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ANALYST CONTACTS

Mr. Shamsher Dewan

Senior Vice President
+91 124 4545 328
shamsherd@icraindia.com

Mr. Srikumar Krishnamurthy

Senior Vice President
+91 44 4596 4318
ksrikumar@icraindia.com

Mr. Rohan Kanwar Gupta

Vice President
+91 1245 4545 808
rohan.kanwar@icraindia.com

This rating methodology updates and supersedes ICRA's earlier methodology document on this subject, published in June 2021. This revised version incorporates a few modifications intended to provide additional clarity on how ICRA assesses various factors relevant for the credit assessment of passenger vehicle (PV) Original Equipment Manufacturers (OEMs). As an example, this version more fully explains how ICRA assesses the product portfolio strengths of PV OEMs. That said, ICRA's overall approach to rating PVOEMs remains materially similar. Also, a section has been added to provide a broad perspective on how environmental, social and governance (ESG) risks are incorporated by ICRA in its credit assessments.

Overview

With an annual production of 3.9 million units in FY2023, the Indian PV industry was the third largest in the world. Based on the Society of Indian Automobile Manufacturers' (SIAM's) classification, the PV industry is broadly classified under three sub-segments—i.e., i) passenger car (PC) segment, ii) utility vehicle (UV) segment and the iii) van segment.

Small cars (hatchbacks and compact sedans) account for a majority of the volumes within the PC segment. They primarily cater to price sensitive customers who have requirements of high fuel efficiency and low operating costs. With this segment constituting a large share of the domestic PC market, competitively priced product offerings augur well for volume sales of original equipment manufacturers (OEMs).

To price their products competitively, the OEMs have developed India-specific platforms (e.g., vehicles with sub four-metre length) that attract lower tariff—the benefit of which gets eventually passed on to the customers. ICRA believes that an OEM's ability to adapt its product portfolio, in line with the evolving regulatory structure and customer preference is important to sustain its position in the market.

Rating Methodology

This rating methodology explains ICRA's approach to assessing the business and financial risk profiles of companies in the PV industry. This rating methodology aims to help entities, investors and other interested market participants understand ICRA's approach in analysing quantitative and qualitative risk characteristics that are likely to affect the ratings of PV manufacturers. This methodology does not include an exhaustive treatment of all factors that are reflected in the ratings but enables the reader to understand the rating considerations that are usually the most important. ICRA's risk analysis framework for PV entities can be broadly divided into the following elements:

Industry Risk Assessment

- Growth prospects
- Cyclicity
- Competitive intensity
- Regulatory/ Policy risk

Business Risk Analysis

- Scale
- Market position and brand strength
- Product portfolio
- Technology and product development capabilities
- Sales & service network
- Extent of localisation
- Geographic Diversification

Financial Risk Analysis

- Profitability Metrics
- Leverage and Coverage indicators
- Cash Flows and Liquidity Profile
- Capital Expenditure and Investment Plans
- Tenure Mismatches and Risks Relating to Interest Rates and Refinancing
- Foreign Currency Risk
- Consolidated Financial Analysis

Other Elements of Credit Risk Assessment

- Parentage/ Group Support
- Financing Availability/Captive Financing
- Financial Flexibility
- Debt Servicing Track Record
- Contingent Liabilities and Off-balance Sheet Exposures
- Event Risk
- Asset Concentration Risk

Management Quality and Corporate Governance**Assessment of Environmental, Social and Governance (ESG) Risks**

- Environmental (E) and Social (S) Risks
- Governance Practices

Industry Risk Assessment

Growth prospects

Growing urbanisation and strong replacement demand, coupled with low PV penetration levels in relation to several other emerging markets and an under-developed public transport system, are factors that are likely to support the growth prospects for the industry. Despite the demand disruption caused by the pandemic and ensuing supply shortages (in particular shortage of semiconductor chips), structural positive factors like high financing penetration, increasing urbanisation and low PV penetration level have aided the industry in recording a robust growth in FY2023, with volumes reaching all-time high level of ~3.9 mn units (~27% YoY growth). Even as the growth is expected to moderate on account of the high base, these structural positive factors are likely to continue to aid the industry's growth prospects.

Cyclical

In comparison to other automotive segments like commercial vehicles or tractors, the domestic PV industry is less cyclical, which lends comfort to the overall credit profile of PV manufacturers. Despite increasing acceptability of premium variants/models in recent years, a sizeable share of PV sales comes from entry level cars with a price sensitive clientele. This makes the industry's demand prospects highly dependent on consumer income sentiments that are inter-alia linked to the performance of both the rural as well as the urban economy. Thus, adoption of prudent business and financial risk policies remain essential for a PV OEM to reduce vulnerability to periods of downturn in demand. ICRA assesses an OEM's risk mitigation strategies and financial resilience to evaluate their preparedness for periods of cyclical demand downturn.

Competitive intensity

The Indian PV market comprises several well-established domestic and international OEMs. Although OEMs with a foreign parentage benefit from their technical expertise, product portfolio and the experience of their parent, besides financial support, they are still required to establish a domestic distribution network and gain local market understanding to develop products suited to the local market.

