Khushbu Auto Finance Limited

September 15, 2020

Ratings

Facilities	Amount (Rs. crore)	Ratings[1]	Rating Action
Long-term Bank Facilities	105.42 (reduced from 115.00)	**CARE A (CE); Stable [Single A (Credit Enhancement); Outlook: Stable]**	**Revised from CARE A+ (CE); Negative [Single A Plus (Credit Enhancement; Outlook: Negative)]**
Total Facilities #	**105.42 (Rupees One hundred five crore and forty two lakh only)**		

Detail of facilities in Annexure-1

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

Unsupported Rating[2]	**CARE BBB- [Triple B Minus]**

Unsupported rating do not factor-in the explicit credit enhancement

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 moderation in credit profile of AAL mainly due to moderation in sales volume of its vehicles during FY20 (FY refers to the period April 1 to March 31) on the back of weak demand scenario in the automobile industry which has further aggravated during 5MFY21 on the back of Covid-19 induced lockdowns leading to expectation of significant decline in its Total Operating Income (TOI) during FY21 along-with moderation in its profitability. The revision in rating also factors deterioration in the asset quality of KAFL whereby its entire debt is guaranteed by AAL.

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 and strong brand equity. The credit profile of AAL also factors its comfortable leverage and debt coverage indicators along with its efficient working capital management and established relationship with suppliers.

The credit profile of AAL, however, continues to remain constrained by its susceptibility to volatility in raw material prices, regulatory risk, exposure to intense competition from established players in the below one-tonne capacity segment of the industry, slowdown in demand for the automobile sector which is currently facing a challenging scenario and its large size debt funded capex which is nearing its completion in the backdrop of a weak demand scenario.

CARE also notes that AAL has not availed any moratorium as a Covid relief measure, in line with Reserve Bank of India (RBI) guidelines, for servicing of its bank facilities which underlines its adequate liquidity profile.

Rating Sensitivities

Positive Factors

- Sustained growth in AAL's scale of operations with TOI of more than Rs.700 crore while maintaining its comfortable leverage and debt coverage indicators
- PBILDT margin of more than 12% on a sustained basis
- Significant improvement in market share in passenger and cargo vehicle segment

Negative Factors

- Decline in scale of operations marked by TOI lower than Rs.400 crore on a sustained basis
- Decline in profitability margins marked by PBILDT margin of less than 10% on a sustained basis leading to adverse impact on its debt coverage indicators
- Any inordinate delay in commissioning of the project beyond envisaged timelines along with significant cost overrun
- Sustained stabilization related issues in the new plant resulting in lower than envisaged capacity utilization and thereby adversely impacting its returns compared with what was previously envisaged
- Extension of corporate guarantees for the bank facilities of KAFL by AAL beyond the existing level

Key Rating Drivers of KAFL for unsupported rating

The unsupported rating assigned to the bank facilities of Khushbu Auto Finance Limited (KAFL) factors in vast experience of its promoters in the automobile and financing industry, synergetic benefits from AAL's dealer network, healthy capital

[1]*Complete definition of the ratings assigned are available at www.careratings.com and other CARE publications*

[2] *As stipulated vide SEBI circular no SEBI/ HO/ MIRSD/ DOS3/ CIR/ P/ 2019/ 70 dated June 13, 2019*

adequacy and liquidity. The rating also derives strength from primarily secured nature of its loan portfolio and demonstrated support from the promoter group.

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.

CARE also notes that KAFL has availed moratorium as a Covid relief measure from only one of its working capital lenders on servicing of interest for the period from March 2020 to August 2020.

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 established integrated manufacturing facility located at Rajkot, Gujarat (one of the biggest centres for auto ancillary manufacturing in India) with the 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 centres 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 in all business segments of the three-wheeler industry along with geographical diversification

AAL is a fairly diversified company in terms of sales of its vehicles viz. Application wise – Passenger & Cargo, Tonnage wise - 0.35 tonne & 0.50 tonne, Fuel-type wise – Diesel & Alternate fuels, Engine wise – Front & Rear engines, Geography wise – within Gujarat & outside Gujarat, Domestic & Exports. Gujarat remains a major contributor in its sales accounting for 28.91% of total sales in FY20 however it has been gradually diversifying its operations to other parts of India & exports. “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 KAFL declined during FY20 due to 12% overall decline in exports from India. Looking at improving presence of AAL, its promoters had revived its captive NBFC viz. KAFL in FY17 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.

Strong financial risk profile marked by comfortable leverage and debt coverage indicators

AAL has a strong financial risk profile reflected by sustained growth in scale of operations along-with healthy profit margins in general. However, due to subdued demand and imposition of nationwide lockdown in last week of March 2020, company’s sales volume declined by 12%; on account of which company reported decline in total operating income by 6.31% to Rs.628.36 crore during FY20 from Rs. 670.70 crore during FY19. However, company was able to mostly maintain profitability during FY20 marked by PBILDT margin of 11.72% (P.Y. 12.74%) and PAT margin of 8.34% (P.Y. 7.92%). AAL has remained debt free on a standalone basis since FY13 and has been building up a strong net-worth position. However, during 5MFY21, company has drawn term debt of Rs.15 crore in order to fund its ongoing capex for setting up additional manufacturing facility. AAL’s adjusted overall gearing stood at 0.40 times as on March 31, 2020 (0.47 times as on March 31, 2019) after factoring the corporate guarantee of Rs.115 crore extended by it for the bank facilities of KAFL. Extension of corporate guarantees to KAFL beyond the envisaged levels shall be a key credit monitorable for AAL.

