India Ratings & Research
A Fitch Group Company

India Ratings Affirms Hinduja Leyland Finance at 'IND AA-'/Stable; Rates Bank Loan

12

OCT 2020

By Jinay Gala

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 actions are as follows:

Instrument Type	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of Issue (billion)	Rating/Outlook	Rating Action
Lower tier II subordinated debt*	-	-	-	INR0.35(reduced from INR2.5)	IND AA-/Stable	Affirmed
Bank loan	-		-	INR1	INDAA-/Stable	Assigned

*Details in annexure,

The rating factors in HLF's sizeable franchise in the commercial vehicle financing space, its diversified portfolio across products and geographies, improved capital buffers, the synergy benefits owing to the company being a subsidiary of Ashok Leyland Limited (ALL), stable funding, the adequate liquidity profile and the experienced management.

The rating also factors in HLF's high loan growth in the previous years, which has led to an unseasoned book, its moderate pre-provision operating buffers and higher credit costs compared to peers.

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 expanded its geographical presence in the country and remains a sizeable player in the vehicle finance space. The company has modified its customer strategy from moving away from first-time users (borrowers with no experience in managing the vehicle) to first-time buyers and is incrementally focusing on adding small road transport operators and strategic customers.

Synergy Benefits from ALL: As per the management, HLF funds about 8% of ALL's retail sales, which comprised about 27.1% of the former's on-book loans in FY20 (FY19:30%, FY18: 39%). ALL has regularly infused equity in HLF, supporting its expansion plans. ALL increased its stake in HLF to 68.8% in 1QFY21 from 61.8% in December 2019; the

Hinduja group collectively held 96.2% stake in HLF in 1QFY21. Also, ALL has publicly articulated its intention to hold majority shareholding in HLF even post the dilution through the initial public offering in the medium term. Additionally, ALL's chairman and chief financial officer sit on HLF's board. ALL has been adding new vehicle segments across tonnage capacities, thereby increasing its market share; this has indirectly been benefiting HLF.

Improvement in Capitalisation, but Adequate Buffers Need to be Maintained Throughout the Cycle: HLF's tier I capital ratio stood at 15.2% in 1QFY21 (FY20: 14.4%, FY19: 11.1%), as the growth in the assets under management (AUM; FY20: 4%; FY19: 31.9%, FY18: 36.9%) was lower than that in internal accruals (10.7%, 12.9%, 12.7%). There have been regular and timely equity infusions from shareholders for supporting business growth. In FY20, ALL increased its share in HLF to 68.8% from 61.8% by investing around INR3 billion, primarily by intra-group transfers and buying out some shares of the private equity partner, taking its total investment in HLF since inception to INR18.4 billion. HLF is planning to raise INR3 billion in FY21, through existing or new investors, to strengthen the capital buffers as well as to support its growth plans.

Stable Funding Profile: Banks account for a large portion of HLF's funding (1QFY21: 90%, FY20: 87%, FY19: 73.7%), with relationships spread across 21 banks. HLF's capital market borrowings such as non-convertible debentures and subordinated debt, collectively formed 9.8% of the overall funding in 1QFY21 (FY20: 12.9%, FY19: 19.6%). 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 (1QFY21: 97.9%, FY20: 97.2%, FY18: 91%). Moreover, the company typically maintains three months of disbursements in the form of unutilised bank lines, typically term loans, NCDs and cash credits, totalling about INR24.5 billion on a net basis as of August2020 which along with cash and liquid investments of INR5 billion as of August 2020; even in the absence of any inflows, these funds would be sufficient to meet the repayment obligations for the subsequent six months, offering a coverage of 1.55x. HLF has been able to mobilise funds under the targeted long-term repo operations and partial credit guarantee schemes floated by the Reserve Bank of India along with refinance lines from Small Industries Development Bank of India (debt rated at 'IND A1+') .