The domestic PV industry is dominated by select OEMs, with the top five OEMs collectively enjoying over 85% market share. A significant part of the market is exposed to price-based competition, both because of a price sensitive customer profile as well as the OEMs' pursuit of the market share metric. Given the price sensitivity of a large segment of the domestic market, an OEM's pricing strategy influences its market position, particularly in the mass market segment. Thus, OEMs with established brands that come with demonstrated performance and low operating cost efficiency are more likely to withstand the aggressive pricing strategies employed by competitors. While the customer base for the mass market segment remains sensitive to changes in ownership costs, the demand for premium segment offerings is relatively less price sensitive. Yet, this does not imply that competitive intensity in the premium segment is low—only that the drivers of competition are different and relate to performance attributes and brand strength.

Despite increasing competitive intensity from international players over the past decade, the incumbents have been able to maintain their healthy market positions, supported by their strong brand franchise, well-established distribution networks and wide product portfolios. Incumbents as well as new players continue to make sizeable investments towards new product development and R&D to address changing customer preferences and regulatory requirement.

Regulatory/ Policy risk

Over the past few years, there have been multiple changes in regulatory norms, particularly relating to computation of insurance cost, implementation of emission norms and safety standards, resulting in some level of volatility in demand closer to the switching date; examples of the same are changes in mandatory third-party liability cover and personal accident cover insurance norms in September 2018 and switch over to Bharat Stage VI emission norms (Phase 1 in April 2020 and Phase 2 in

April 2023). In the coming years, besides tighter emission and safety standards, policies encouraging adoption of alternative fuel or electric-powered vehicles (EVs) are likely. While an OEM's ability to comply with changing norms will be largely dependent on its ability to invest in building technological and product development capabilities as well as in setting up incremental capacities, as required, the timelines for implementing them also remain a key sensitivity.

Business Risk Assessment

Scale

An entity's scale, as measured by its revenues, is one of the key drivers of business strength and operating flexibility. Large scale of operations generally reflects greater market penetration, improved bargaining power and higher purchasing efficiencies, while enhancing the business attractiveness for various stakeholders, including employees, customers and investors. Effectively, a large scale enables better cost absorption and greater ability to offer competitive pricing to buyers.

A sustained revenue growth above the industry average is considered as a strong credit positive, indicating an increase in revenue market share, or improved realisations supported by new product launches or a more favourable product mix. Conversely, a decline in revenues during a period of positive industry growth generally indicates declining market share, either due to increased competitive intensity in the market or due to the OEM's inability to introduce new products in line with consumer requirements.

While analysing an OEM's revenue growth, ICRA tries to evaluate the increase in volumes and realisations separately. Increase in volumes above the industry average indicates improvement in market share and is a credit positive; though the same is viewed in tandem with movement in realisations. Declining realisations could indicate aggressive pricing strategies employed by the OEM or entry into low-priced segments, which could impact the profitability of the company. At the same time, if revenue growth is accounted for by improvement in realisations, the reasons for the same and the sustainability are evaluated. Change in product mix towards higher-priced products is considered as a credit positive, as the same generally supports improvement in profitability.

Some OEMs manufacture engines/powertrains and supply to other OEMs which support their scale of operations. Additionally, there is also a prevalence of OEM-to-OEM partnerships in terms of platform-sharing, technology-sharing, and rebadging, with a view to mitigate product development risks, while supporting the scale of operations.

Market position and brand strength

The market share of an OEM is assessed along with the competitive intensity and growth outlook for the industry. With the top five players in the Indian PV market accounting for more than 85% of the domestic volumes (FY2023), the market is largely concentrated with a few OEMs.

Given the price sensitivity of a large segment of the domestic market, an OEM's pricing strategy is crucial for its market share. Regular product launches and a higher product renewal rate allow an OEM to meet changing consumer preferences and retain or improve its market share. A PV OEM who regularly refreshes its product profile by offering variants of its existing models, across price points is better equipped to maintain its market share. An OEM deriving sales from single brand/product is relatively more vulnerable to competition as well as changing customer preferences, compared to another player with a relatively diversified and stable product mix. The strength of proven brands and the associated customer loyalty serves as an entry barrier. The ratings factor in the manner in which an OEM nurtures its brand through above-the-line promotions and other investments, while attracting both repeat buyers as well as first-time buyers. The OEMs who offer established brands with demonstrated performance and low operating cost efficiency are more likely to withstand competitive pressures.

Product portfolio

ICRA considers the strength of an OEM's product portfolio as a key driver of its ability to sustain a competitive business position in the market. The strength of an OEM's product portfolio is largely determined by the diversity of its offerings across segments and powertrains.

