

## Khushbu Auto Finance Limited

February 21, 2022

### Ratings

Facilities/Instruments	Amount (Rs. crore)	Rating <sup>1</sup>	Rating Action
Long Term Bank Facilities #	131.24	CARE BBB (CE); Negative [Triple B (Credit Enhancement); Outlook: Negative]	Revised from CARE A- (CE); Negative [Single A Minus (Credit Enhancement); Outlook: Negative]
<b>Total Bank Facilities</b>	<b>131.24</b> <b>(Rs. One Hundred Thirty-One Crore and Twenty-Four Lakh Only)</b>		

Details of instruments/facilities in Annexure-1

**#Bank Facilities are backed by unconditional and irrevocable corporate guarantee extended by Atul Auto Ltd.**

<b>Un Supported Rating</b>	<b>CARE BBB- (Triple B Minus) [Reaffirmed]</b>
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### Detailed Rationale & Key Rating Drivers

The rating assigned to the above bank facilities of Khushbu Auto Finance Ltd (KAFL) is based on the credit enhancement in the form of an unconditional & irrevocable corporate guarantee extended by Atul Auto Ltd. (AAL).

The revision in rating assigned to the bank facilities of KAFL factors significant moderation in credit profile of AAL mainly due to more than expected delay in recovery of sales volume of its vehicles arising from continuous sluggish demand scenario in three-wheeler automobile industry. The moderation in credit profile of AAL is reflected from cash losses incurred by it during 9MFY22 (FY refers to the period from April 1 to March 31) and its consequent adverse impact on its debt coverage indicators and liquidity.

However, the credit profile of AAL continues to derive comfort from its experienced promoters with strong management team having long track record of operations in the three-wheeler segment of auto industry, its state-of-the-art manufacturing facility, established distribution network, established relationship with suppliers and strong brand equity; along with its moderate capital structure.

The credit profile of AAL further continues to remain constrained by its susceptibility to volatility in raw material prices, exposure to intense competition from established players in the below one-tonne capacity segment of the industry, slowdown in demand for the three-wheeler automobile sector which is currently facing a challenging scenario, regulatory risk associated with the industry and sub-optimal utilization of its recently completed large size partly debt funded expansion project in the backdrop of a weak demand scenario.

### Rating Sensitivities

#### **Positive factors - Factors that could lead to positive rating action / upgrade:**

- Improvement in vehicle sales volume of AAL marked by annual sales of around 35,000 vehicles
- Improvement in PBILDT margin to more than 7% on a sustained basis along with improvement in AAL's leverage and debt coverage indicators

#### **Negative factors - Factors that could lead to negative rating action / downgrade:**

- Decline in scale of operations with vehicle sales volume remaining lower than 20,000 vehicles on a sustained basis leading to continued stress on AAL's profitability and debt coverage indicators
- Prolonged sub-optimal capacity utilization of AAL's newly commissioned plant adversely impacting its ROCE on a sustained basis
- Weakening in standalone credit profile of KAFL

### Outlook: Negative

The 'Negative' outlook on the long-term rating of KAFL is due to expectation of continued slow recovery in demand for three-wheelers and its consequent adverse impact on the credit profile of AAL. The outlook may be revised to 'Stable' if there is faster than expected recovery in demand for three-wheelers and AAL is able to significantly improve its sales volume leading to improvement in its credit profile.

### Key Rating Drivers of KAFL for unsupported rating

The unsupported rating assigned to the bank facilities of KAFL factors in vast experience of its promoters in the automobile and financing industry, synergetic benefits from AAL's dealer network, healthy capital adequacy and adequate liquidity. The rating also derives strength from primarily secured nature of its loan portfolio and demonstrated support from the promoter group.

<sup>1</sup>Complete definition of the ratings assigned are available at [www.careedge.in](http://www.careedge.in) and other CARE Ratings Ltd.'s publications

The unsupported rating is, however, constrained on account of its moderate asset base and earning profile, weak asset quality, concentrated resource profile, interest rate risk, moderate scale of operations, moderate product diversification with geographical concentration of its operations.

