March 25, 2020

Ashok Leyland Limited: Long-term rating downgraded to [ICRA]AA (negative); short-term rating reaffirmed at [ICRA]A1+

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term: Fund-based working capital limits	900.00	2,000.00	[ICRA]AA (negative); downgraded from [ICRA]AA+; outlook revised from stable
Long-term: Term loans	-	500.00	[ICRA]AA (negative); assigned
Short-term: Non-fund based limits	750.00	1,200.00	[ICRA]A1+; Reaffirmed
Short-term: Unallocated	255.00	-	-
Long-term: Non-convertible debenture	-	600.0	[ICRA]AA (negative); assigned
Short-term: Commercial paper	2,000.00	2,000.00	[ICRA]A1+; Reaffirmed
Total	**3,905.00**	**6,300.00**	

**Instrument details are provided in Annexure-1*

Rationale

The rating action considers the expected deterioration in Ashok Leyland Limited's (ALL) financial risk profile over the medium term with the longer than expected slowdown in domestic commercial vehicle (CV) industry and ALL's increasing investment outlay in group entities. Demand sentiments remain weak amidst factors like slowing economic growth, surplus capacity, likely impact of COVID-19 on end user industries etc. This coupled with the higher than expected increase in debt-funded investments in group entities {including ~Rs. 390 crore in NBFC-arm, Hinduja Leyland Finance Limited (HLFL)} is likely to impact ALL's debt coverage indicators over the next three to four quarters.

ALL's dependence on the medium and heavy commercial vehicle (M&HCV) industry continues to be high despite some successful attempts at de-risking into light commercial vehicles (LCV). ALL's sales volumes declined by 39% in the M&HCV segment and 6% in the LCV segment during 11m FY2020. To minimise the impact, the company has taken various cost control and stock correction measures, which supported by healthy financial flexibility with lenders is likely to mitigate the impact to an extent. The ratings remain tempered by vulnerability of ALL's earnings to the inherent cyclicality in the CV industry, stiff competition in the industry, and subdued performance of few subsidiaries and group entities, necessitating continuous funding requirement. The ratings also consider ALL's position as second largest player in the domestic M&HCV segment, its long operational track record, experienced management team, strong brand recall, product and technological capability and well-diversified network. The ratings also favourably consider ALL's comfortable capital structure and strong liquidity position supported by healthy growth in revenues and earnings over the last three years (ending FY2019).

Key rating drivers and their description

Credit strengths

Strong operational profile - ALL, by virtue of its long-standing presence, diversified product portfolio, strong brand recall, well-diversified network presence, product and technological capability and its products finding application across key end-user industries, is a dominant player in the domestic M&HCV industry with a market share of 34% in FY2019. ALL's market share declined to 32% in 11M FY2020 amidst intense competition. Over the last one decade, ALL has transformed from a South-centric to a pan-India player and holds a strong market share in most of the geographies that it operates in. Aggressive network expansion in non-south markets, strong brand outreach, new product launches, increased acceptance of its engines and technology, and strong servicing capabilities aided its market share gains. With the current transition to new emission norms (BS-VI) with effect from April 1, 2020 and its focus on new modular platform wherein it would work on a made-to-order production system, ALL expects to improve the market share with launch of more variants (in M&HCV, LCV and export segments), although vehicle pricing will be a key monitorable.

Comfortable credit metrics - ALL's performance in the last three years (ending FY2019) was strong, supported by healthy demand from core industries, pickup in construction activities as well as pent-up demand post transition to Goods and Service Tax (GST). This coupled with turnaround in its key investee companies (especially the LCV-related subsidiaries[1]) supported the improvement in ALL's credit profile. ALL's financial profile is characterised by comfortable capital structure and strong liquidity position supported by healthy growth in revenues and earnings in the last three years (ending FY2019). The standalone and consolidated gearing is estimated at 0.4x (standalone) and 0.6x (consolidated excluding NBFC related business) as of March 2020. The company's liquidity position is supported by Rs. 1,700 crore of cash balances (as of January 2020) and sanctioned fund-based lines of Rs. 2,000 crore, on which the utilisation has been minimal.

