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India Ratings Affirms Hinduja Leyland Finance at 'IND AA-'; Outlook Stable

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India Ratings and Research (Ind-Ra) has affirmed Hinduja Leyland Finance Limited's (HLF) Long-Term Issuer Rating at 'IND AA-'. The Outlook is Stable. The instrument-wise rating action is as follows:

Instrument Type	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of Issue (billion)	Rating/Outlook	Rating Action
Lower tier II subordinated debt	-	-	-	INR2.5	IND AA-/Stable	Affirmed

Details in annexure

The rating factors in HLF's sizeable franchise in commercial vehicle financing space, diversified portfolio across products and geographies, synergy benefits on account of subsidiary of Ashok Leyland Limited (ALL), stable funding, adequate liquidity profile and experienced management.

The rating also factors in HLF's higher loan growth leading to unseasoned book, moderate pre-provision operating buffer, higher credit costs and modest capital buffers.

KEY RATING DRIVERS

Sizable Franchise; Well-Diversified Portfolio across Product Segments: HLF's loan portfolio remains fairly diversified and spread over multiple segments in vehicle finance, loan against property and portfolio buyouts. HLF has pan-India geographical presence and remains sizeable player in the vehicle finance space. Loan book grew at a CAGR of 36% over FY16-FY19, with sizable portion of book remaining unseasoned. HLF has modified its customer strategy from moving away from first time user (borrowers with no vintage in managing vehicle) to first time buyer customers and is incrementally focusing on adding small road transport operators and strategic customers.

Synergy Benefits from ALL: As per the management, HLF funds about 12% of retail sales of ALL which comprise about 30% of HLF's on-book loans in FY19 (FY18: 39%). ALL has regularly infused equity in HLF supporting its expansion plans. ALL holds 61.8% stake in HLF, while Hinduja Group collectively holds 92.4% in HLF as at FY19. Also, ALL has articulated to hold majority shareholding in HLF, even post dilution through initial public offer in the medium term. ALL has been adding new vehicle segments across tonnage capacities, thereby increasing volumes and market share. HLF benefits indirectly from the expansion in ALL's product line. HLF has a well-diversified loan book with products funded across original equipment manufacturers.

Stable Funding Profile: Bank comprises large part of HLF's funding (1QFY20: 77.4%, FY19: 73.74%, FY18: 68.4%) with relationship spread across 22 banks. HLF's capital market borrowings such as non-convertible debentures and subordinated debt, collectively formed 16.9% as of 1QFY20 (FY19: 19.6%, FY18: 26%) of the overall funding. The agency considers HLF's ability to access bank funds to be reasonable, given its potential to leverage the Hinduja Group's banking relationships.

Liquidity Indicator - Adequate: HLF has a well-matched asset-liability maturity (ALM) profile across various tenors, supported by a high proportion of long-term borrowings (1QFY20: 90.8%, FY19: 91%, FY18: 90.6%). Moreover, the company typically maintains three months of disbursements in the form of unutilised bank lines, typically term loans and cash credits, totalling about INR15.6 billion on a net basis as on 1QFY20.

HFL's ALM profile in less than one-year buckets remains largely matched, even post Ind-Ra's stress test with gaps adequately covered with unutilised bank lines. The company's funding is also well-diversified across banks and capital markets. Ability of HLF to monetise its retail book through securitisation, adds to existing funding diversity.

PPoP Buffers Largely Stable: HLF's pre-provision operating profit (PPoP)/average assets remained stable over FY18-FY19 (FY19: 5.6%; FY18: 5.9%) largely supported by moderate operating expense. However, credit costs (CC) as a percentage of average assets stood at 3.2% in FY19 (FY18: 3.7%). The credit cost for HLF stands elevated due to aggressive write-off policy, where accounts in harder buckets would be fully provided on books.

Ind-Ra expects PPoP to remain stable in the medium term, supported by low operating expenses (operating expenses/average assets for FY19: 1.4%, FY18: 1.4%). However, higher PPoP translating into profitability will depend on HLF's ability to manage credit costs. HLF's PPoP/CC buffer for HLF stood at 1.92x in 1QFY20 (FY19: 1.78x).

