July 18, 2022

SML Isuzu Limited: Long-term rating reaffirmed; short-term rating downgraded to [ICRA]A1

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Cash Credit	25.00	25.00	[ICRA]A+ (Negative); Reaffirmed
Term Loans	25.00	25.00	[ICRA]A+ (Negative); Reaffirmed
Fund Based Limits	347.00	347.00	[ICRA]A1; Downgraded from [ICRA]A1+
Total	**397.00**	**397.00**	

**Instrument details are provided in Annexure-I*

Rationale

The revision in the short-term rating of SML Isuzu Limited (SML) takes into consideration an expectation of an increase in the company's debt levels in the near-term, because of non-discretionary capex requirements of ~Rs. 80 crore in FY2023 (which are expected to be partly funded by debt). SML's sales had remained significantly impacted in the last two years by the macro-economic challenges brought about by the pandemic, especially the lacklustre demand for buses given the aversion to public transportation and curtailed capex by corporates and educational institutes. Given the low scale of operations in FY2021 and FY2022, the company reported operating losses, which has led to significant erosion in net worth. In the absence of equity infusion from the parent entity, Sumitomo Corporation (43.96% stake in the company as on March 31, 2022), and an increased dependence on working capital borrowings (~Rs. 234 crore as on March 31, 2022 over ~Rs. 160 crore as on March 31, 2021) to fund the operating losses, the company's credit indicators remained weak in FY2022. Going forward, even though ICRA expects the company to report a healthy revenue growth in FY2023, aided by an improved demand outlook for the CV industry, a meaningful improvement in the debt coverage indicators is expected to be only gradual in nature, as the company's dependence on external borrowings is expected to continue to increase over the near-term, given the inflationary pressure on profitability and nondiscretionary capex requirements. Nevertheless, ICRA continues to draw comfort from SML's strong parentage and healthy financial flexibility it enjoys as reflected by its ability to secure additional credit facilities (backed by corporate guarantee from Sumitomo Corporation for certain facilities), thereby supporting its liquidity position in this challenging period.

The reaffirmation of the long-term rating considers the established presence of SML in the school and executive bus segment in India, and its strong parentage with its largest shareholder, Sumitomo Corporation, lending it both managerial as well as strategic support, besides supporting its creditworthiness among financiers. SML has historically maintained a strong market position in the school and executive bus segment in India, supported by strong brand and expanding sales channel. In the passenger carrier segment, SML is present in 5–12 tonne sub-segment with ~15-16% market share in the addressable segment. Given the significance of the bus segment to its overall business, both in terms of revenue and profitability, the company has been focusing on upgrading its product portfolio to compete more effectively in the staff sub-segment and has launched front overhang (FOH) diesel buses over the recent past.

The ratings also favourably factor in an expectation of a gradual improvement in the financial performance of the company going forward, aided by revival in the CV industry. With increasing vaccination penetration, gradual opening up of offices and educational institutions, the bus sales volumes are likely to revive sequentially going forward. The goods carrier segment demand is also expected be supported by economic recovery, Government spending on infrastructure, and deferred replacement demand. ICRA continues to expect that a pick- up in volumes for the bus segment would aid SML's revenue growth prospects and help mitigate the impact of cyclicality in the CV segment to an extent over the medium term. Further, ICRA notes SML's market share in the 3.5T to 12T truck segment has increased to ~7% in FY2022 from ~4% in FY2020, aided by acceptability of its new cabin and increased focus of marketing team and dealers on truck sales; its ability to continue to improve its market presence in the LCV goods carrier segment would remain key in enhancing its revenue growth prospects over the medium term.

ICRA notes that SML's revenue growth prospects over the medium to long-term remain exposed to the gradual shift towards electric vehicles (EVs). Although penetration of e-buses is primarily limited to the state road transport undertakings (SRTU) at present, the e-bus market in India is likely to witness a healthy traction over the medium term. Accordingly, SML's ability to adapt to the transition towards EVs will remain critical to support its business prospects, and it may need to invest materially to enhance its product profile.

The Negative outlook on the long-term rating reflects ICRA's opinion that even as the industry outlook looks favourable, a meaningful improvement in the company's debt coverage indicators is expected to be only gradual, as its dependence on external borrowings is expected to continue to increase over the near-term, given the inflationary pressure on profitability and nondiscretionary capex requirements.

Key rating drivers and their description

Credit strengths

Strong parentage, with large shareholding by Sumitomo Corporation – Sumitomo Corporation (rated Baa1 by Moody's) is the largest shareholder of the company (43.96% stake), lending both managerial as well as strategic support to the company, besides supporting its creditworthiness among financiers. This has enabled SML to raise funds from banks/ financial institutions at competitive rates. Furthermore, Sumitomo Corporation has provided corporate guarantee for credit facilities from Japanese banks, which reflects the promoter's willingness to support the company. The promoters have active representation in the company's board and senior management, including the managing director.