### **Detailed description of the key rating drivers (of the guarantor, AAL)**

#### **Key Rating Strengths**

#### ***Experienced promoters with strong management team who have long track record of operations in three-wheeler segment of auto industry***

AAL is promoted by the Chandra and Patel families based out of Jamnagar in Gujarat. The entire operations are currently managed under the first-generation leadership of Mr. J.J. Chandra, Chairman & Managing Director, who has an extensive business experience of more than 3 decades in three-wheeler industry. Mr. M.J. Patel, Whole time Director and Chief Financial Officer, having more than three decades of experience looks after the finance function of the company. Mr. N.J. Chandra, Whole time Director, plays an instrumental role in the overall business strategy of AAL being well supported by the experienced senior management team having vast knowledge of the automobile industry.

#### ***State-of-the-art manufacturing facility with established distribution network***

AAL has an integrated three-wheeler manufacturing facility located at Rajkot, Gujarat (one of the biggest centers for auto ancillary manufacturing in India) with an installed production capacity of 60,000 units per annum. AAL has established a strong marketing and distribution network of 330 touch points with pan-India presence (200 primary dealers and 130 sub-dealers) and it continues to penetrate further into rural and semi-urban areas apart from expanding its presence in urban markets too. It operates with 15 regional offices along with its two training centers that provide sales & marketing and technical training to dealers to boost the sales and enable customer satisfaction. AAL continues to focus on its Research & Development (R&D) activity to meet the specific requirement of its customers like comfort, safety, mileage, technology up-gradation, improving product quality etc.

#### ***Presence across various business segments of the three-wheeler automobile industry along with geographical diversification***

AAL is a fairly diversified company in terms of sales of its vehicles viz. application wise – passenger and cargo, tonnage wise - 0.35 tonne & 0.50 tonne, fuel-type wise – diesel and alternate fuels, engine wise – front and rear engines, geography wise – within Gujarat and outside Gujarat, domestic and exports. Gujarat remains a major contributor in its sales accounting for ~18% of total sales in FY21 however it has been gradually diversifying its operations to other parts of India and in export markets. "Atul Gem" and "Atul Shakti" are its key vehicles in the rural and semi-urban markets. AAL was continuously expanding its presence in export markets as evidenced by growth in exports by ~62% during FY19 over FY18. However, exports of AAL declined during FY20 & FY21 due to an overall decline in exports from India. AAL also benefits from its captive NBFC, KAFL, which is now actively supporting the sales of AAL by providing retail finance to end users since financing is a pre-requisite for growth of the three-wheeler industry.

#### ***Moderate leverage***

During 9MFY22, AAL availed term debt of Rs.75 crore largely as reimbursement towards its concluded capex. This coupled with losses incurred by it resulted in AAL's adjusted overall gearing standing at a moderate 0.82 times as on December 31, 2021 (0.45 times as on March 31, 2021) after factoring the corporate guarantee of Rs.145 crore extended by it for the bank facilities of KAFL.

#### ***Efficient working capital management along with established relationship with suppliers***

AAL has demonstrated an efficient working capital management with comfortable operating cycle of 73 days during FY21 even after significant decline in its scale of operations. During FY21, its operating cycle marginally expanded mainly due to higher inventory levels. In the normal course of business, it extends credit of around one month to its dealers and maintains inventory for one month, which is largely offset by its creditor's period of around one month and the balance is funded out of internal accruals. The company enjoys 14 days of creditor's payment days from Greaves Cotton Ltd. (diesel engine supplier) and for remaining suppliers it receives around 45-60 days of credit. Having its captive NBFC in the form of KAFL also provides further support to its working capital management.

#### ***Liquidity: Adequate***

Liquidity profile of AAL has diluted on the back of majority of its internal accruals/accumulated liquidity being deployed towards its large size project and funding of its cash losses during FY21 and 9MFY22, yet AAL has adequate liquidity marked by cushion of around Rs.10 crore in the form of unutilised fund-based working capital limits as well as Rs.15 crore of undisbursed portion of its sanctioned term loan. Its term loan instalment repayments are scheduled to commence from September 2022 which also provides some cushion till its operations ramp-up.