Credit challenges

Vulnerability of earnings to the cyclicality and competition in CV industry - With over 85% of standalone revenues being derived from CV sales (in FY2019), ALL's dependence on the inherently cyclical CV industry is high with close linkages of demand to economic development, industrial growth, investments in infrastructure and regulatory changes (emission norms, scrappage policy etc). CV demand has been sluggish in the last 18 months affected by slowing economic growth, revision in axle load norms, tightened lending environment and rise in operating costs impacting small fleet owners. ICRA expects the CV demand to remain subdued in FY2021. Also, the industry is characterised by intense competition with elevated pricing pressure from major players. ALL's ability to maintain its market share and earnings profile and debt protection metrics will be key credit monitorable.

Around 88% and 91% of consolidated revenues and net profits respectively was derived from its standalone operations in FY2019. Due to the slowdown, ALL's standalone revenues de-grew by ~32% while operating and net profits had declined by 54% and 78% respectively during the period Apr-Dec 2019. While the company has undertaken several cost control and stock corrective measures, the effect of lower revenues and higher dividend pay-out affected the cash accruals during 9M FY2020. During FY2020, the company paid out dividend of Rs. 1,093 crore and has declared an interim dividend of Rs. 0.5 per share in March 2020 (subject to approval of shareholders) taking the total pay-out to ~Rs. 1,270 crore. ALL has scaled down its standalone capital expenditure (capex) from Rs. 1,800 crore to ~Rs. 1,300 crore for FY2020; while the investment spend in its group entities is estimated at ~Rs. 600 crore (including ~Rs. 390 crore in NBFC-arm, HLFL). For FY2021, the cumulative spend on capex and investments is expected to be less than Rs. 700 crore.

Increased investment in group companies and subdued performance of key investee entities - Over the years, ALL has written off/closed several loss-making ventures and remains open to further pruning of investments, if required. While the funding support to the investee company have gradually reduced in recent years, the performance of few key investee entities remains subdued (especially Optare PLC and Ashok Leyland (UAE) LLC).

Breaking away from past trends, the company is increasing its stake in its NBFC arm during March 2020. Given the current market conditions, this investment is entirely debt funded. This coupled with subdued performance of key

[1] Ashok Leyland Vehicles Limited, Ashley Powertrain Limited and Ashok Leyland Technologies Limited were merged with ALL in FY2019

investee entities like (Optare PLC, Albonair GmBH, Ashok Leyland (UAE) LLC) will result in moderation of consolidated earnings and debt coverage indicators over the next few quarters. Nevertheless, some of these investments are aimed at strengthening technological capabilities and achieving business and geographical diversification. The ability of these investee entities to achieve self-sustenance and support the consolidated cash flows will remain critical credit monitorables.

Liquidity position: Strong

ALL's liquidity is **strong** with cash and liquid investments of over Rs. 1,700 crore as of January 2020, and sanctioned fund-based lines of Rs. 2,000 crore, on which the utilisation has been minimal. The company primarily uses the low-cost commercial paper (Rs. 2,000 crore) for funding its working capital requirements. While the ongoing slowdown shall restrict the operational cashflows in near-term, the same is likely to improve over the medium term.

Rating sensitivities

Positive triggers: Negative outlook on the long-term rating currently restricts an upgrade in the rating. Sustained improvement in earnings, cashflows and debt coverage metrics supported by a faster than expected revival in demand shall support a favourable rating action.

Negative triggers: Downward pressure on the rating could arise with sharp deterioration in ALL's financial profile affected by longer than expected recovery in demand scenario, high debt funded capital expenditure/investment in group companies or dividend payouts.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Commercial Vehicle Industry
Parent/Group Support	Not Applicable
Consolidation / Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of ALL, excluding the NBFC-subsidiary - Hinduja Leyland Finance Limited (HLFL). However, the analysis considers the ongoing and future funding support likely to be extended by ALL to HLFL.

About the company

ALL is the second-largest manufacturer in the M&HCV segment in India. ALL is the flagship entity of the Hinduja Group. ALL's key products include buses, trucks, engines, defence and special vehicles. It has manufacturing plants located in Ennore (Tamil Nadu), Hosur (Tamil Nadu), Alwar (Rajasthan), Bhandara (Maharashtra), and Pantnagar (Uttarakhand). In FY2019, ALL merged its wholly-owned LCV-related subsidiaries namely Ashok Leyland Vehicles Limited, Ashley Powertrain Limited and Ashok Leyland Technologies Limited with itself to have operational synergies and greater flexibility in decision making.