Asset Quality to be Monitored for Seasoning: HLF's overdue based on 90 days past due basis increased to 4.4% in 1QFY20 (FY19: 4.7%, FY18: 5%). The delinquencies are largely driven by small commercial vehicle, tractor, three-wheeler and two-wheeler segments which comprise 25% of overall AUM as on 1QFY20. Also, HLF's gross stage 3 asset as a percentage of on-book AUM stood at 6% in FY19 (FY18: 5%). As franchise scales up, Ind-Ra believes IT system needs to be updated to monitor real time portfolio quality with focus on analytics to drive early warning indicators. Also, lower delinquencies in portfolio buyout and loan against property book, largely moderates overall asset quality pressure. However, with the seasoning of loan book, there could be a rise in delinquencies in loan against property book (1QFY20: 11.7% of AUM, FY19: 11.1%, FY18: 12.8%).

Ind-Ra expects the new axle load norms, applicable for new and existing vehicles, has increased system capacity and has led to a slowdown in vehicle sales, thus reducing the disbursement growth for the industry. Also, economic slowdown with excess capacity created in vehicle segment has exerted pressure on freight rates, which could reduce capacity utilisation impacting servicing capability of borrowers. Also, Ind-Ra maintains a cautious view on loan against property, where the industry is facing rising delinquency, largely due to a slowdown in real estate prices, aggressive property valuations, slowdown in refinancing and challenges in monitoring end-use of funds and borrower cash flows.

Weak Capitalisation Needs to be Strengthened: HLF's Tier I capital ratio stood at 11.1% in FY19 (FY18: 12.2%), as the growth in AUM (FY19: 31.9%, FY18: 36.9%) exceeded the growth in internal accruals (12.9%, 12.7%). Over the next few years, HLF's high loan growth trajectory is likely to necessitate regular equity injections. There has been regular and timely equity infusion from shareholders for supporting business growth, with ALL contributing larger share. In FY19, the company received capital infusion of INR2 billion in the form of right issue in FY19 (FY18: INR4.5 billion).

RATING SENSITIVITIES

Positive: Stable asset quality through-the-cycle, along with the adequate seasoning of the portfolio from the current high-growth phase, prudent funding and liquidity buffers, along with a stronger capital buffer could lead to a rating upgrade.

Negative: Significant weakening of asset quality, along with an increase in credit cost or a fall in capital buffers due to high growth strategy without adequate internal accruals to support growth or infusion of capital, could lead to a rating downgrade. Consistent fall in operating buffers i.e. PPOP/CC of less than 1.5x or build-up of negative gaps in early buckets of asset-liability tenor would be negative for the rating.

COMPANY PROFILE

HLF was incorporated in 2008 and was registered as a non-deposit accepting non-banking finance company in March 2010. The company is promoted by ALL, the Hinduja Group's flagship automobile manufacturing company. HLF operates in more than 1,560 locations across 23 states in India.

FINANCIAL SUMMARY

Particulars	FY19 (IND-AS)	FY18 (IND-AS)
Total assets (INR billion)	202.0	157.9
Total equity (INR billion)	272.4	202.0
Net income (INR billion)	2.76	1.82
Return on average assets (%)	1.5	1.3
Equity/assets (%)	13.5	12.8
Tier 1 capital (%)	11.1	12.2
Source: HLF		

RATING HISTORY

Instrument Type	Current Rating/Outlook			Historical Rating/Outlook		
	Rating Type	Rated Limits (billion)	Rating	19 September 2018	1 August 2017	19 May 2016
Issuer rating	Long term	-	IND AA-/Stable	IND AA-/Stable	IND A+/Stable	IND A+/Stable
Lower tier II subordinated debt	Long-term	INR2.5	IND AA-/Stable	IND AA-/Stable	IND A+/Stable	IND A+/Stable

ANNEXURE

Instrument	ISIN	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of Issue (billion)	Rating/Outlook	Rating Action
Lower tier II subordinated debt	INE146O08027	28 March 2014	12.00	28 March 2021	INR0.10	IND AA-/Stable	Affirmed
Lower tier II subordinated debt	INE146O08019	21 February 2014	12.00	21 February 2021	INR0.25	IND AA-/Stable	Affirmed
Lower tier II subordinated debt	INE146O08035	3 June 2014	12.40	3 November 2019	INR1.10	IND AA-/Stable	Affirmed
Lower tier II subordinated debt	INE146O08043	3 June 2014	12.40	3 April 2020	INR1.05	IND AA-/Stable	Affirmed

COMPLEXITY LEVEL OF INSTRUMENTS

For details on the complexity level of the instrument, please visit https://www.indiaratings.co.in/complexity-indicators.

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Applicable Criteria

Non-Bank Finance Companies Criteria
Rating FI Subsidiaries and Holding Companies

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