Efficient working capital management along with established relationship with suppliers

AAL has demonstrated an efficient working capital management with comfortable operating cycle of 56 days during FY20. 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

AAL has adequate liquidity marked by sufficient cushion from its envisaged cash accruals with term debt instalment repayment obligations starting from FY22. Its capex requirement is majorly funded through internal accruals and it has in place term loan sanction of Rs.90 crore for drawal; its comfortable leverage provides sufficient gearing headroom. AAL also has sanction of Rs.15 crore of working capital limits; with negligible utilization. It is more than adequate to meet its incremental working capital needs over the next one year. Also, its current ratio stood comfortable at 1.96 times as on March 31, 2020. However, on the back of majority of its internal accruals/accumulated liquidity deployed towards its large size on-going project, its hitherto comfortable liquidity has diluted over a period of time.

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 mainly because of low leverage & majority of its debt in the form of working capital borrowings.

Key Rating Weaknesses

Adverse impact of demand slowdown in the automobile sector along-with Covid-19 pandemic affecting AAL's performance

During FY20, overall automobile industry faced challenges due to various factors such as increased insurance costs, uneven monsoon, high ownership costs, curtailed lending by the NBFC segment, weak festival demand, weak consumer sentiments, migration to BS-VI norms and the spread of Covid-19 in the country by end of the year. Auto industry usually pushes more vehicles in the market in the last month of every financial year. However, due to nationwide lockdown from March 24, 2020, company could not do so this time— both domestically and globally. Hence, AAL's overall sales volume declined by 12% during FY20 to 44,082 units. Also, export volume declined by 39% during FY20 over FY19. Due to imposition of nationwide lockdown, company had shut its manufacturing facilities from March 24, 2020 till May 2020 due to which company could sell only 1,477 units during Q1FY21 as against 10,514 units in Q1FY20. Hence, TOI of the company for Q1FY21 moderated by 82% on Y-o-Y basis to 26.87 crore and it also incurred cash losses during the quarter. Subsequently, there has been some growth in sales volume in the months of July & August 2020; however, the same are still on the lower side.

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 & special fibres and large number of component parts 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. AAL's ability to control its cost structure in the light of fluctuating cost of key raw materials and subdued demand scenario for the sector would be critical. 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 improve its 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. Although it enjoys decent market share of ~16% in the cargo segment; it had a very meager market share of ~3% in the passenger segment during FY20. 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.

Ongoing capacity expansion project in the backdrop of industry slowdown; along with increase in size of capex compared with original plan

In line with its long term vision to acquire a decent market share in three-wheeler segment and to fuel future growth, AAL has 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 enhanced to Rs.225 crore and the same is further enhanced to Rs.280 crore to be funded through term debt of Rs.90 crore and remaining through internal accruals. Due to enhancement in project cost, term debt for the revised project cost is higher than envisaged debt which shall lead to moderation in capital structure of AAL.

As articulated by the company management, the upward revision in cost of project has arisen largely due to establishment of own manufacturing capacity for alternate fuel engines; also, company has 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 has cumulatively incurred Rs.211 crore on the project till August 31, 2020 which is funded through term debt of Rs.15 crore and remaining entirely through internal accruals. Company has achieved 90% completion of project work and expects to complete entire installation by end of September 2020 instead of earlier estimation of March 2020. However, due to prevailing auto industry scenario & outbreak of COVID19, company has planned to defer capex of ~Rs.50 crore which is not directly linked to commencement of commercial production. Also, company has decided to commence commercial operations from new plant only after situation gets normalized and there is revival in demand.

Lower than expected growth in loan book of KAFL during FY20 and deterioration in its asset quality; along with subdued outlook for NBFCs

In the backdrop of subdued NBFC sector scenario, coupled with subdued demand in automobile industry, KAFL's loan portfolio remained largely stable at Rs.146.71 crore as on March 31, 2020 as against Rs.139.80 crore as on March 31, 2019. Three-wheeler financing constituted ~72% of its total loan portfolio as on March 31, 2020 (balance comprised of two-wheeler, commercial vehicle and LAP financing). KAFL's outstanding loan portfolio as on March 31, 2019 was spread across eight states. However, around 80% of the asset under management (AUM) as on March 31, 2020 was concentrated in Gujarat (45.47%), Karnataka (19.97%) and Andhra Pradesh (13.68%).

Profitability of KAFL, too, exhibited moderation marked by decline in its ROTA to 2.18% during FY20 compared with 5.21% during FY19 mainly due to higher loan provisioning/write offs.

