August 16, 2021

Mahindra Heavy Engines Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based – Working Capital Facilities	45.00	45.00	[ICRA]AA+ (Stable); reaffirmed
Fund-Based / Non-fund Based – Working Capital Facilities	12.00	12.00	[ICRA]AA+ (Stable); reaffirmed
Long-term / Short-term, Fund-based / Non-fund Based Facilities	50.00	50.00	[ICRA]AA+ (Stable) / [ICRA]A1+; reaffirmed
Long-term / Short-term, Unallocated	43.00	43.00	[ICRA]AA+ (Stable) / [ICRA]A1+; reaffirmed
Total	**150.00**	**150.00**	

**Instrument details are provided in Annexure-1*

Rationale

The reaffirmation of ratings continue to take into account Mahindra Heavy Engines Limited's (MHEL) status as a wholly-owned subsidiary of Mahindra & Mahindra Limited[1] (M&M, rated [ICRA]AAA (Stable) / [ICRA]A1+) and the cost-plus pricing arrangement for supplying utility vehicle (UV) engines with its principal customer, M&M. The volume off-take and pricing arrangement with M&M mitigates 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 itself in the future. MHEL is strategically important for the core automotive business of M&M, and is a captive supplier of engines for some of its UVs, apart from the existing sole engine supplier status for M&M's trucks and bus division (MTBD). Moreover, MHEL is the sole supplier of transmission assemblies for MTBD's 'Furio' range of intermediate commercial vehicles (ICVs).

The ratings also factor in the debt free status maintained by MEHL over the past two financial years. The liquidity position of the company continues to remain strong as reflected by its cash as well as liquid investments of ~Rs. 43 crore and unutilised fund-based bank lines of Rs. 50 crore as on March 31, 2021. ICRA expect the company to maintain net-debt free status in the next 2-3 years.

MHEL's utilisation of installed capacity in its medium and heavy commercial vehicle (M&HCV) engines business has remained sub-optimal, while its UV engines business is highly dependent on select models that face stiff competition from incumbents as well as new entrants. Hence, MHEL's profit margins are susceptible to the capacity utilisation and economies of scale. Nevertheless, MHEL is a debt-free entity, and in the absence of any major capital expenditure (capex) or investment plans, its capital structure and coverage indicators are expected to remain strong in the near term.

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

Key rating drivers and their description

Credit strengths

Strong operational, technological, managerial and financial support from its parent, M&M – MHEL's board of directors include M&M's senior management. MHEL is a captive supplier of engines for some of the UVs, apart from its existing sole engine supplier status with M&M's MTBD. ICRA notes that the promoter group has demonstrated timely direct and indirect financial support to MHEL, whenever required. A trend that ICRA expects will sustain itself in the future.

Strategic importance for M&M as captive engine manufacturer of its M&HCVs and recently launched UVs – MHEL is the sole supplier of all engines for M&M's M&HCVs as well as its UVs, such as KUV 100, Marazzo and XUV 300. Moreover, MHEL is the sole supplier of transmission assemblies for the 'Furio' series of ICVs by MTBD. The cost-plus pricing arrangement with M&M for its UV engines also lends support to MHEL's profitability.

Comfortable capital structure and liquidity - Owing to healthy accruals and modest capex, the company has ploughed back accruals to retire debt and has become debt free since December 2019. The company does not have any major capex/investment plans and it is likely to remain debt free in the near term. Moreover, incremental capex is funded primarily by internal accruals, keeping the capital structure at a comfortable level. The liquidity position of the company continues to remain strong as reflected by its cash as well as liquid investments of ~Rs. 43 crore and unutilised fund-based bank lines of Rs. 50 crore as on March 31, 2021.

Credit challenges

Profitability highly dependent on capacity utilisation and scale economics – The domestic CV industry remains highly cyclical. The utilisation of MHEL's installed capacity for M&HCVs has remained sub-optimal due to headwinds in the Indian CV industry during the past two years. Nevertheless, diversification in the UV segment mitigates the impact of the cyclical CV segment to an extent.

High dependence on M&M's M&HCV division, which is currently a marginal player in a largely duopolistic Indian M&HCV industry – The subdued performance of M&M's M&HCV division has affected the performance of MHEL in recent years. Nevertheless, equity infusion from M&M protected erosion in its net worth to a large extent, apart from providing much needed liquidity support. Aided by relatively stronger volume off-take in the UV engines business and subsequent economies of scale benefit, MHEL has reported net profits from FY2017 onwards. The cost-plus pricing arrangement with its principal customer for UV engines lends support to MHEL's profitability and partially mitigates demand risk in the UV segment.