Strong market position in the school bus and executive coach segment in India – SML has a strong presence in the school bus and executive coach segment in India with an overall market share of ~5% in the domestic bus segment in FY2022 (impacted to an extent by muted school bus sales during the pandemic) and a market share of 15-16% in the 5-12T bus segment. The company's strong presence in this segment is supported by its strong brand and expanding sales channel. Historically, the school bus sales segment has accounted for 75-80% of the company's total bus sales. Even though the pandemic induced disruptions had significantly impacted the segment volumes over FY2021-FY2022, SML is expected to benefit from a recovery in demand, going forward.

Product launches aid in plugging gaps in product portfolio, coupled with expanding sales network to support growth over medium to long-term – The company has taken several initiatives to improve its product portfolio, such as launching of its Global Series Trucks (with new improved cabins) and FOH buses. In the special application vehicle segment, the company launched new tippers (which have a higher horsepower and a new powertrain), which is witnessing a healthy demand. The company also manufacturers ambulances, whose sales picked up during the pandemic. Moreover, in the special application vehicle segment, the company manufacturers a vehicle for the cold chain market, whose demand is expected to increase. SML has also improved its international presence over the last two years and its vehicles are well accepted in neighbouring countries like Nepal, Bangladesh and Sri Lanka. Further, the company is focusing on improving its exports to African and West Asian markets. These efforts to plug portfolio gaps and expand its sales network are likely to support its business growth and help maintain its market position over the medium term.

Credit challenges

Prolonged slowdown in CV demand, aggravated by the pandemic, impacted earnings; increase in debt levels weakened credit metrics – SML's sales have remained significantly impacted over the last two years by the macro-economic challenges brought about by the pandemic, especially the lacklustre demand for buses given the aversion to public transportation and curtailed capex by corporates and educational institutes. Given the low scale of operations in FY2021 and FY2022, the company reported operating losses which has led to significant erosion in net worth, besides increased dependence on working capital borrowings (~Rs. 234 crore as on March 31, 2022 compared to ~Rs. 160 crore as on March 31, 2021). Accordingly, the company's return and credit indicators remained weak in FY2022. Going forward, even though ICRA expects the company to report a healthy revenue growth in FY2023 aided by an improved demand outlook for the CV industry, a meaningful improvement in the debt coverage indicators is expected to be gradual in nature, as the company's dependence on external borrowings is expected to increase over the near-term given the inflationary pressure on profitability and nondiscretionary capex requirements of ~Rs. 80 crore in FY2023 (in relation to the proposed implementation of On-board diagnostics and electronic stability control norms). Nevertheless, comfort is drawn from the strong financial flexibility available to the company by virtue of being majorly owned by Sumitomo Corporation. The same is reflected by company's ability to raise unsecured short-term borrowings from Japanese banks at competitive interest rates.

Exposed to cyclicality in the CV industry; although higher share of buses partially mitigates the risk - SML is exposed to cyclicality in the CV industry, which leads to volatility in its cash flows and profit margins. However, this is partially mitigated by the higher share of buses in its portfolio, which enjoys comparatively steadier demand. ICRA expects the bus segment to continue to help SML mitigate the impact of cyclicality in the CV segment to an extent over the medium term.

Low market share in the CV industry because of limited product range in goods carrier segment and intense competition in the bus segment from several large players - SML is a niche player in the domestic CV industry because of limited product range compared to large CV OEMs. At present, the company has limited capabilities to compete with incumbents in the goods carrier segments, especially in the HCV category (i.e., vehicles above 12 tonne). Its product offerings in the goods carrier segment are limited to the niche 3.5–12 tonne category, with no presence in high volume segments such as small commercial vehicles (SCVs) and MHCV trucks. Nevertheless, with focused efforts, the company has been able to improve its market share over the last two years in the 3.5–12 tonne goods carrier category to 7% in FY2022 from 4.3% in FY2020, aided by acceptability of its new cabin and increased focus of marketing team and dealers on truck sales, as the demand for its key product segment, buses, was subdued.

The competition in the bus segment is steadily increasing with a slew of feature-packed new model introductions by market players. Like the goods carrier segment, the bus segment is also dominated by Tata Motors Limited (TML), which is the only full range player across the spectrum of passenger carriers. Other market players like Volvo Eicher Commercial Vehicles (VECV) and Force Motors have also been gaining ground in the bus segment. As a result, SML is likely to face higher competition in the bus segment, even when the industry revives. Given the importance of the bus segment to its overall business, the company has upgraded its product portfolio to compete more effectively and has launched FOH diesel buses in FY2021. Despite the high competition, the management remains confident that SML will maintain its strong market position in the addressable segment.