A healthy presence across various market segments such as compact, sedans and utility vehicles is factored in positively while assessing the strength of an OEM's product portfolio. Product offerings targeted at the mass market segment, if accepted well, are more likely to garner higher sales volumes than premium offerings; over the recent past, an increasing preference for the UV segment has been playing out, aided by factors such as advent of the entry level utility vehicle segment, higher ground clearance and wheelbase aiding drive quality, higher seating position aiding view of the road ahead, ample storage space etc. The OEMs which have a wider portfolio of offerings across segments are likely to exhibit less vulnerability to demand variations and competitive intensity in any specific segment. Additionally, presence across segments also helps the OEM to better tap growth opportunities and benefit from changing customer preferences towards a specific segment, even if another segment faces headwinds.

A healthy contribution of alternative fuel powertrains to overall sales is factored in favourably, given the ongoing emphasis on reducing vehicle emissions. Given the stringent regulatory measures for diesel vehicles (limitations on period for usage of diesel vehicles across certain cities) and disproportionate increase in their prices post revision in emission norms, the OEMs with large dependence on diesel vehicles were adversely impacted. Consequently, an OEM with the flexibility to shift its production in line with demand dynamics can protect its market share in the wake of changing customer preferences or regulatory developments. A PV OEM with a healthy presence across alternative fuel powertrains (CNG, electric as well as hybrid vehicles) remains better placed to meet the desired emission standards and the same is considered as a credit strength.

Technology and product development capabilities

An OEM's technological capabilities and research and development (R&D) focus determine its ability to introduce new products and meet the latest technological and regulatory requirements. With increased customer expectations of power, usability and safety features in new models, it is imperative for an OEM to regularly invest in R&D and enhance its technological capabilities to keep up with changing trends in the market. Moreover, the increasing thrust towards cleaner vehicles and adoption of EVs and hybrids vis-à-vis conventional petrol or diesel power vehicles also poses a medium to long-term challenge for PV manufacturers dependent on conventional vehicles.

The evolving regulatory requirements regarding emission norms and safety regulations also necessitate constant upgradation and adaptation of vehicles in a cost-efficient manner. In this respect, wherever possible, ICRA tries to evaluate an OEM's technology tie-ups (including parent support) for product design and engineering, and its in-house R&D capabilities. Investments in R&D and product development also serve as indicators of the OEM's focus on improving its product development capabilities, and its ability to develop new products. In addition, with the increasing potential of export markets, the OEMs' product development capabilities become more critical, given the need to develop products suited to diverse market demands.

Sales & service network

An extensive sales and service network is a key determinant of the OEM's reach and competitive position. Such a network enables higher visibility and stronger brand recall; it also provides access to service outlets and spare parts, thereby improving after-sales service and increasing customer loyalty. Given the time and investment required in building an extensive network, it acts as a strong barrier against new entrants and supports incumbent OEMs in preserving their market share. Viability of dealerships is also important for an OEM to sustain growth and market share in the longer term. In certain instances, the OEMs also provide support to their dealers in the form of lenient credit periods and attractive financing cost against the backdrop of sub-optimal volumes or dwindling market share.

Extent of localisation

Most domestic OEMs outsource their component manufacturing, which enables them to focus on key activities like product design and development, critical manufacturing processes, final assembly, and marketing and distribution. Component outsourcing enables greater flexibility to the OEM during both downturns and peak demand periods. A strong vendor network also enables the OEM to work on a lean working capital cycle, with just-in-time (JIT) supplies.

Given the dependence of OEMs on their ancillaries, their relationships with each other are also critical for maintaining disruption-free production and new product development. ICRA notes that component suppliers in these engagements need to invest in capacity expansion in line with the OEM's plans. ICRA also takes into consideration the joint efforts of the OEM and its vendors in product development and manufacturing efficiencies to meet targets for annual cost reductions. ICRA evaluates the extent of localisation in the sourcing of the OEM, and its dependence on foreign suppliers. High dependence on imports exposes the OEM to foreign exchange fluctuations and import duty structure, which also impacts its pricing strategy, competitive positioning and inventory requirements. ICRA, hence, evaluates the OEM's localisation plans and its likely impact on profitability.

Sometimes, the OEMs make strategic investments in component vendors in the form of direct ownership or through investments by group entities. Such backward integration initiatives, especially for manufacturing critical components, significantly mitigates business risks for the OEM by enabling greater control and ensuring relatively lesser disruption in production.