KAFL's asset quality deteriorated during FY20 marked by rise in its Gross NPA from 7.08% as on March 31, 2019 to 11.73% as on March 31, 2020. However, as articulated by company management, major increase in NPA lies with IDP (Income Distribution Partner) wherein collection risk is lying at their end. Extent of direct and indirect support extended by AAL to KAFL along-with performance of KAFL going forward would also be a key credit monitorable. KAFL's capital structure, however, stood comfortable with overall gearing at 1.21 times and Capital Adequacy Ratio (CAR) at 42.57% as on March 31, 2020.

Due to subdued economic environment, last three years have been challenging period for the NBFCs with moderation in growth and rising delinquencies resulting in higher provisioning thereby impacting profitability. However, comfortable capitalization levels and liquidity management continue to provide comfort to the credit profile of NBFCs despite impact on profitability. Also, with the improvement in economic environment, asset quality pressures should ease which will partially offset the impact of migration towards 90 -day NPA recognition norm. However, the spread of the COVID-19 pandemic has led to a nation-wide lockdown which is likely to impact the overall growth and collections of NBFCs sector. As a result, in CARE's view the credit risk profile of NBFCs is expected to deteriorate over the medium term. Liquidity profile, resource raising ability, funding support from parent/group and exposure to vulnerable asset classes and operating profiles in terms of geographies and borrower types would be critical monitorable factors in the NBFCs sector.

Analytical approach:

For Credit Enhanced Rating: Guarantor's (i.e. AAL's) assessment since bank facilities of KAFL are entirely backed by unconditional & irrevocable corporate guarantee extended by AAL. CARE 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 has considered the standalone financials of KAFL along with the operational and financial linkages with its group company i.e. AAL.

Applicable Criteria

Criteria on assigning 'outlook' and 'credit watch' to Credit Ratings
CARE's Policy on Default Recognition
Financial ratios – Non-Financial Sector
Financial ratios – Financial Sector
Rating Methodology-Manufacturing Companies
Rating Methodology-Commercial Vehicles
Rating Methodology: Non- Banking Financial Companies
Criteria for Rating Credit Enhanced Debt
Rating Methodology: Factoring Linkages in Ratings

About the Company (KAFL)

Khushbu Auto Finance Ltd (KAFL) is an associate concern of AAL whereby AAL holds 30% equity stake while balance equity stake is held by the promoter group of AAL. KAFL was incorporated in 1994 with the concept 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. Apart from financing three wheelers of AAL, KAFL also provide loans for two wheelers, commercial vehicles and 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.146.71 crore as on March 31, 2020. KAFL has got sanction for Rs.100 crore working capital bank facilities & outstanding term loan which are entirely backed by corporate guarantee of AAL.

Khushbu Auto Finance Ltd.

Brief Financials (Rs. crore)	FY19 (A)	FY20 (Prov.)
Total operating income	31.13	32.65
PAT	7.64	3.20
Total Assets	143.91	150.58
Interest Coverage (times)	2.18	1.47
ROTA (%)	5.21	2.18
Gross NPA (%)	7.08	11.73
Net NPA (%)	5.27	10.35

A: Audited; Prov.: Provisional

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 strong 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. The company has installed capacity of manufacturing 60,000 units p.a. at Rajkot plant and is in the process of enhancing its capacity by adding another 60,000 units 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 local rural market of Gujarat. Later in 2000 it broadened its product line with the introduction of "Atul Shakti" and "Atul Gem" which are the best-selling products along with 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.

Atul Auto Ltd.

Brief Financials (Rs. crore)	FY19 (A)	FY20 (A)
Total operating income	670.70	628.36
PBILDT	85.42	73.67
PAT	53.12	52.38
Overall gearing (times)	0.00	0.00
(Adjusted) Overall gearing #	0.47	0.40
Interest coverage (times)	132.01	90.95

A: Audited;
 # adjusted overall gearing is worked out after addition of guaranteed debt of KAFL to the total debt of AAL

As per provisional results for Q1FY21, AAL reported TOI of Rs.26.87 crore (Q1FY20: 148.70 crore) with a net loss of Rs.6.77 crore (Q1FY20: PAT of Rs.11.25 crore).

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating History for last three years: Please refer Annexure-2

Annexure-1: Details of Facilities

Name of the Instrument	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Fund-based - LT-Cash Credit	-	-	-	100.00	CARE A (CE); Stable
Fund-based - LT-Term Loan	-	-	Sept 2021	5.42	CARE A (CE); Stable
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 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018
1.	Fund-based - LT-Cash Credit	LT	100.00	CARE A (CE); Stable	-	1)CARE A+ (CE); Negative (06-Sep-19)	1)CARE A+ (SO); Stable (30-Oct-18)	1)CARE A+ (SO); Stable (01-Aug-17)
2.	Fund-based - LT-Term Loan	LT	5.42	CARE A (CE); Stable	-	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-	-	-	-	-

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

Sr. No.	Name of the 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

Note on complexity levels of the rated instrument: *CARE has classified instruments rated by it on the basis of complexity. This classification is available at www.careratings.com. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

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About CARE Ratings:
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