Moreover, KAFL also had adequate liquidity marked by good amount of unutilised bank limits. It has comfortable asset liability management (ALM) with no cumulative mismatches in any time bucket during next one year mainly because of low leverage and majority of its debt in the form of working capital borrowings.

### **Key Rating Weaknesses**

#### ***Significant adverse impact of demand slowdown during 9MFY22 leading to cash losses and consequent moderation in its debt coverage indicators***

After the sharp decline in vehicle sales volume of AAL by 63% during FY21 on a y-o-y basis on the back of slowdown in demand due to Covid-19 pandemic, AAL's management had expected good pick-up in demand during FY22 on the lower base of FY21. However, due to subsequent Covid waves in 9MFY22 and prolonged slowdown in demand for three-wheeler automobile industry, AAL's sales continued to remain sluggish as reflected from its sales volume of 11,499 vehicles in 9MFY22 vis-à-vis the low base of 11,302 vehicles in 9MFY21. Lower sales volume coupled with higher commodity prices and additional overheads w.r.to recently commenced new manufacturing facility in Ahmedabad has resulted in significantly higher cash losses for AAL in 9MFY22 on a y-o-y basis as against previously envisaged profitable operations during the period. Accordingly, despite its moderate capital structure, its debt coverage indicators have moderated sharply due to widening of its cash losses in 9MFY22.

#### ***Susceptibility to volatility in the raw material prices***

AAL requires a wide variety of raw materials for production of its vehicles including steel, aluminum, glass, rubber and special fibres along with large number of component parts which go into the assembling of an automobile. The raw materials are commodities where prices are directly linked to international market and are volatile in nature. Prices of majority of the commodities went up in the last one year. AAL's ability to control its cost structure in the light of rising cost of key raw materials and subdued demand scenario for the sector would be critical for its turnaround to profitable operations. Alternatively, its ability to manufacture fuel efficient, less polluting vehicles with the back-up of strong marketing/branding initiatives shall be the key for AAL to restore its earlier profitability margins.

#### ***Exposure to competition from the below one-tonne capacity three-wheeler manufacturers***

The three-wheeler automobile industry is highly competitive with the presence of large number of local and unorganised players for small commercial vehicles. Also, AAL faces direct competition from established players in the organised market which have a better brand visibility such as Piaggio Vehicle Pvt Ltd, Bajaj Auto Ltd, Mahindra & Mahindra and TVS Motors Ltd. During FY21, market share of AAL declined to ~10% in the cargo segment (PY: 15%) and ~1% in the passenger segment (PY: 3%). Therefore, AAL's ability to grow its scale of operations with optimum utilisation of its manufacturing facility (including the expanded new capacity) in the light of competitive three-wheeler segment is a key monitorable. Also, AAL's ability to minimize vehicle recalls due to any manufacturing defect shall be another key performance driver and protector of its profitability margins. Further, any adverse regulatory step w.r.to three-wheeler industry can have a bearing on the performance of AAL.

#### ***Recent completion of large sized partly debt funded project in the backdrop of prolonged industry slowdown***

In line with its long-term vision to acquire a decent market share in three-wheeler segment and to fuel future growth, AAL had taken up a project to set up new manufacturing unit at Bavla, near Ahmedabad with an annual capacity of 60,000 units. The initial estimated project cost was Rs.150 crore which was envisaged to be largely funded from internal accruals. Subsequently the size of project was enhanced to Rs.280 crore which was planned to be funded through term debt of Rs.90 crore and remaining through internal accruals/available liquidity. As articulated by the company management, the upward revision in cost of project had arisen largely due to establishment of own manufacturing capacity for alternate fuel engines; also, company had made certain modification in its capex design, apart from additional compliance cost for BS-VI norms, cost for R & D related to e-vehicles, etc.

