January 05, 2024

Mahindra Heavy Engines Limited: Long-term rating continues on Rating watch with positive implications; short-term rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based – Working Capital Facilities	20.00	20.00	[ICRA]AA+; continues on Rating watch with positive implication
Long-term / Short-term, Fund-based / Non-fund Based Facilities	5.00	5.00	[ICRA]AA+; continues on Rating watch with positive implication/ [ICRA] A1+; reaffirmed
Total	**25.00**	**25.00**	

**Instrument details are provided in Annexure-I*

Rationale

ICRA had placed the ratings of Mahindra Heavy Engines Limited (MHEL/the company) on rating watch with positive implications in August 2023, following the announcement of the proposed merger with its parent entity, Mahindra & Mahindra Limited[1] (M&M; rated [ICRA]AAA(Stable)/[ICRA]A1+) and the expected improvement in credit profile on account of the same. Given that the transaction is yet to be completed, the rating continues to remain on rating watch with positive implications.

The ratings continue to take into account MHEL's status as a wholly-owned subsidiary of M&M, for whom it acts as a captive supplier of engines. ICRA also notes the pricing arrangement for supplying heavy and light engines to M&M. The volume offtake and pricing arrangement with M&M mitigate the demand risk to an extent and supports MHEL's profitability. ICRA notes that the promoter Group has provided timely, direct and indirect financial support to MHEL, whenever required—a trend that ICRA expects will sustain, going forward. The ratings also factor in MHEL's strategic importance for the core automotive business of M&M as a captive supplier of engines for some of its utility vehicles (UVs), as well as for M&M's trucks of 10T-45T and for the powerol business.

The ratings also factor in the debt-free status maintained by MHEL over the past three financial years. The liquidity position of the company continues to be strong, reflected in its free cash and liquid investments of Rs. 96.1 crore as on March 31, 2023, and availability of bank lines. ICRA expects the company to maintain its net debt-free status over the medium term, in the absence of any significant debt-funded capex or investments.

Nonetheless, the ratings remain constrained by the fact that utility vehicle (UV) engines business is highly dependent on select models that face stiff competition from incumbents as well as new entrants. Moreover, with its entire revenues derived from the supply of engines, the business is subject to risks arising from the impending electrification in the domestic market. Accordingly, the company's ability to evolve its product profile and remain relevant as electrification penetration increases, would remain critical. ICRA also notes that MHEL's profitability is susceptible to the capacity utilisation and economies of scale.

[1] *MHEL became a wholly-owned subsidiary of M&M (rated [ICRA]AAA (Stable) and [ICRA]A1+) upon completion of the merger of Mahindra Vehicle Manufacturers Limited with M&M in July 2021.*

Key rating drivers and their description

Credit strengths

Strong operational, technological, managerial and financial support from its parent, M&M – Being a wholly-owned subsidiary of M&M and considering its status as a captive supplier of engines for M&M's M&HCVs and small UVs, the company enjoys strong operational linkages with its parent company. Additionally, M&M has demonstrated its managerial and financial support to the entity, with MHEL's Board of Directors including M&M's senior management, along with timely direct and indirect financial support extended to MHEL, whenever required. This was evident when the Board of Directors of the company had approved the Scheme of Merger by Absorption of the Company with M&M in August 2023, subject to requisite approvals/consents. The company has filed the Scheme of Merger with the National Company Law Tribunal (NCLT) and the regulatory process for the same is in progress as on date. M&M is also expected to continue to support MHEL until the merger is completed, for its incremental capital expenditure (capex) and investment requirements, as well as for meeting any other funding requirements.

Strategic importance for M&M as captive engine manufacturer of its M&HCVs and selected UVs – MHEL is a captive supplier of engines for some of the UVs manufactured and sold by M&M, such as Thar and XUV 300, apart from its sole engine supplier status for M&M's M&HCVs. The pricing arrangement with M&M for its UV engines also lends support to MHEL's profitability.

Comfortable capital structure and strong liquidity – Owing to healthy accruals and modest capex, the company has ploughed back accruals to retire debt and remains debt-free currently. The company does not have any major capex/investment plans and, accordingly, is likely to remain debt-free in the near term as well. Moreover, incremental capex would be funded primarily by internal accruals, keeping the capital structure at a comfortable level. The liquidity position of the company continues to be strong, reflected in its free cash as well as liquid investments of Rs. 96.1 crore as on March 31, 2023, along with availability of bank lines.

Credit challenges

Profitability linked to a highly cyclical CV industry – The domestic CV industry remains highly cyclical. However, in past few quarters, volumes have remained healthy, supported by macroeconomic recovery and infrastructure development, which have been reflected in MHEL's volumes and revenues as well. Moreover, diversification into the UV segment mitigates the impact of the cyclical CV segment, to an extent.

Dependence on M&M's M&HCV division, a marginal player in a largely duopolistic Indian M&HCV industry – M&M's ability to improve its domestic M&HCV market share, which has remained marginal in the past years is key to the performance of MHEL over the years. Nevertheless, the business gained from M&M for supplying engines for its smaller UVs, supported the company's volumes and revenues. MHEL reported net profits from FY2017, supported by the scale-up and subsequent economies of scale benefit. The pricing arrangement with its principal customer also lends support to MHEL's profitability and partially mitigates demand risks.

High dependence on few models in UV segment – MHEL has been supplying engines for M&M's UVs—viz., Thar and XUV 300. These models face stiff competition from incumbents like Maruti Suzuki India Limited (Brezza, Ertiga) and Hyundai Motors India Limited (Creta, Venue). At present, MHEL is not supplying engines for some of M&M's models like Bolero and Scorpio, which are manufactured in-house by M&M.

