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India Ratings Affirms Motherson Sumi Systems at 'IND AAA'/Negative; Off RWN

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India Ratings and Research (Ind-Ra) has affirmed Motherson Sumi Systems Limited's (MSSL) Long-Term Issuer Rating at 'IND AAA' while resolving the Rating Watch Negative (RWN). The Outlook is Negative. The instrument-wise rating actions are given below:

Instrument Type	ISIN	Date of Issuance	Coupon Rate	Maturity Date	Size of Issue (billion)	Rating/Outlook	Rating Action
Fund-based working capital limits		-	-	-	INR6.0	IND AAA/Negative /IND A1+	Ratings affirmed; off RWN
Non-fund-based working capital limits		-	-	-	INR1.0	IND AAA/Negative /IND A1+	Ratings affirmed; off RWN
Term loan		-	-	November 2022	INR11.376	IND AAA/Negative	Ratings affirmed; off RWN
Commercial paper		-	-	7-365 days	INR1.5	IND A1+	Affirmed
Non-convertible debentures (NCDs)	NE775A07016	21 April 2020	7.84%	20 April 2023	INR5.0	IND AAA/Negative	Ratings affirmed; off RWN

The NCDs are listed, secured, and redeemable in nature. The proceeds of the issue are being used for refinancing the existing debt, and/ or general corporate purpose, and/or working capital.

Analytical Approach to Change Post Reorganisation: Ind-Ra continues to take a consolidated view of MSSL and its subsidiaries (collectively referred to as the group), as they have a similar business profile, cater largely to the same set of customers across geographies, and have a strong management presence. Samvardhana Motherson Reflectec (SMR), Samvardhana Motherson Peguform (SMP) and PKC Group Limited (PKC) are its key subsidiaries that are engaged in the rear-view mirror, polymer modules and wiring harness businesses outside India. Also, Ind-Ra continues to factor in the debt held at Samvardhana Motherson International Ltd (SAMIL, 'IND AA'/RWP) while doing the consolidation.

On 2 July 2020, MSSL announced business restructuring, involving the demerger of the domestic wiring harness (DWH) business of MSSL into a separate legal entity while merging SAMIL into MSSL along with all the subsidiaries and JVs of SAMIL. Post this restructuring, MSSL would hold 100% shareholding of Samvardhana Motherson Automotive Systems Group BV (SMRP BV), and all the subsidiaries and JVs of SAMIL would become the JVs and subsidiaries of MSSL. MSSL could subsequently be renamed as SAMIL. The revised structure would remove cash flow subordination at SAMIL level and ensure a more simplified structure. Post the reorganisation, Ind-Ra will analyse the merged entity which will include SAMIL and all its subsidiaries and JVs, along with the subsidiaries and JVs of MSSL including PKC, SMR, SMP. This will exclude the DWH business.

On 13 April 2020, Ind-Ra had placed the ratings of MSSL on RWN, as the COVID-19 pandemic was considered an event, and due to the uncertainties regarding the impact of the same on MSSL's credit metrics, which remains dependent on growth across various economies, consumers' buying behaviour, and credit profile of various original equipment manufacturers (OEMs). However, over the last 90 days, some clarity has emerged as the economies have opened up gradually. The Negative Outlook reflects a slower production ramp-up in the global auto volumes. This along with the high fixed cost nature of the industry and deterioration in the credit profile of end-consumers could result in MSSL's leverage remaining higher than expected. Additionally, continued losses at the company's greenfield plants in Alabama and Hungary could be a drag on the performance, resulting in a higher leverage ratio than the rating triggers. However, a diversified profile in terms of customers, geographic presence and product offerings lowers the concentration risk in any particular aspect.