AAL had cumulatively incurred Rs.238 crore on the project till March 31, 2021 which was funded through term debt of Rs.75 crore and remaining through internal accruals/available liquidity. However, commencement of the plant was delayed to September 2021 due to prevailing subdued auto industry scenario and outbreak of COVID-19 pandemic; and its subsequent capacity utilization has remained sub-optimal. Expected returns from such a large capex is likely to be delayed considering the continuing slowdown in industry demand, thereby impacting the return on its capital employed in the medium-term.

#### ***Investment in KAFL to acquire its entire stake along-with extension of corporate guarantee for higher amount of debt of KAFL***

Earlier, AAL held 30% equity stake in KAFL, however, it has now acquired balance 70% equity stake in KAFL with an additional investment of ~Rs.45 crore. Apart from this additional investment in KAFL, AAL has extended its corporate guarantee for total debt of Rs.145 crore in KAFL. As KAFL has now become its wholly owned subsidiary, AAL is also exposed to the risks associated with KAFL's financing business.

In the backdrop of subdued NBFC sector scenario, coupled with subdued demand in automobile industry, KAFL's loan portfolio has remained largely stagnant during the last three years ended FY21. During 9MFY22, with delay in recovery of economic activity, asset quality deteriorated marked by Gross NPA of 16.01% (8.90% as on March 31, 2021) and Net NPA of 13.37% (7.55% as on March 31, 2021) while it continued to have comfortable overall gearing at 1.35 times and Capital Adequacy Ratio (CAR) at 56.50% as on December 31, 2021. However, upon higher NPAs and provisions, its profitability has declined in 9MFY22.

### **Analytical Approach:**

**For Credit Enhanced Rating:** Guarantor's (i.e. AAL's) assessment since bank facilities of KAFL are entirely backed by unconditional and irrevocable corporate guarantee extended by AAL. CARE Ratings Limited has analysed AAL on standalone basis while the corporate guarantee extended by it is also factored in the assessment.

**For Un-supported Rating:** For the purpose of credit risk assessment of KAFL without considering the explicit credit enhancement from AAL, CARE Ratings Limited has considered the standalone financials of KAFL along with the operational and financial linkages with its parent company i.e. AAL.

**Applicable Criteria:**

[Criteria on assigning Outlook and Credit Watch to Credit Ratings](#)

[CARE's Policy of Default Recognition](#)

[Rating Methodology – Manufacturing Companies](#)

[Rating Methodology – Commercial Vehicle Industry](#)

[Rating Methodology – Non-Banking Finance Companies](#)

[Financial Ratios – Non-Financial Sector](#)

[Financial Ratios – Financial Sector](#)

[Liquidity Analysis of Non-Financial Sector Entities](#)

[Rating Methodology: Notching by factoring linkages in Ratings](#)

[Criteria for Rating Credit Enhanced Debt](#)

**About the Company (KAFL)**

KAFL was incorporated in 1994 with the aim of captive financing arm of AAL and till 2009 it continued to finance the vehicles manufactured by AAL only. During 2008-09 post global financial crises, KAFL stopped new funding as a part of financial consolidation. However, KAFL was revived from latter part of FY17 and it is actively supporting AAL's products for its vehicle finance to the end users. Now, KAFL is a wholly owned subsidiary of AAL. Apart from financing three wheelers of AAL, KAFL also provides loans for two wheelers, commercial vehicles and loan against property (LAP). KAFL continues to leverage AAL's strong brand equity and wide distribution network with deep penetration across rural and semi-urban markets. The outstanding loan portfolio of KAFL stood at Rs.165.70 crore as on December 31, 2021. Entire sanctioned debt of KAFL is backed by corporate guarantee of AAL.