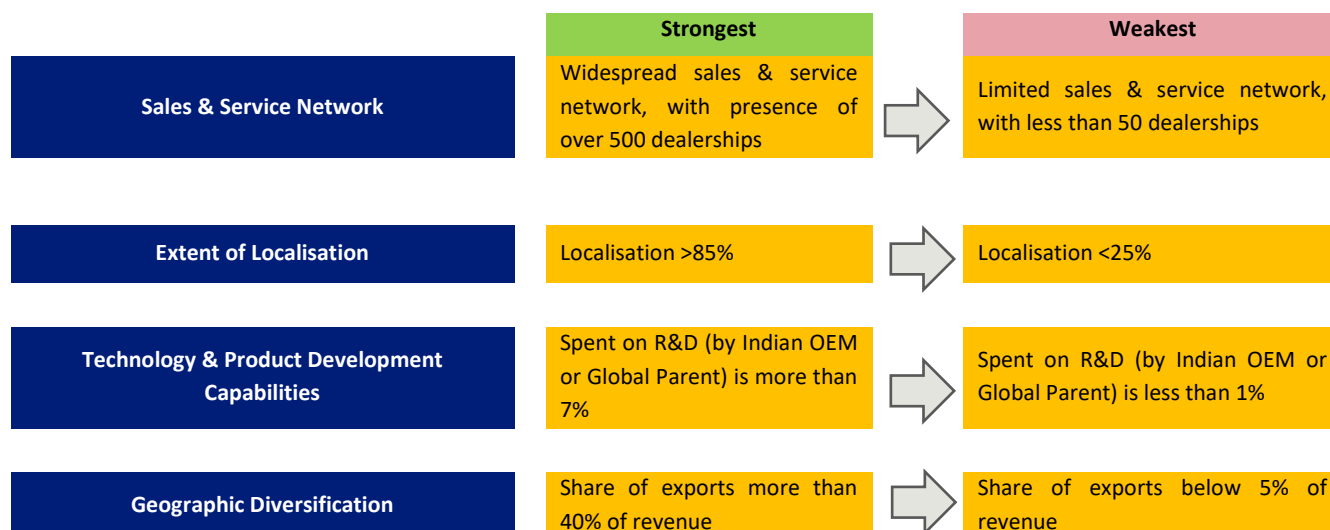
Geographic Diversification

The PV industry in India still continues to be characterised by lower penetration levels than developed markets. While the urban segment accounts for a majority share of the domestic PV sales, the rural segment also has a sizeable (~35-40%) share in the domestic PV sales, especially in hatchbacks as well as the UV segment. An OEM with a presence in geographically diverse areas is less vulnerable to demand downturns in any specific region. Additionally, presence in regions with relatively low PV penetration (e.g., rural areas) augurs well for volume growth. ICRA tries to evaluate on a best effort basis an OEM's dependence on select states/regions and the impact of the same on its growth prospects.

ICRA also factors in an OEM's presence in the overseas markets, and the share of export sales in its revenues. Several OEMs have developed the Indian market as an export hub for small cars, which has also helped them improve the overall capacity utilisation, despite weak domestic demand for their products. A healthy presence in export markets as well as domestic markets diversifies revenue streams and generally lends stability to its overall revenue.

Summary of the Salient Business Risk Factors

	Strongest		Weakest
Scale	> Rs. 30,000 crore	➡	Revenue < Rs. 3,000 crore
Market position and brand strength	Market Share > 20%	➡	Market Share < 2%
Product portfolio – Segment-wise mix	Presence across all three segments with at least 30% revenues each from two segments	➡	Significant dependence on a single segment
Product portfolio - Powertrain mix	Contribution of alternative fuels to overall sales > 20%	➡	Contribution of alternative fuels to overall sales < 5%



Financial Risk Assessment

The various financial metrics assessed by ICRA could be divided into four categories—viz., Profitability, Leverage, Coverage and Liquidity. This document provides a brief summary of why ICRA considers these ratios to be important. For a more detailed description, readers may refer to the note titled, *Approach for Financial Ratio Analysis*, published on ICRA's website. Depending on the uncertainty around how the various credit drivers could evolve in the future, ICRA also carries out sensitivity analyses to assess the impact of key variables on various financial metrics.

Profitability

An entity's ability to sustain profitability through a business cycle is one of the key factors that ICRA incorporates in its analysis to differentiate between rated entities. The profitability of an OEM is a function of its scale of operations, level of localisation, pricing ability, product mix, and bargaining power with its suppliers. Although higher operating efficiencies and increased capacity utilisation translate into improved profitability, because of the high capital intensity in the passenger vehicle industry and higher share of fixed costs compared to other segments in the automotive industry (like two-wheeler/three-wheeler industry), it becomes imperative for a PV OEM to rationalise its fixed costs to sustain its profitability. In this respect, higher levels of outsourcing and a product mix in favour of higher margin products, support the OEM in maintaining its profitability. A lean operating setup, characterised by low fixed overheads, provides the rated entity the cost flexibility required during a downcycle, thereby protecting its profitability.

Capacity utilisation is one of the key indicators for assessing the operational efficiency of a PV manufacturer. An OEM with high-capacity utilisation, despite a low market share, can still have better profitability and return indicators than a larger player with sub-optimal capacity utilisation. An OEM requires investments in capacity expansion and product development from time to time. Although much of the component manufacturing is outsourced to suppliers, the OEMs must regularly invest in capacity expansion and R&D. Strong operating cash flows enable entities to undertake critical investments, without unduly stressing the balance sheet. An entity's capacity to generate adequate levels of cash flow relative to debt, and interest are crucial factors, which could impact its credit risk profile. In the absence of adequate profits, an entity's cash flow generation is likely to fall short of the levels needed to support the working capital and capital expenditure needs that are associated with expansion.

With raw material costs being the largest component of an OEM's cost-structure, fluctuations in prices of key raw materials like steel, aluminium, plastic and rubber have an impact on the profitability of the OEM. Thus, the bargaining power of the OEM with its suppliers, and its ability to undertake price hikes to offset the impact of increase in input costs are also considered when rating an OEM.