KEY RATING DRIVERS

Global Slowdown to Impact Operating Performance in FY21: The consolidated revenue was flat at INR635.4 billion in FY20 (FY19: INR635.2 billion). The decline on account of the slowdown in the global auto industry was offset by higher revenues in SMP, as its two plants in Hungary and Alabama have started contributing to the revenues. The consolidated EBITDA margin dropped to 8.2% in FY20 (FY19: 8.4%) primarily due to: 1) lower margins at SMP, driven by the commissioning and slower-than-expected ramp-up of greenfield plants and on the consolidation of Samvardhana Motherson Reydel Companies, 2) lower margins in the domestic operations amid the slowdown and 3) the fixed cost being incurred during the lockdown. However, the decline was limited on account of a margin improvement at PKC and SMR businesses. Furthermore, the group's plants across China (7% of total revenue), Europe (49%), US (15%) and India (12%) and other parts of the world were shut down due to the COVID-19 pandemic. This led to the loss in the company's revenue for 10-15 days in FY20 and one month in FY21. Most of the companies 152 manufacturing facilities are now operational. Also, barring about 20 facilities where capacity utilisation is below 25%, other facilities have close to normal operations.

Ind-Ra expects the FY21 consolidated revenue could fall in the range of 15%-20% yoy organically, while the consolidated EBITDA margin could decline by 140-160bp yoy due to a continued weak demand and fixed cost amid the lockdown especially in 1QFY21. Ind-Ra expects a recovery in the sales volume and revenue from FY22. SMRPBV had a large order book of EUR13.2 billion as of FY20 (equivalent to INR1,118 billion), which provides adequate revenue visibility.

The standalone revenues declined 9% yoy to INR68.7 billion in FY20 and EBITDA margins dropped to 16.0% (FY19: 16.8%).

Credit Metrics Comfortable, but Could Deteriorate in FY21: The consolidated net adjusted leverage (net debt adjusted for lease liabilities/EBITDA) was stable 1.6x at FY20 (FY19: 1.7x). However, the consolidated interest coverage deteriorated to 8.7x in FY20 (FY19: 12.6x), owing to the decline in EBITDA. The company's cost of borrowing is low, as 90% of the debt is denominated in foreign currency, taken at competitive rates.

Ind-Ra expects leverage could increase above 2.0x in FY21, due to the delay in the ramp up of greenfield plants and production disruptions amid the COVID-19 outbreak. Moreover, if COVID-19 is not contained timely and global auto sales remain subdued beyond FY21, the leverage could remain elevated for a longer period. Furthermore, MSSL has been pursuing acquisitions as part of its growth strategy. Any large debt-funded acquisition could hamper the debt metrics for a period of one-two years.

At end-FY20, the consolidated gross adjusted debt was INR131.4 billion (FY19: INR128.6 billion), including lease liabilities of INR13.6 billion (FY19: INR13.2 billion), as reported in books under IND AS-116. Earlier, the agency was considering lease liability as per its own rating criteria, leading to a difference in the overall amount of lease liabilities. Furthermore, since dividends from MSSL are the main cash flow driver for SAMIL, the repayments of SAMIL's debts and interest thereon are largely dependent on MSSL's upstreaming of dividends. On adjusting SAMIL's debt, the group leverage is 1.8x (FY20: 2.0x).

Details of Reorganisation of Group Structure: On 2 July 2020, the boards of MSSL and SAMIL approved the reorganisation of the group structure. The reorganisation entails -

1. Demerger of DWH business from MSSL into a separate legal entity. This entity will be listed on stock exchange and will maintain the current shareholding structure. MSSL and Sumitomo Wiring Systems, Japan will retain a 33.4% and 25.3% stake respectively in this new legal entity.
2. The subsequent merger of SAMIL into MSSL. This will also lead to SMRP BV becoming the 100% subsidiary of the merged entity. And will also bring all auto component and allied businesses in SAMIL under MSSL. The merged entity is likely to be renamed as SAMIL.

On 30 January 2020, MSSL had announced that it had sought in-principle approval from its board of directors to demerge the DWH business into a separate legal entity. All other remaining businesses were to remain under the current legal entity. Also, the 49% shareholding of SMRP BV under SAMIL was to be fully transferred to MSSL through a share swap transaction. SAMIL was to remain a separate entity.