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

PPoP to Credit Buffer Moderate Compared to Peers: HLF's pre-provision operating profit (PPoP)/average assets moderated to 5.2% in FY20, largely due to a decline in other income (FY20: 1.2%; FY19: 1.7%). The credit costs (CC) as a percentage of average assets improved to 3% in FY20 (FY19:3.2%, FY18: 3.7%). The credit cost for HLF stands elevated due to the aggressive write-off policy, wherein accounts in harder buckets would be fully provided for in the books.

Ind-Ra expects the PPoP to remain stable in the medium term, supported by low operating expenses (operating expenses/average assets - FY20: 1.6%; FY19: 1.4%, FY18: 1.4%), resulting from the utilisation of some services through external service providers. However, the translating of higher PPoP into profitability will depend on HLF's ability to manage credit costs in lieu of the challenging operating environment. HLF's PPoP/CC buffer for HLF stood at 1.58x in 1QFY21(FY20:1.71x, FY19: 1.78x). Ind-Ra expects the PPOP to CC cost buffers to come under pressure in FY21, which could continue into the initial quarters of FY22 on account of the pandemic. However, the same should stabilise towards the end of FY22.

Asset Quality to be Monitored for Seasoning: HLF's 90+dpd on its overall AUM (on book +off book+ committed loan disbursement) stood at 4.5% in 1QFY21(FY20:4.4%, FY19:4.7%, FY18: 3.9%). The gross stage 3 plus write off as a percentage of earning on-book assets for HLF stood at 8.6% in FY20 (FY19: 7.8%), with provision coverage (including the write-off portion) of 57.9%. The delinquencies are largely driven by light commercial vehicles, multi utility vehicles, medium commercial vehicles and two-wheeler segments, which jointly comprised 11.1% of the overall AUM in 1QFY21, with combined delinquencies of 11.9%. The AUM grew at a CAGR of 23.2% over FY17-FY20, with a sizable portion of book remaining unseasoned.

As the franchise scales up, Ind-Ra believes the company's information technology system would need to be updated to monitor real-time portfolio quality, with a focus on analytics to drive early warning indicators. Lower delinquencies in the portfolio buyout and loan against property book largely mitigate the pressure on overall asset quality. However, with the seasoning of the loan book, there could be a rise in delinquencies in the loans against property book (share in AUM - FY20: 13%; FY19: 11.1%; FY18: 12.8%).

Ind-Ra believes the new axle load norms, applicable for new and existing vehicles, had increased system capacity and led to a slowdown in vehicle sales, thus reducing the disbursement growth for the industry even before COVID-19-led disruptions. This along with the economic slowdown has exerted pressure on freight rates, which could reduce capacity utilisation, impacting the servicing capability of borrowers. Also, Ind-Ra has maintained a cautious view on the loans against property segment, wherein the industry has been facing rising delinquencies, 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.

COVID-19 Impact: The ongoing COVID-19 crisis could have a material impact on delinquencies post the end of moratorium. Business momentum would pick up only at a slow pace, thereby creating pressure on self-employed borrowers, as their cashflows would be insufficient to meet the repayment burden post the moratorium. Ind-Ra expects there could be higher delinquencies along with restructuring in 2HFY21, as the heavy vehicle finance industry would continue to remain under pressure due to overcapacity and a sluggish pick-up in demand. In the medium term, the industry might witness pent-up demand for two-wheelers and three wheelers, as customers would prefer to purchase these vehicles to avoid the public transportation system, given the prevalence of social distancing norms in the wake of the pandemic; however, this demand would largely be driven by replacement demand. Considering the prevailing stress in the operating environment, Ind-Ra believes vehicle financers would need to maintain adequate liquidity to cover their immediate three-month repayments on an on-going basis, and would also need to focus on collections to control the migration of softer delinquencies.

The book under moratorium for HLF stood at 31.4% at end-August 2020, while its collection efficiency improved to 74.7% September 2020 vs 68.6% in August 2020. Post the ending of moratorium benefit, the book might need restructuring or could witness slippages into non-performing assets; this would be a key monitorable. To cover a certain portion of stress, HLF had made a COVID-19 provision of INR0.8billion, forming 0.32% of the AUM, as of end-June 2020.

