Armoured Vehicles Nigam Limited

June 15, 2022

Rating

Facilities	Amount (₹ crore)	Rating[1]	Rating Action
Long-term bank facilities	2,000.00	CARE AA+; Stable (Double A Plus; Outlook: Stable)	Assigned
Total bank facilities	**2,000.00 (₹ Two thousand crore only)**		

Details of facilities in Annexure-1.

Detailed rationale and key rating drivers

The rating assigned to the bank facilities of Armoured Vehicles Nigam Limited (AVNL) derives strength from the experienced management team, the established and long track record of operations with the manufacturing base providing a wide range of battle tanks and defence vehicles, the entire stake owned by the Government of India (GoI) and the strategic importance to it, the healthy order book position providing revenue visibility for the next five years, ie, until FY28, the large manufacturing capacities with an adequate pool of trained manpower, the strong capital structure marked by healthy net worth base and minimal reliance on debt.

AVNL has strategic tie-ups with original equipment manufacturers (OEMs) and it directly serves the Ministry of Defence (MoD) and its divisions, such as the Defence Research and Development Organisation (DRDO) and the Indian Armed Forces.

The rating also derives strengths from the support extended by the GoI in the form of offering interest-free advances to the extent of 60% of the orders to be executed during the year. Furthermore, the rating also factors in the significant amount of cash and liquid funds available with AVNL as on March 31, 2022, with minimal utilisation of working capital limits, which provides an adequate cushion.

These strengths are, however, partially offset by the sole dependency on the defence sector and its working capital-intensive nature of operations due to the high inventory levels. Moreover, considering the operating profit margins are low, it further remains vulnerable to input cost fluctuations, although the same is passed on to some extent.

The 'Stable' outlook reflects CARE Ratings Limited's (CARE Ratings') expectation that AVNL will continue to benefit from its strategic importance as the major supplier of armoured vehicles to the Indian defence forces and the high sectoral entry barriers, which will limit competition. Any change in the status quo with the GoI will be a key monitorable for the company, going forward.

Rating sensitivities

Positive factors – Factors that could lead to positive rating action/upgrade:

- Significant and sustained improvement in the operating performance, leading to higher cash accruals.
- Gross current asset days sustaining under 500 days.

Negative factors – Factors that could lead to negative rating action/downgrade:

- Any change in the stance of GoI support to AVNL, reflecting lower order inflows and revenues.
- Weakening of the operating performance, leading to a significant decline in margins and constrained liquidity.
- Large debt-funded capex or sizeable working capital requirements, weakening the capital structure.

Detailed description of the key rating drivers

Key rating strengths

Experienced management team; 100% stake owned by the GoI: The leadership team at AVNL comprises highly qualified and experienced personnel. Sanjeev Kishore, an engineer from HBTU-Kanpur, also an alumnus of the National Defence College Delhi and the IIM-Ahmedabad is the Chairman and Managing Director (CMD) of AVNL and has served in the organisation for almost 35 years. He has served various functions in the organisations and is well-versed with various technologies used in battle tanks, ie, T90s, T-72 Trawl Tank, Bridge Layer Tank and T-72 (OH), among others. He is ably supported by Sanjay Dwivedi, Director-Operations, C Ramachandran, Director-Finance and B Pattanaik, Director-Human Resources. All of them have more than three decades of experience in various roles across various organisations. As on March 31, 2022, the GoI holds 100% of the total equity share capital of the company. Any change in the status quo with the GoI will be a key monitorable in the future.

Established track record of operations and manufacturing base:: The MoD had 41 Ordnance factories (OF) under it and with an appointed date of October 01, 2021, these OFs were divided into seven government companies, of which AVNL is one of the prime entities. AVNL, although incorporated in August 2021, is an established player with a wide range of products in segments in which it operates, ie, battle tanks (Vijayanta, T-72 Ajeya, T-90 Bhisma, MBT Arjun), engines required for tanks, fuses, and

[1]Complete definition of the ratings assigned are available at www.careedge.in and other CARE Ratings Ltd.'s publications

other bullet-proofed and mine protection vehicles and transport-need vehicles for the Army. The company has been providing its products and services to the MoD, the Indian Army, the Indian Navy, and the Indian Air Force, MHRF including CRPF, BSF and ITBP among others, and thus, is strategically important to the GoI.