As per the reorganisation, DWH will have domestic wiring harness business while all other businesses in the current standalone entity including export of wiring harness business, wires, moulded components and assemblies, metal machining components and rubber components will remain under MSSL. MSSL would also entail SMR, SMP, PKC, and all other existing JV and subsidiaries overseas. All businesses of SAMIL through its 13 subsidiaries and 15 Joint ventures / Associates including Lighting, Shock absorbers, moulds and tooling, sheet metals, and other auto ancillary and non-auto business would also become part of the merged entity.

The transaction is to be effected pursuant to a Composite Scheme of Amalgamation and Arrangement and is subject to the receipt of regulatory and other approvals including approval from the shareholders, creditors, National Company Law Tribunal etc. The transaction is likely to be completed by mid-FY22, and effective from 1 April 2020.

Demerger of DWH to be Credit Neutral: As per proforma financials, DWH recorded revenue of INR39.4 billion and EBITDA of INR5.3 billion in FY20. DWH is among the highest return on capital employed generating business of the group (FY20: 55%, FY19: 64%). However, given that the proportion of DWH to the consolidated FY20 revenues and EBITDA is 6% and 10% respectively, Ind-Ra does not see the impact to be material. Moreover, MSSL will hold 33.4% stake in DWH and will also receive 5.5% management fee from DWH.

Benefits of Reorganisation: As per the management, the proposed reorganisation is aimed at: a) simplification of group structure, b) alignment of interest of all stakeholders by bringing all auto-component businesses under one umbrella, and meeting the objective of Sumitomo Wiring System of focused participation in the DWH business; and c) create platforms for growth through diversification of revenue mix in line with the stated 3CX10 strategy and providing flexibility in raising capital. Ind-Ra believes that various JVs and subsidiaries of SAMIL coming under the merged entity would lead an equally large auto ancillary entity which would be as diversified as the existing entity with presence in various new products through subsidiaries and JVs of SAMIL with a fairly simplified structure.

Consolidated Financials to Remain Robust excluding DWH: As per the proforma financials shared by the company, the merged entity would have revenue of INR616.2 billion in FY20 (FY19: INR614.9 billion) and EBITDA of INR50.4 billion (INR54.3 billion). The net adjusted leverage (net adjusted debt including lease liabilities/ EBITDA) would be 1.9x as of FY20. As against this, on a consolidated basis, MSSL (including DWH), reported revenue of INR635.3 billion in FY20 (FY19: INR635.2 billion) and EBITDA of INR52.0 billion (INR53.5 billion). The net adjusted leverage stood at 1.6x as of FY20.

Ind-Ra has been monitoring the group's net leverage on including the net debt and corporate guarantees being given by SAMIL; including which the group's net adjusted leverage as of FY20 was 1.8x (FY19: 2.0x), in line with the proforma ratio above.

The business and financial profile of the resultant entity is broadly in line with that of the existing consolidated profile of MSSL. Ind-Ra believes that the reorganisation is credit neutral for the ratings of MSSL.

Liquidity Indicator - Adequate: The company has adequate liquidity at the consolidated level as well as the operating subsidiaries' level. The group had a reasonable cash balance of INR48.7 billion at FY20 (FYE19: INR35.4 billion) and unused bank facilities of around INR55.6 billion as of June 2020. The company recorded positive free cash flow of INR23.3 billion (FY19: INR5.7 billion), due to lower capex and the receipt of tooling-related receivables in 4QFY20. As the capex is likely to remain low in FY21, Ind-Ra expects the free cash flow to remain positive in FY21 as well, though at reduced levels due to weaker profitability.

The company has scheduled debt repayment of INR1.0 billion in FY21 and INR42 billion in FY22, including USD400 million (INR29.6 billion) of senior secured notes due in December 2021 at SMRPBV. The refinancing risks are low, as MSSL is equipped with financial flexibility through its ability to raise capital in both India and international debt markets. However, any large acquisition could impact the company's liquidity position.