Key financial indicators (audited)

	Standalone		Consolidated#	
	FY2018	FY2019	FY2018	FY2019
Operating Income (Rs. crore)	26,356.4	29,055.0	29,635.6	33,196.8
PAT (Rs. crore)	1,717.7	1,983.2	1,813.8	2,194.6
OPBDIT/OI (%)	11.2%	10.8%	14.3%	14.8%
RoCE (%)	30.8%	30.9%	17.4%	16.8%
Total Outside Liabilities/Tangible Net Worth (times)	1.4	1.2	3.0	3.0
Total Debt/OPBDIT (times)	0.4	0.2	3.7	3.9
Interest Coverage (times)	20.1	44.6	3.5	3.3
DSCR	2.6	4.2	1.0	0.9

Source: ALL, ICRA research; OPBDITA: Operating Profit before Depreciation, Interest and Taxes; PAT: Profit after Tax; RoCE: Return on Capital Employed

#Consolidated includes NBFC; however, the NBFC numbers has been excluded for analysis purpose

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2020)						Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	FY2020			FY2018		FY2017
					25-March 2020	26-July 2019	29-April 2019	30-March 2018	28-Sep 2017	06-Jan 2017
1	Commercial paper	Short term	2,000	NA	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
2	Non-convertible Debenture	Long term	195.0	195.0	[ICRA]AA (negative)	-	Withdrawn	[ICRA]AA (positive)	[ICRA]AA (stable)	[ICRA]AA (stable)
3	Fund based limits	Long term	2,000	NA	[ICRA]AA (negative)	[ICRA]AA+ (stable)	[ICRA]AA+ (stable)	[ICRA]AA (positive)	[ICRA]AA (stable)	[ICRA]AA (stable)
4	Term loans	Long term	500.0	500.0	[ICRA]AA (negative)	-	-	[ICRA]AA (positive)	[ICRA]AA (stable)	[ICRA]AA (stable)
5	Non-fundbased limits	Short term	1,200	NA	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
6	Fund based limits	Short term	0.0	NA	-	-	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
7	Unallocated	Short term	0.0	NA	-	[ICRA]A1+	[ICRA]A1+	-	-	-

Amount in Rs. crore

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/WCDL	-	-	-	2,000.00	[ICRA]AA (negative)
NA	Non-fund based	-	-	-	1,200.00	[ICRA]A1+
NA	Commercial paper	-	~6%	7-365 days	2,000.00	[ICRA]A1+
NA	Term loans	Sep 2020	~8%	FY2026	500.0	[ICRA]AA (negative)
NA	NCD	NA	NA	NA	600.00	[ICRA]AA (negative)

Source: ALL

Annexure-2: List of entities considered for consolidation (as of 31.03.2019)

Company name	Ownership	Consolidation Approach
Subsidiaries		
Global TVS Bus Body Builders Limited	66.67%	Full consolidation
Gulf Ashley Motor Limited	92.98%	Full consolidation
Optare Plc and its subsidiaries	99.11%	Full consolidation
Ashok Leyland (Nigeria) Limited	100.00%	Full consolidation
Ashok Leyland (Chile) SA	100.00%	Full consolidation
HLF Services Limited	82.38%	Full consolidation
Albonair (India) Private Limited	100.00%	Full consolidation
Albonair GmbH and its subsidiary	100.00%	Full consolidation
Ashok Leyland (UAE) LLC and its subsidiaries	100.00%	Full consolidation
Ashley Aviation Limited	100.00%	Full consolidation
Joint ventures		
Ashley Alteams India Limited	50.00%	Equity method
Hinduja Tech Limited	62.00%	Equity method
Associates		
Ashok Leyland Defence Systems Limited	48.49%	Equity method
Mangalam Retail Services Limited	37.48%	Equity method
Lanka Ashok Leyland Plc	27.85%	Equity method

Note *- Ashok Leyland Vehicles Limited, Ashley Powertrain Limited and Ashok Leyland Technologies Limited (erstwhile subsidiaries) were merged with ALL in FY2019*

Analyst Contacts

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

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

Sri Kumar K
+91 44 4596 4318
ksrikumar@icraindia.com

Relationship Contact

L Shivakumar
+91 22 2433 1084
shivakumar@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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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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