Validation of Business Risk through Profitability Metrics

[Indicative Metrics¹]

	Strongest		Weakest
RoCE	$\geq 25\%$		$< 10\%$
Volatility in RoCE	$\leq 10\%$		$> 55\%$

Leverage and coverage indicators

Financial leverage is a measure of an entity's dependence on borrowed funds. Lower the dependence on borrowings, the lower (better) the leverage. When an entity borrows, it is obliged to pay both interest as well as principal to the lenders as per a defined schedule. This increases the fixed cost burden on the borrowing entity and in the limiting case, increases the default risk. While high leverage may mean high risk from a credit perspective, it is an often-adopted course by shareholder-oriented managements, given that high leverage, in good times, leads to high returns on equity capital. An entity's financial leverage could thus be a function of its management's financial policy and risk tolerance, besides being a point-in-time reflection of an entity's business and financial choices. An entity with lower leverage is better equipped to withstand volatility in cash flow generation in situations of economic downturn, competitive challenges, unexpected costs, changing consumer preferences, or regulatory changes. The OEMs that generally pursue an aggressive financial policy, which involves significant reliance on debt financing, are likely to be more vulnerable to cyclical downturns than the OEMs who pursue a conservative financial policy.

The OEMs with healthier balance sheets are better positioned to sustain product development and expansion initiatives. One with a stronger balance sheet is also well equipped to support its vendors/dealers in tight liquidity conditions, which helps in building strong ties and in strengthening its market position over the long term. A low Total Debt-to-EBITDA multiple supports an OEM's ability to service its debt obligations, fund growth opportunities and improve its competitive position without being overly reliant on external sources.

Assessment of Leverage

[Indicative Metrics]

	Strongest		Weakest
Total Outside Liabilities/ Net Worth	$\leq 0.9x$		$> 3.0x$
Total Debt/ OPBITDA	$\leq 0.5x$		$> 5.0x$

Coverage is a measure of an entity's debt-servicing ability and is calculated as the ratio of profits to the debt servicing obligations during a given period. Higher the ratio, higher the cushion available with an entity to withstand variability in profits for making good its financial obligations. Coverage is a function of an entity's profits, leverage and debt characteristics (in terms of cost of debt and repayment schedule). The interest coverage indicator reflects the company's ability to fund the cost of external borrowings after meeting all operating expenditure requirements. The debt service coverage ratio (DSCR) is a measure of an entity's debt-servicing ability and is calculated as the ratio of profits to the debt servicing obligations during a given period. Entities with higher profitability and lower leverage will generally have better coverage ratios and, thereby, healthier financial risk profiles.

¹ The indicative financial metrics mentioned here and elsewhere in the document are intended to provide a broad overview to the readers regarding what ICRA generally considers as 'relatively strong' or 'relatively weak' metrics. It is, however, possible that an entity has relatively weaker metrics on one or more financial parameters, but its credit risk is assessed to be low because of other mitigating factors, including (but not limited to) stronger metrics on other financial parameters, a healthy business risk profile, strong financial flexibility or a strong promoter group that is willing to extend distress support to it.

Assessment of Coverage

[Indicative Metrics]

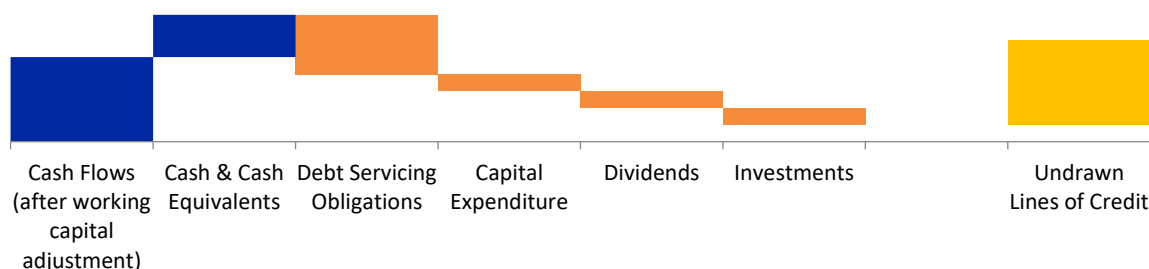
	Strongest		Weakest
Interest Coverage	$\geq 18.0x$		$< 2.0x$
DSCR	$\geq 4.0x$		$< 1.1x$

Cash flows & liquidity profile

The rating exercise is primarily focused on assessing the future debt servicing capability of a company. Since it is cash that is required to service the debt obligations, it is imperative that a cash flow analysis is undertaken to evaluate the external funding requirements and likely financial position of the company, going forward. A cash flow statement represents the sources from which cash is generated, as well as its deployment. Analysed here are the trends in an entity's funds flow from operations, cash consumed to fund the working capital, the retained cash flows after paying out dividends or carrying out share buybacks, and the free cash flows after meeting debt repayment obligations and capital expenditure (capex) needs.