Established market position with large manufacturing abilities: Being the major supplier of armoured vehicles to the Indian Armed Forces, AVNL enjoys an established market position in a growing defence sector. The Ordnance Factory Medak (Medak, Telangana) produces one of the best infantry combat vehicles (ICVs) in the world known as SARATH and is the only manufacturer of ICVs for the Indian Army. Major products of the company include parts of arms, ammunition, weapons, battle tanks, bullet-proof vehicles, defence vehicles fuses, gearboxes, etc. The majority of the revenue (around 88% of the total revenue) comes from the armoured vehicle product segment, followed by specialised trucks, which constituted around 9% of the total revenue. However, the company, along with its five production units, provide a wide variety of vehicles and other requirements to suit the dynamic needs of the Indian Army. AVNL has five manufacturing facilities in four states spread across 5,209 acre. These include an engine factory and a heavy vehicle factory in Tamil Nadu, a machine tools prototype factory in Maharashtra, an Ordnance Factory Medak in Telangana and a vehicle factory in Jabalpur, Madhya Pradesh. These large manufacturing facilities of the units can serve the rapid expansion of the domestic and export markets.

Reputed client base with a focus on indigenisation through R&D with DRDO: AVNL solely supplies to government organisations like the Indian Army, the Indian Navy, the Indian Air Force, MHA and various other defence corporations. AVNL has received various repeat orders, specifically in armoured vehicles, owing to its track record in providing products and services. The company has been manufacturing products through technology transfer and has, over the years, systematically indigenised the products. The government's push for indigenisation will benefit AVNL in securing orders from public sector undertakings (PSUs) and government organisations to a great extent. The company has achieved indigenisation of 90-95% across its product portfolio.
AVNL has strategic tie-ups with OEMs such as Ashok Leyland, Tata Motors, JK Tyres, L&T, Bharat Forge, etc, for strategic advantages.

Healthy order book position: The company's unexecuted order book as on March 31, 2022, stood at ₹39,382 crore, to be serviced by FY28, thus providing revenue visibility from the short term to the medium term. Additionally, the government's focus on rolling out enabling reforms to increase India's defence product manufacturing capabilities and gradually reduce imports will support the order inflow in the medium to long term. Of the total order book of ₹39,382 crore (to be completed by FY28), ₹6,726 crore and ₹4,844 crore are expected to be executed by FY23 and FY24, respectively, providing adequate revenue visibility in the medium term. Furthermore, the government's push for indigenisation with the launch of the Make in India campaign is expected to augur well for AVNL's order book addition. The execution of these orders as per the stipulated timelines remains a key monitorable for AVNL.

Key rating weaknesses

Sole dependency on the domestic defence sector: The Ministry of Defence is AVNL's sole customer. The company bids for defence projects floated by the ministry on a fixed-contract basis. The Indian Army is the major customer, accounting for around 88% of the turnover. In case of any changes in the procurement policy of the defence forces or a significant cutback in defence spending, the company's revenue and order book position can be adversely impacted. Due to the high concentration of the government sector orders, the revenue booking and cash flows are vulnerable to delays in project execution or final payment clearance in some cases. The total share of non-defence revenues is 2.05%. In addition, AVNL is planning to increase its export footprint by targeting higher defence equipment exports to friendly countries, which can reduce its over-reliance on the domestic defence business. Currently, exports account for only 0.01% of total revenue.

Low profitability margins and exposure to fluctuations in raw materials cost: The company's income from operations on a consolidated basis has been at ₹2,685 crore for FY22. AVNL witnessed a weak PBILDT margin in FY22, at 4.71%, and the PAT% margin remained low, at 2.06% in FY22. Most of the orders are bound by budgetary constraints, pressuring pricing flexibility and are received on a fixed cost basis, thus exposing to the risk of adverse movements in raw material prices persists. Before corporatisation, prices were fixed based on a cost basis, as a result of which there is no element of profit. After corporatisation, the indents placed by the services on the erstwhile Ordnance Factory Board (OFB) were converted to deemed contracts. While the deemed contracts do not have any added element of profit, they will have the provision for a fixed 6% price escalation per annum from the year 2022-23 onwards. This apart, if there is a significant rise in input costs of raw materials, the same will be passed on to the government during the subsequent deliveries, which mitigates the risk arising from fluctuations in raw materials costs.

Elongated working capital cycle: The operating cycle of AVNL is elongated, at 170 days in FY22, and is expected to remain at the current level in the coming years as well. The company has a high inventory holding period, at 217 days in FY22, as it maintains inventory to service the order book based on client-specific requirements. This apart, time also gets consumed at the customers' end, considering that when the initial product is introduced, the same will be presented to the client for quality check and testing, which additionally adds to the inventory cycle. However, the receivable days are less as the GoI pays 60% of the order value in advance and the remaining 40% at the time of delivery. The gross current assets days are elevated at over 955 days for FY22 on account of the large unbilled revenue; however, the gross current assets days are expected to reduce going forward, led by the liquidation of unbilled revenue and strong revenue growth as per the schedule of implementation of orders.

This apart, the company has an adequate cushion in working capital limits with the cash credit facility almost being unutilised during the last two months ending May 31, 2022.

