)	[ICRA]AA- (negative)
5	Non-fund based	Short term	750	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
6	Fund-based (proposed)	Short term	200	[ICRA]A1+	[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

Details of Instruments

Name of the instrument	Date of issuance	Coupon rate	Maturity Date	Size of the issue (Rs. Cr)	Current Rating and Outlook
Fund based - cash credit	-	-	-	900.00	[ICRA]AA (Stable)
Non-Convertible debenture-1	28/6/2012	10.20%	28/6/2017	100.00	[ICRA]AA (Stable)
Non-Convertible debenture-2	28/12/2012	10.15%	28/12/2017	150.00	[ICRA]AA (Stable)
Non-Convertible debenture-3	21/6/2013	9.60%	21/6/2018	150.00	[ICRA]AA (Stable)
Term Loans (proposed)	-	-	-	55.00	[ICRA]AA (Stable)
Fund based (proposed)	-	-	-	200.00	[ICRA]A1+
Non-fund based	-	-	-	750.00	[ICRA]A1+
Commercial paper	-	-	-	900.00	[ICRA]A1+

Source: ALL

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