Liquidity is the measure of an entity's ability to meet its short-term cash obligations from various internal or external resources. Internal resources include cash flows from operations, unencumbered cash and cash equivalents on balance sheet and cash inflows expected from the monetisation of physical and financial assets. External resources include undrawn lines of credit or equity capital. The short-term obligations include both the committed as well as the contingent claims on an entity's cash, including the debt servicing obligations, working capital requirements, capex and other investment outlays, dividend and share buyback-related outflows, besides the sudden demand arising from crystallisation of discrete events such as unfavourable outcome of an ongoing litigation. The higher the cushion available between the resources available (especially internal resources) and the obligations, the better the liquidity profile of an entity. Liquidity is generally assessed in conjunction with the vulnerability of an entity to timely refinancing / renewal of short-term sources of funding. Depending upon the circumstances, an entity that has a relatively modest liquidity profile, but a strong refinancing ability may not be viewed too unfavourably. ICRA also notes that the liquidity available with an entity may be for a temporary period and hence an entity's overall policy towards maintaining adequate liquidity (given the trade-off between returns and liquidity) is accorded due importance in the analytical approach.

Liquidity snapshot over any defined period



Capital expenditure & investment plans

The capital expenditure plans of an OEM reflect its plans for capacity expansion, localisation, complying with evolving regulatory norms and new product development. Investment related to increasing the level of indigenisation is generally a positive, as it would result in improved levels of profitability going forward. New product plans also highlight the commitment

of the OEM to refresh its product portfolio and introduce new products/variants. The quantum of capital expenditure and funding plans for the same are also evaluated to understand their impact on the financial risk profile of the company, going forward.

Tenure mismatches and risks relating to interest rates and refinancing

Large dependence on short-term borrowings to fund long-term investments or other long-term funding requirements can expose an entity to significant re-financing risks, especially during periods of tight systemic liquidity. ICRA evaluates the extent of such mismatches and the mitigating factors therein. One source of mitigation could be the existence of adequate buffers of liquid assets/ committed bank lines to meet short-term obligations. Another source of mitigation could be the entity's strong financial flexibility to be able to garner fresh funds at a short notice or a potent ability to refinance. Further, ICRA evaluates the extent to which an entity might be impacted by movement in interest rates.

Foreign currency-related risk

The extent of exchange risk that an entity faces would be determined by its net exports/imports position and foreign currency borrowings. ICRA considers the import/export mix of the company to assess its exchange risk, the hedging strategy it has adopted, and the implications of such a strategy, while evaluating the entity's performance. Unhedged foreign exchange liabilities, if material, could pose a significant risk to the balance sheet, unless covered by a natural hedge from exports.

Consolidated financial analysis

With some of the PV OEMs having ownerships in ancillary companies and financing arms, it is necessary to analyse their consolidated and group-level financial indicators. Various parameters such as capital structure, debt coverage indicators and future funding requirements are assessed at a consolidated level or on limited consolidation basis (i.e., excluding any captive financing subsidiary while factoring the ongoing and future funding interchange - including the likely extraordinary support among them), which provides a better picture of the company's financial risk profile.

Other Elements of Credit Risk Assessment

Parentage/ Group support

While the credit rating of an entity is a function of its standalone credit profile, in certain cases, the entity's credit quality can also be driven by the relationship with its parent or the promoter group (henceforth referred to as the parent). The Indian PV industry is characterised by several international OEMs through their subsidiaries as well as a few well-established domestic OEMs. In cases where the company is directly owned by a foreign parent, the rating of the Indian entity is influenced by the parent's standing and any formal support arrangements in place with the entity, especially during the gestation period when subsidiaries may require financial support. Any pay-outs from the OEM to the parent in the form of royalty, technical fees, purchase of proprietary components, etc., are also evaluated for their impact on the OEM's profitability.

If the parent's credit profile is relatively stronger than the rated entity, ICRA assesses the ability and the likelihood of the parent extending extraordinary support to the entity. Support here refers to financial support from the parent expected to be available for the entity in the form of loans, equity, extended credit period and advances in times of credit or liquidity stress on the entity. Support here does not mean operational support in the form of new business opportunities, technology sharing, distribution network sharing and so on, as these aspects are factored in the standalone credit profile assessment. If the parent's credit profile is relatively weaker than the rated entity, the entity's rating may be lower than what its standalone credit profile assessment would have merited, given the possibility that the entity may at some point of time be bound to extend financial support to its weaker parent, possibly to the detriment of its own credit profile.

Financing Availability/ Captive Financing

With a large share of PVs in India being purchased through the financing route, a captive financing arm or established tie-ups with financiers become essential to supporting the OEMs' retail volumes. Given that banks and NBFCs play an important role in financing vehicles, an established tie-up with financial institutions could result in a higher conversion ratio on the dealership front. Because of financing tie-ups, there have been instances where financial institutions have provided loans at favourable terms (higher loan to value, or LTV, or lower interest rates) for vehicles of a specific OEM, which lends a competitive advantage over its peers. Car leasing is another mode of car financing, though it is still at a nascent stage in India. However, a few car OEMs have started offering leasing solutions to their customers.