Liquidity: Strong

The strong liquidity is marked by gross cash accruals (GCA) of ₹176.06 crore against no repayment obligations in FY23. The company has huge cash and bank balances of ₹4,544.54 crore as on March 31, 2022, which accommodates a smooth working capital cycle. With a gearing of 0.00x times as on March 31, 2022, the company has sufficient headroom to raise additional debt for its operations or capex purposes. Moreover, the capex of ₹282 crore planned for modernisation in the near future is completely funded by the GoI. The fund-based utilisation for the company are unutilised for the last two months ended May 31, 2022. Its unutilised bank lines are expected to be adequate to meet its incremental working capital needs over the next financial year.

Analytical approach: Standalone

Factoring linkages with support from the GoI, considering the entity being wholly owned by the GoI and its strategic importance for the country.

Applicable criteria

Policy on default recognition
Factoring Linkages Government Support
Financial Ratios – Non financial Sector
Liquidity Analysis of Non-financial sector entities
Rating Outlook and Credit Watch
Manufacturing Companies

About the company

Headquartered in Avadi, Chennai, AVNL was incorporated as a new Defence Public Sector Undertaking on August 14, 2021. It is an unlisted public company, wholly-owned by the GoI, together with its five ordnance factories. AVNL is involved in the design, development, manufacture, trade, import, export, repair, maintenance, and service of all kinds of defence and non-defence systems and all related vehicles or equipment used by the armed forces. The company has five Ordnance factories with an Engine Factory and Heavy Vehicle Factory located at Avadi in Chennai, Tamil Nadu; a Machine Tool Prototype at Ambernath- Maharashtra; Ordnance Factory Medak-Telangana; and a Vehicle Factory in Jabalpur, Madhya Pradesh. The company is managed by Sanjeev Kishore, who is the CMD of AVNL and has around 35 years of experience in the OFB organisation. The major products of the company include arms, ammunition, weapons, battle tanks, bullet-proof vehicles and gearboxes, among others.

Brief Financials (₹ crore)	March 31, 2022 (P)
TOI	2,685.70
PBILDT	126.41
PAT	55.33
Overall gearing (times)	NA
Interest coverage (times)	NA

P: Provisional

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating history for the last three years: Please refer Annexure-2

Covenants of the rated instruments/facilities: Detailed explanation of covenants of the rated instruments/facilities is given in Annexure-3

Complexity level of various instruments rated for this company: Annexure-4

Annexure-1: Details of instruments/facilities

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (₹ crore)	Rating Assigned along with Rating Outlook
Fund-based - LT-Cash Credit		-	-	-	2,000.00	CARE AA+; Stable

Annexure-2: Rating history for the last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating History			
		Type	Amount Outstanding (₹ crore)	Rating	Date(s) and Rating(s) assigned in 2022-2023	Date(s) and Rating(s) assigned in 2021-2022	Date(s) and Rating(s) assigned in 2020-2021	Date(s) and Rating(s) assigned in 2019-2020
1	Fund-based - LT-Cash Credit*	LT	2,000.00	CARE AA+; Stable	June 13, 2022			

*Long term.

Annexure-3: Detailed explanation of the covenants of the rated instruments/facilities

Not applicable

Annexure-4: Complexity level of the various instruments rated for this company

Sr. No.	Name of Instrument	Complexity Level
1	Fund-based - LT-Cash Credit	Simple

Annexure-5: Bank lender details for this company

To view the lender-wise details of bank facilities, please click here.

Note on complexity levels of the rated instruments: CARE Ratings has classified instruments rated by it on the basis of complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careedge.in for any clarifications.

Contact us

Media contact
Name: Mradul Mishra
Phone: +91-22-6754 3596
E-mail: mradul.mishra@careedge.in

Analyst contact
Name: Naveen Kumar Dhondy
Phone: 8886097382
E-mail: dnaveen.kumar@careedge.in

Relationship contact
Name: Pradeep Kumar V
Phone: +91-98407 54521
E-mail: pradeep.kumar@careedge.in

About CARE Ratings Limited:
Established in 1993, CARE Ratings Ltd. is one of the leading credit rating agencies in India. Registered under the Securities and Exchange Board of India (SEBI), it has also been acknowledged as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI). With an equitable position in the Indian capital market, CARE Ratings Limited provides a wide array of credit rating services that help corporates to raise capital and enable investors to make informed decisions backed by knowledge and assessment provided by the company.
With an established track record of rating companies over almost three decades, we follow a robust and transparent rating process that leverages our domain and analytical expertise backed by the methodologies congruent with the international best practices. CARE Ratings Limited has had a pivotal role to play in developing bank debt and capital market instruments including CPs, corporate bonds and debentures, and structured credit.

****For detailed Rationale Report and subscription information, please contact us at www.careedge.in**