RATING SENSITIVITIES

Positive: Growing the franchise, achieving leadership position in its product segments along with maintaining stable asset quality through-the-cycle, with adequate seasoning of the portfolio, prudent funding and liquidity buffers, coupled with stronger capital buffers, 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 without adequate internal accruals to support growth or delay in infusion of capital, could lead to a rating downgrade. A consistent fall in the operating buffers, i.e. PPOP/CC of less than 1.5x, on a sustained basis or weakening of the liquidity buffers, which could manifest through build-up of negative gaps in the early buckets of asset-liability tenor, would be negative for the ratings.

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. The company offers various vehicle financing products for ALL and other vehicles manufacturers. The company also invests in securitization, assignment and debenture transactions as a part of its portfolio growth strategy. The company has an employee base of 5,545, including both on-roll and off-roll employees. HLF operated across 1,550 locations through 355 branches at end-FY20.

FINANCIAL SUMMARY

Particulars	**FY20(IND-AS)**	**FY19 (IND-AS)**	**FY18 (IND-AS)**
Total assets (INR billion)	207.6	202.0	157.9
Total equity (INR billion)	32.5	272.4	202.0

Net income (INR billion)	2.92	2.76	1.82
Return on average assets (%)	1.4	1.5	1.3
Equity/assets (%)	15.6	13.5	12.8
Tier 1 capital (%)	13.3	11.1	12.2
Source: HLF			

RATING HISTORY

Instrument Type	Current Rating/Outlook			Historical Rating/Outlook		
	Rating Type	Rated Limits (billion)	Rating	16 October2019	19 September 2018	1 August 2017
Issuer rating	Long term	-	IND AA-/Stable	IND AA-/Stable	IND AA-/Stable	IND A+/Stable
Lower tier II subordinated debt	Long-term	INR0.35	IND AA-/Stable	IND AA-/Stable	IND AA-/Stable	IND A+/Stable
Bank loan	Long-term	INR1	IND AA-/Stable	-	-	-

ANNEXURE

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

COMPLEXITY LEVEL OF INSTRUMENTS

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

SOLICITATION DISCLOSURES

Additional information is available at www.indiaratings.co.in. The ratings above were solicited by, or on behalf of, the issuer, and therefore, India Ratings has been compensated for the provision of the ratings.

Ratings are not a recommendation or suggestion, directly or indirectly, to you or any other person, to buy, sell, make or hold any investment, loan or security or to undertake any investment strategy with respect to any investment, loan or security or any issuer.

ABOUT INDIA RATINGS AND RESEARCH

About India Ratings and Research: India Ratings and Research (Ind-Ra) is India's most respected credit rating agency committed to providing India's credit markets accurate, timely and prospective credit opinions. Built on a foundation of independent thinking, rigorous analytics, and an open and balanced approach towards credit research, Ind-Ra has grown rapidly during the past decade, gaining significant market presence in India's fixed income market.

Ind-Ra currently maintains coverage of corporate issuers, financial institutions (including banks and insurance companies), finance and leasing companies, managed funds, urban local bodies and project finance companies.

Headquartered in Mumbai, Ind-Ra has seven branch offices located in Ahmedabad, Bengaluru, Chennai, Delhi, Hyderabad, Kolkata and Pune. Ind-Ra is recognised by the Securities and Exchange Board of India, the Reserve Bank of India and National Housing Bank.

India Ratings is a 100% owned subsidiary of the Fitch Group.

For more information, visit www.indiaratings.co.in.

DISCLAIMER

Applicable Criteria

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

Analyst Names

Primary Analyst

Jinay Gala

Senior Analyst
India Ratings and Research Pvt Ltd Wockhardt Towers, 4th floor, West Wing Plot C-2, G Block. Bandra Kurla Complex Bandra (East), Mumbai 400051
+91 22 40356138

Secondary Analyst

Karan Gupta

Associate Director
+91 22 40001744

Committee Chairperson

Prakash Agarwal

Director and Head Financial Institutions
+91 22 40001753

Media Relation

Ankur Dahiya

Manager – Corporate Communication
+91 22 40356121