Diversified Business Profile: MSSL has a diversified revenue base with regard to customers, geographies and products, and a global manufacturing footprint, which mitigates the risks arising out of business cyclicality, regulatory fallouts and technological obsolescence inherent in the automobile industry.

In FY20, the largest customer (Daimler AG) contributed 13.9% to the revenue. Although the Volkswagen group as a whole continues to account for the largest share of the revenue (FY20: 24%; FY19: around 30%), it is spread across several brands (including Audi, VW, Seat, Scania, MAN and Porsche), platforms and geographies. In terms of segments, standalone (wiring harness, polymer, elastomers and others), SMR (exterior mirrors), SMP (interior polymer modules) and PKC (commercial vehicle wiring harness) contributed 11%, 20%, 51% and 15%, respectively, to the FY20 revenues.

Strong Market Position and Longstanding Customer Relations: MSSL holds a leading share in the passenger vehicle wiring harness market in India. Also, with the PKC acquisition in March 2017, the group has become a leading player in the commercial vehicle wiring harness markets in North America and Europe. The group has increased its presence in the Chinese truck market through the joint ventures of PKC. Moreover, SMR is a global leader in the external rear-view mirror segment. In addition, through SMP, the group is a leading player in polymer modules in the passenger vehicle premium segment in Europe. MSSL also has longstanding relationships with key OEMs globally, along with a high wallet share. The strong business relationships and proximity to OEMs enable the group to mitigate competitive and profitability pressure.

RATING SENSITIVITIES

Any large acquisition and/or slower ramp-up of new capacities, leading to the consolidated net adjusted debt leverage exceeding 2.0x on a sustained basis could lead to a rating downgrade. Ind-Ra would consolidate SAMIL's debt while calculating the trigger.

COMPANY PROFILE

Incorporated in 1986, MSSL, the flagship company of the Samvardhana Motherson Group, is a joint venture between SAMIL and Japan-based Sumitomo Wiring Systems. MSSL manufactures wiring harness products for the passenger vehicle segment in India. It also owns and consolidates SMRPBV, which is a joint venture between MSSL (51% stake) and SAMIL (49% stake). As on March 2020, MSSL was 33.43% held by SAMIL, followed by Sumitomo Wiring Systems (25.10%), the Sehgal family (3.20%), and public and others (38.27%).

CONSOLIDATED FINANCIAL SUMMARY

Particulars	**FY20**	**FY19**
Revenue (INR billion)	635.4	635.2
EBITDA (INR billion)	52.0	53.5
EBITDA margin (%)	8.2	8.4
Interest coverage (x)	8.7	12.6
Net leverage (x)	1.3	1.5
Net adjusted leverage including leases (x)	1.6	1.7

Net adjusted leverage including SAMIL's debt and Corporate guarantee (x)	1.8	2.0
Source: MSSL		

RATING HISTORY

Instrument Type	Current Rating/Rating Watch			Historical Rating/Outlook		
	Rating Type	Rated Limits (billion)	Rating	17 April 2020	27 December 2019	23 October 2018
Issuer rating	Long-term	-	IND AAA/Negative	IND AAA/RWN	IND AAA/Stable	IND AAA/Stable
Fund-based working capital limits	Long-/short-term	INR6.0	IND AAA/Negative/IND A1+	IND AAA/RWN/IND A1+	IND AAA/Stable/IND A1+	IND AAA/Stable/IND A1+
Non-fund-based working capital limits	Long-/short-term	INR1.0	IND AAA/Negative/IND A1+	IND AAA/RWN/IND A1+	IND AAA/Stable/IND A1+	IND AAA/Stable/IND A1+
Term loan	Long-term	INR11.376	IND AAA/Negative	IND AAA/RWN	IND AAA/Stable	IND AAA/Stable
Commercial paper	Short-term	INR1.5	IND A1+	IND A1+	IND A1+	IND A1+
NCDs	Long-term	INR5.0	IND AAA/Negative	IND AAA/RWN	-	-

COMPLEXITY LEVEL OF INSTRUMENTS

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

ABOUT INDIA RATINGS AND RESEARCH

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Applicable Criteria

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