High dependence on few models in the UV segment – MHEL has been supplying engines for M&M's UVs—viz., KUV 100, Marazzo and XUV 300. These models face stiff competition from incumbents like Maruti Suzuki India Limited (Brezza, Ertiga), Hyundai Motors India Limited (Creta, Venue) and Ford India Private Limited (Ecosport). MHEL is currently not supplying engines for M&M's bestselling models like Bolero, Scorpio and XUV 500, which are manufactured at M&M's own manufacturing units.

Liquidity position: Strong

MHEL's liquidity position is strong, supported by cash and callable intercorporate deposits (ICDs) of more than Rs. 90 crore and undrawn bank lines of Rs. 50 crore as on March 31, 2021. The company plans to incur a capex of Rs. 20-30 crore annually during FY2022 to FY2024. Meanwhile, internal accruals will largely fund incremental capex and working capital requirement 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.

Rating sensitivities

Positive factors – Substantial improvement in the company's scale of operations and profitability indicators, while maintaining capital structure at a conservative level, could trigger a rating upgrade.

Negative factors – A negative rating trigger could arise in case of deterioration in the credit profile of the parent entity or dilution in the company's strategic importance for the promoter group. 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 Component Manufacturers
Parent/Group Support	Parent Company: Mahindra & Mahindra Limited (rated [ICRA]AAA (Stable) and [ICRA]A1+) The ratings assigned to MHEL factor in the very 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 also exists a consistent track record of M&M extending timely financial support to MHEL, whenever a need has arisen.
Consolidation/Standalone	The ratings are based on the standalone financial profile of the company.

About the company

Mahindra Heavy Engines Limited (erstwhile Mahindra Navistar Engines Private Limited, a 51:49 joint venture (JV) between M&M and Navistar; M&M acquired[2] Navistar's 49% stake in the JV in 2013, making it a wholly-owned subsidiary) has set up a manufacturing facility for engines in the 180–315HP range at Chakan, Maharashtra. The facility has an annual production capacity of 15,000 M&HCV engines, and is 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 recently launched 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.

[2] *M&M paid a consideration of $33 million (~Rs. 175 crore) for Navistar's stake in two JVs, i.e., a truck manufacturing JV as well as an engine manufacturing JV.*

Key financial indicators (audited)

MHEL	FY2020	FY2021
Operating Income (Rs. crore)	1,001.5	1,057.0
PAT (Rs. crore)	39.1	257.3
OPBDIT/OI (%)	7.7%	31.3%
PAT/OI (%)	3.9%	24.3%
Total Outside Liabilities/Tangible Net Worth (times)	0.4	0.3
Total Debt/OPBDIT (times)	0.0	0.0
Interest Coverage (times)	30.3	5,721.6

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2022)				Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating in	Date & Rating in FY2021	Date & Rating in FY2019	Date & Rating in FY2018
					Aug 16, 2021	May 29, 2020	Feb 15, 2019	Feb 09, 2018
1	Term Loan	Long-term	-	-	-	-	[ICRA]AA+ (Stable)	[ICRA]AA (Stable)
2	Fund-based Facilities	Long-term	45.00	-	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA (Stable)
3	Fund-based / Non-fund Based Facilities	Long-term	12.00	-	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA (Stable)
4	Fund-based / Non-fund Based Facilities	Long-term / Short-term	50.00	-	[ICRA]AA+ (Stable) / [ICRA]A1+	[ICRA]AA+ (Stable) / [ICRA]A1+	[ICRA]AA+ (Stable) / [ICRA]A1+	[ICRA]AA (Stable) / [ICRA]A1+
5	Unallocated amount	Long-term / Short-term	43.00	-	[ICRA]AA+ (Stable) / [ICRA]A1+	[ICRA]AA+ (Stable) / [ICRA]A1+	[ICRA]AA+ (Stable) / [ICRA]A1+	[ICRA]AA (Stable) / [ICRA]A1+

Complexity level of the rated instruments

Instrument	Complexity Indicator
Fund-based Facilities	Simple
Fund-based / Non-fund Based Facilities	Simple
Fund-based / Non-fund Based Facilities	Simple
Unallocated amount	Not applicable

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 analyzing 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, is available on ICRA's website: Click Here

Annexure-1: Instrument details

ISIN No/Banker Name	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (RS Crore)	Current Rating and Outlook
NA	Fund-based Facilities	-	-	-	45.00	[ICRA]AA+ (Stable)
NA	Fund-based / Non-fund Based Facilities	-	-	-	12.00	[ICRA]AA+ (Stable)
NA	Fund-based / Non-fund Based Facilities	-	-	-	50.00	[ICRA]AA+ (Stable) / [ICRA]A1+
NA	Unallocated amount	-	-	-	43.00	[ICRA]AA+ (Stable) / [ICRA]A1+

Source: *Company*

Annexure-2: List of entities considered for consolidated analysis – Not applicable

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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.

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