(Rs. Crore)

Brief Financials of KAFL	FY20 (A)	FY21 (A)	9MFY22 (UA)
Income Operating Income	32.65	33.87	24.41
PAT	3.20	5.29	1.17
Total Assets	150.58	158.83	186.69
Net NPA (%)	10.35	7.55	13.37
ROTA (%)	2.18	3.42	NA

A: Audited; UA: Un-audited; NA: Not Available

**About the Guarantor (AAL)**

AAL, incorporated in 1986 and based out of Rajkot, Gujarat, is promoted by Chandra and Patel families. It manufactures three-wheelers (passenger as well as cargo segment) under the brand name of 'Atul' and is also engaged in manufacturing of spare parts, components and allied products. It majorly deals in below one-tonne capacity with all gasoline engine variants and has also added alternate fuel and electric vehicles in its product portfolio. The company has installed capacity of manufacturing 60,000 units p.a. at Rajkot plant and it has recently enhanced its capacity by adding another 60,000 units p.a. at its new facility at Bavla, near Ahmedabad. The promoters of AAL commenced their operations in 1975 by pioneering with its flagship product "Chakda", which became an icon in the rural market of Gujarat. Later in 2000 it broadened its product line with the introduction of "Atul Shakti" and "Atul Gem" which are its best-selling vehicles along with more than 45 models (including tailor-made). AAL has also entered in energy operated vehicle category by launching "Atul E-Lite" product. AAL is continuously expanding its pan-India presence and is also listed on both BSE and NSE.

(Rs. Crore)

Brief Financials of AAL	FY20 (A)	FY21 (A)	9MFY22 (UA)
Total Operating Income	628.36	297.25	209.89
PBILDT	73.67	(6.27)	(16.55)
PAT	52.38	(10.21)	(19.20)
Overall Gearing (times)	0.00	0.05	0.30
Adj. Overall Gearing (times)#	0.40	0.45	0.82
Interest Coverage (times)	90.95	-ve	-ve

A: Audited; UA: Un-audited

# adjusted overall gearing is calculated after addition of guaranteed debt of KAFL to the total debt of AAL

**Status of non-cooperation with previous CRA:** Not Applicable

**Any other information:** Not Applicable

**Rating History (Last three years):** Please refer Annexure-2

**Covenants of rated instrument / facility:** Not Applicable

**Complexity Level of various instruments rated for this company:** Please refer Annexure-3

**Annexure-1: Details of Instruments/Facilities**

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Fund-based - LT-Cash Credit		-	-	-	105.00	CARE BBB (CE); Negative
Fund-based - LT-Term Loan		-	-	Dec. 2024	26.24	CARE BBB (CE); Negative
Un Supported Rating-Un Supported Rating (Long Term)		-	-	-	0.00	CARE BBB-

**Annexure-2: Rating History of last three years**

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2021-2022	Date(s) & Rating(s) assigned in 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019
1	Fund-based - LT-Cash Credit	LT	105.00	CARE BBB (CE); Negative	1)CARE A-(CE); Negative (03-Aug-21)	1)CARE A (CE); Stable (15-Sep-20)	1)CARE A+(CE); Negative (06-Sep-19)	1)CARE A+(SO); Stable (30-Oct-18)
2	Fund-based - LT-Term Loan	LT	26.24	CARE BBB (CE); Negative	1)CARE A-(CE); Negative (03-Aug-21)	1)CARE A (CE); Stable (15-Sep-20)	1)CARE A+(CE); Negative (06-Sep-19)	1)CARE A+(SO); Stable (30-Oct-18)
3	Un Supported Rating-Un Supported Rating (Long Term)	LT	0.00	CARE BBB-	1)CARE BBB-(03-Aug-21)	1)CARE BBB-(15-Sep-20)	-	-

**Annexure-3: Complexity level of various instruments rated for this company**

Sr. No	Name of instrument	Complexity level
1	Fund-based - LT-Cash Credit	Simple
2	Fund-based - LT-Term Loan	Simple
3	Un Supported Rating-Un Supported Rating (Long Term)	Simple

**Annexure 4: 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 instrument:** 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](mailto:care@careedge.in) for any clarifications.

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### About CARE Ratings Limited:

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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.

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