While evaluating an OEM with a captive financing unit (CFU), ICRA evaluates the strategic importance of the CFU to the OEM, depending upon the share of vehicles financed by CFU to overall vehicles sold by the OEM in the target market as well as the CFU's own financial position. Its own credit profile and its linkage with that of the principal OEM, its reach and distribution network and the extent of ownership by the OEM determine the extent of strategic support the OEM derives from the financing unit. While a captive financing arm supports business growth for the OEM by ensuring credit availability at competitive rates to customers, it is also critical for the financing arm to ensure that it follows prudent lending practices and maintains a healthy asset quality by way of strong collection processes and risk management practices. Otherwise, this may result in the OEM requiring an infusion of fresh capital into the financing arm to cover for the latter's poor asset quality.

Financial flexibility

An entity's financial flexibility (or the lack thereof) is reflected in its ability to access capital or money markets at short notice and enjoy the confidence of banks, financial institutions, and intermediaries. A strong financial flexibility allows an entity to raise fresh borrowings or refinance existing ones in quick time, whenever required. Financial flexibility could depend on factors such as an entity's large scale of operations with strong financials, large, unencumbered cash flows, unencumbered assets and the flexibility to borrow against such assets, or strong parentage or linkages with a strong group.

In contrast, among the various measures of an entity's depleting financial flexibility, one relates to a high share of pledged promoter shareholding. A sign such as this may imply that the entity might be persuaded to distribute high dividends or support the promoter group through other means to the detriment of its own credit profile. If the promoters fail to repay their loans (availed by pledging of shares) or top up collateral when required, the lenders could sell the pledged shares. In some cases, this could trigger a change-of-control clause in the rated entity's bond indentures or loan documents and require it to redeem its debt ahead of schedule, creating a liquidity squeeze, besides affecting fresh capital-raising ability.

Debt servicing track record

The debt servicing track record of the company forms an important rating consideration. Any history of past delays or defaults in meeting interest and principal repayment obligations reduces the comfort level with respect to the company's future debt servicing capability and willingness. Nevertheless, the reason behind past defaults is also analysed, which could also be due to adverse demand situations in the underlying industry. The company's ability to honour its debt obligations during the period of cyclical stress is also factored in.

Contingent liabilities and off-balance sheet exposures

ICRA reviews the contingent liabilities and off-balance sheet exposures as disclosed by the entity in its Annual Report and evaluates the likelihood of their devolvement and the financial implications of the same.

Event risk

ICRA recognises the possibility of events, such as unrelated diversification, mergers and acquisitions, business restructuring, asset sales and spin-offs, capital restructuring; and litigations, which could have a material impact on the credit profile of a

company. Incorporating the impact of such discrete events in the credit rating, from the beginning, is often difficult. Depending on whether and when such events occur, the rating opinion could be substantially different. To take rating decisions in such cases, ICRA applies its analytical judgment based on the rated entity's track record, the credibility of the management and the experience of having seen similar situations play out in other entities. However, given the nature of such events, it is possible that the rating may undergo a material change later, upon the occurrence of the event.

Asset Concentration Risk

ICRA also takes into consideration the number of manufacturing facilities owned and operated by the OEM, and the geographical diversity of the same. An OEM with multiple manufacturing facilities is inherently less exposed to single-asset related risks, including operational shutdowns due to natural calamities, fires, and industrial issues, among others. Geographical diversification with respect to manufacturing facilities is also a positive factor as it better equips the OEM to cater to demand from different regions, while minimising transportation costs. Furthermore, there are many regions in the country offering fiscal incentives to companies for setting up manufacturing facilities there—the entity's presence in such locations and its impact on the OEM's profitability are also factors that are considered in the rating decision.

Management Quality

In addition to the industry, business and financial risk analysis, all credit ratings incorporate an assessment of the quality of the rated entity's management and its financial policies. An entity with an experienced management is considered a positive factor. The management risk analysis also factors in the historical track record of the entity or the group in timely servicing its obligations.

Quality of Management and Financial Policies

As a part of its process, ICRA undertakes discussions with the rated entity's management to understand its views on past performance as well as its future plans and strategies, besides the outlook on the industry. Some of the points assessed are:

- Experience of the promoter/ management in the industry
- Commitment of the promoter/ management to the rated entity
- Risk appetite of the promoter/ management and risk mitigation plans
- Policies on leveraging, managing interest rate and currency risks
- The management's success in introducing new projects and managing changes in the external environment
- The management's plans on new projects, acquisitions and expansions
- Track record of balancing the interests of shareholders, creditors and other stakeholders

Periodic interactions with the management help ascertain the shifts, if any, in their financial policies.

Assessment of Environmental, Social and Governance (ESG) Risks

Environmental (E) and Social (S) Risks

As this methodology highlights, while undertaking credit assessment of entities, ICRA seeks to incorporate all relevant credit considerations into its rating decisions while taking a forward-looking view on the risks and the mitigants. The relevant credit considerations include (sometimes overtly, sometimes covertly) the E&S factors that could affect the rated entity/ transaction. While ICRA's analytical approach does not explicitly disaggregate these risks to assess their impact on the rating, these risks are often assessed broadly. Further, it is not always feasible to fully or precisely disaggregate the sub-components of E&S risks in credit analysis since these considerations often tend to overlap.