Susceptible to risks from electrification over the medium term – With the pace of electrification gradually gaining momentum in the domestic automotive market, MHEL as a supplier of internal combustion (IC) engines remains vulnerable to the risks arising from this underlying industry paradigm shift. Although electrification in the domestic PV market is expected to be only a gradual trend, and that in the CV market more long drawn, the company's ability to adapt itself to changing consumer preferences, in a timely manner, would remain critical.

Liquidity position: Strong

MHEL's liquidity position is strong, supported by free cash and liquid investments of Rs. 96.1 crore as on March 31, 2023, and unutilised fund-based limits of Rs. 10 crore as on November 30, 2023. The company plans to incur a capex of ~Rs. 20-25 crore annually during FY2024–FY2026, largely towards maintenance requirements, which would be easily funded from internal accruals. Owing to its debt-free status, the company does not have any debt obligations. Accordingly, internal accruals would be sufficient for meeting its capex and working capital requirements over the medium term. ICRA believes that due to the strong strategic, financial and operational linkages, M&M will continue to provide timely financial support to the company in case of any exigencies until the merger is completed.

Rating sensitivities

Positive factors – The rating watch will be resolved upon successful completion of the ongoing merger process with M&M.

Negative factors – Inability to conclude the merger process in a timely and successful manner, or deterioration in the credit profile of the parent entity or dilution in the company's strategic importance for the promoter group could be negative factor. Moreover, sharp deterioration in operating performance could also result in downward rating pressure.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating Methodology for Auto Components
Parent/Group support	Parent / Group Company: Mahindra & Mahindra Limited (M&M). The ratings assigned to MHEL factor in the high likelihood of its parent, M&M, extending financial support, given the high strategic importance that MHEL holds for it. We also expect M&M to be willing to extend financial support to MHEL out of its need to protect its reputation from the consequences of a Group entity's distress. There is also a consistent track record of M&M extending timely financial support to MHEL, whenever a need has arisen.
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the standalone financials of MHEL.

About the company

Mahindra Heavy Engines Limited (erstwhile Mahindra Navistar Engines Private Limited) was incorporated as a 51:49 joint venture (JV) between M&M and Navistar. Thereafter, M&M acquired Navistar's 49% stake in the JV in 2013, making MHEL its wholly-owned subsidiary. MHEL has set up a facility to manufacture engines in the 180–315HP range at Chakan, Maharashtra, with an annual production capacity of 18,000 M&HCV engines. It has been operating as a captive supplier for M&M's M&HCV division (erstwhile Mahindra Navistar Automotives Limited's foray into M&HCVs). In FY2016, the company commissioned an assembly line for smaller engines, which are used in M&M's smaller UVs. The facility is located adjacent to MVML's greenfield unit for light commercial vehicles (LCVs), M&HCVs and sports utility vehicles (SUVs). In FY2020, MHEL also started supplying transmission assemblies for M&M's ICV range.

Additionally, as announced in August 2023, MHEL is also in the process of being merged with M&M, which will be completed over the next few quarters, subject to receipt of necessary approvals. The presence of senior management from M&M in MHEL's Board of Directors, and M&M's intent to merge MHEL into itself indicate the strategic importance of MHEL for its parent entity.

Key financial indicators (audited)

Standalone	FY2022	FY2023
Operating income	1,141.9	1,454.2
PAT	83.0	68.8
OPBDIT/OI	13.5%	8.4%
PAT/OI	7.3%	4.7%
Total outside liabilities/Tangible net worth (times)	0.4	0.5
Total debt/OPBDIT (times)	0.0	0.0
Interest coverage (times)	216.0	128.2

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs. crore

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2024)					Chronology of rating history for the past 3 years		
		Type	Amount rated (Rs. crore)	Amount outstanding (Rs. crore)	Date & rating in FY2024		Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021
					Jan 05, 2024	Aug 16, 2023	Nov 28, 2022	Aug 16, 2021	May 29, 2020
1	Fund-based Work Capital Facilities	Long-term	20.00	-	[ICRA]AA+ %	[ICRA]AA+ %	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)
2	Fund-based / Non-fund Based Facilities	Long-term	-	-	-	-	-	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)
3	Fund-based / Non-fund Based Facilities	Long-term / Short term	5.00	-	[ICRA]AA+ %/ [ICRA]A1+	[ICRA]AA+ %/ [ICRA]A1+	[ICRA]AA+ (Stable) / [ICRA]A1+	[ICRA]AA+ (Stable) / [ICRA]A1+	[ICRA]AA+ (Stable) / [ICRA]A1+
4	Unallocated amount	Long-term / Short term	-	-	-	-	-	[ICRA]AA+ (Stable) / [ICRA]A1+	[ICRA]AA+ (Stable) / [ICRA]A1+

%: On Rating Watch with positive implications

Complexity level of the rated instruments

Instrument	Complexity Indicator
Fund-Based Working Capital Facilities	Simple
Fund-Based / Non-Fund Based Facilities	Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	**Fund-based Working Capital Facilities**	NA	NA	NA	20.00	[ICRA]AA+; Rating watch with positive implication
NA	**Fund-based / Non-fund Based Facilities**	NA	NA	NA	5.00	[ICRA] AA+; Rating watch with positive implication; /[ICRA]A1+

Source: Company

Annexure II: List of entities considered for consolidated analysis – Not applicable

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About ICRA Limited:

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