That said, the materiality of the E&S risks and the time horizon over which they are expected to crystallise differ widely across sectors and entities. In some cases, while the E&S risks could be material, their effect on the credit profile may be muted because of other fundamental strengths of the entity. In other cases, the adverse impact of E&S risks is expected to play out in the distant future and, hence, these considerations do not necessarily weigh on the rating today—with the expectation that when these risks manifest in the future, the rated entity would possibly have already adapted itself by realigning its business model.

While evaluating E&S risks, ICRA's objective is only to assess the direct and indirect risks that an entity faces and how it already is or is intending to mitigate the impact of such risks on its credit profile. As an example, ICRA only assesses whether an entity is exposed to physical climate risks, or carbon transition risks such as those arising from changes in regulations or other environmental and social risks; and seeks to understand the various mitigation and adaptation approaches that the entity is implementing to mollify these risks. In spite of the above, as an example, it is possible that even if entity A has a higher carbon footprint than entity B, it does not materially affect ICRA's credit opinion on entity A. This is because ICRA's credit opinion on an entity considers a wide gamut of credit-relevant factors, and the E&S factors are only one among those.

PV OEMs remain exposed to climate transition risks arising from a likelihood of tightening emission control requirements, with the Government focused on reducing the adverse impact of automobile emission; accordingly, an OEM's prospects remain linked to its ability to meet tightening emission requirements. The companies in the sector may need to invest materially to develop products to cater to the regulatory thresholds or expected transition to alternative fuel vehicles, which may have a moderating impact on their return and credit metrics. The exposure to litigation/penalties arising from issues related to waste and water management for the manufacturers remains relatively low.

The OEMs have a high dependence on human capital; as such retaining human capital, maintaining healthy employee relations as well as supplier ecosystem are essentials for disruption-free operations. Another social risk that PV OEMs face 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 on demand. The entities also remain exposed to any major shift in consumer preferences/demographics, which are a key driver for demand, and accordingly may need to make material investments to realign their product portfolio.

Governance Practices

A sound corporate governance structure attempts to make clear the distinction of power and responsibilities between the Board of Directors and the management. The constitution of an entity's Board and the Board's participation in strategy formulation, besides the entity's adherence to legal and statutory compliances is factored in during credit assessments. ICRA seeks to gain a qualitative understanding of an entity's commitment to following transparent and credible practices by the way its financial statements are reported, its level of disclosures, consistency in communication and openness in sharing information during the credit rating exercise. Besides, the corporate group structure (whether simple or complex), the rated entity's related party transactions and instances of supporting group entities at the expense of debt holders are assessed.

Summing Up

ICRA's credit ratings are a symbolic representation of its opinion on the relative credit risk associated with the instrument being rated. This opinion is arrived at following a detailed evaluation of the entity's business and financial risks, its competitive strengths, its likely cash flows over the near-to-medium-term and the adequacy of such cash flows vis-à-vis its debt servicing obligations and other funding requirements. ICRA's approach to rating PV manufacturers also incorporates the evaluation of various business risk parameters such as the company's market share, product portfolio, technology development strength,

distribution network and the management strategy for maintaining financial performance through the cycle and its overall approach towards investment and growth.

ANNEXURE

Summary of rating factors and an example to illustrate the key building blocks of the credit rating

		Strong			Comfortable			Adequate			Moderate			Weak		
Industry Risk	Industry Position															
Business Risk	Scale															
	Market position and brand strength															
	Product Portfolio															
	Sales & Service Network															
	Extent of localisation															
	Technology & Product Development Capabilities															
	Geographic Diversification															
Financial Risk	Leverage															
	Coverage															
		Enhance					Support/ Neutral					Hinder				
Do these factors enhance or hinder the credit profile?	Diversification															
	Refinancing Dependence, Liquidity and Financial Flexibility															
	Currency Risk															
	Financial Policy															
	Management, Governance & Reporting															
		Very High				High				Moderate				Low		
Parent Support	Likelihood of Parent Support															
	Rating of Parent	AAA	AA+	AA	AA-	A+	A	A-	BBB+	BBB	BBB-	BB+	BB	BB-	B/ C category	
	Final Rating	AAA	AA+	AA	AA-	A+	A	A-	BBB+	BBB	BBB-	BB+	BB	BB-	B/ C category	

The above graphic is only for illustration purpose and does not represent a rating output from a formulaic model. The ratings assigned by ICRA are determined by Rating Committees based on both quantitative and qualitative considerations.

Contact us for any feedback or comments at: methodologies@icraindia.com

RELATIONSHIP CONTACT

L Shivakumar

+91 22 6114 3406

shivakumar@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani

+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

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 and www.icraresearch.in

ICRA Limited



Registered Office

B-710, Statesman House 148, Barakhamba Road New Delhi-110001
Tel: +91 11 23357940-45



Branches



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