Liquidity position: Adequate

SML's liquidity is **adequate,** supported by cash and bank balances of Rs. 11.1 crore as on March 31, 2022 and average buffer of ~Rs. 171 crore in working capital facilities over the sanctioned limits of Rs. 452.0 crore in the 11-month period ending in May 2022. In relation to these sources of cash, SML has capex requirements of ~Rs. 80-85 crore in FY2023 (expected to be part funded by sanction of new term loans) and debt repayments of ~Rs. 48 crore in FY2023.

Rating sensitivities

Positive factors – Given the negative outlook, a rating upgrade in unlikely in the near-term. However, healthy recovery in CV demand and consequent improvement in the company's profitability and credit metrics will be considered favourably for revising the outlook to Stable. The company's ability to strengthen its business profile by gaining market share in the goods carrier segment and new product launches in the higher tonnage segment, while maintaining its market position in the passenger carrier segment, will be critical for a favourable rating action thereafter.

Negative factors – Negative pressure on the rating could arise in case of inability to correct asset-liability mismatch or continued weak financial performance, on account of a weaker than expected recovery in the CV industry. Additionally, negative pressure on the ratings could arise if SML cedes material market share in its addressable segments. Timely financial support from promoters will also remain a key monitorable.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	[Corporate Credit Rating Methodology] [Rating Methodology for Commercial Vehicle Manufacturers] [Impact of Parent or Group Support on an Issuer's Credit Rating]
Parent/Group support	Parent Company: Sumitomo Corporation, Japan The rating assigned to SML factors in the very high likelihood of its parent entity, Sumitomo Corporation (43.96% stake), extending financial support to it because of the close business linkages between them. ICRA also expects Sumitomo Corporation to be willing to extend financial support to SML out of its need to protect its reputation from the consequences of a group entity's distress. The managing director and four other board members of SML are representatives of Sumitomo Corporation.
Consolidation/Standalone	The rating for SML Isuzu Limited is based on its standalone financials.

About the company/promoter

Incorporated in 1983, SML Isuzu Limited (formerly Swaraj Mazda Limited) is a CV OEM with healthy market position in the school bus segment. The company was set up as 'Swaraj Vehicles Limited' for manufacturing light commercial vehicles (LCVs) and was promoted by Punjab Tractors Limited (PTL) in technical and financial collaboration with Mazda Motor Corporation, Japan, and Sumitomo Corporation, Japan. However, the technical collaboration agreement with Mazda expired in 2004 and Mazda exited by selling off its stake to Sumitomo Corporation. Around the same time, SML entered into a technical collaboration agreement with Isuzu Motors, Japan.

At present, SML Isuzu operates in the LCV and medium commercial vehicle (MCV) segments of the automobile industry and has a product portfolio of buses, trucks (including tippers) and specific application vehicles. The company has a manufacturing facility at Nawanshahar, Punjab, with a production capacity of 24,000 units per annum. Sumitomo Corporation and Isuzu Motors own 43.96% and 15% stake, respectively, in the company.

Sumitomo Corporation: Sumitomo Corporation, headquartered in Tokyo, is one of Japan's largest trading companies, and a core member of the Sumitomo Group. The firm's total assets as of the fiscal year ended March 31, 2022 amounted to ¥9.5 trillion. The company trades and invests in a wide range of sectors and classifies its businesses under six business segments: (1) metal products; (2) transportation and construction systems; (3) environment and infrastructure; (4) media and digital; (5) living related goods and services, and real estate, and (6) mineral resources, energy, chemical and electronics. The Group has multiple investments in India in the automotive and other industrial segments.

Key financial indicators (audited)

SML Standalone	FY2021	FY2022
Operating income	589.2	921.5
PAT	-133.5	-99.8
OPBDIT/OI	-11.9%	-4.7%
PAT/OI	-22.7%	-10.8%
Total outside liabilities/Tangible net worth (times)	2.1	4.0
Total debt/OPBDIT (times)	-3.7	-6.9
Interest coverage (times)	-3.0	-2.0

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore; Source: Company, ICRA Research; All calculations are as per ICRA Research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2023)				Chronology of rating history for the past 3 years				
		Type	Amount rated (Rs. crore)	Amount outstanding as of Mar 31, 2022 (Rs. crore)	Date & rating in FY2023	Date & rating in FY2022*	Date & rating in FY2021		Date & rating in FY2020	
					Jul 18, 2022	Aug 18, 2021	Dec 16, 2020	Aug 20, 2020	Feb 05, 2020	Dec 30, 2019
1	Cash Credit	Long Term	25.00	NA	**[ICRA]A+ (Negative)**	**[ICRA]A+ (Negative)**	**[ICRA]A+ (Negative)**	**[ICRA]A+ (Negative)**	**[ICRA]AA- (Negative)**	**[ICRA]AA- (Negative)**
2	Term Loans	Long Term	25.00	16.00	**[ICRA]A+ (Negative)**	**[ICRA]A+ (Negative)**	**[ICRA]A+ (Negative)**	**[ICRA]A+ (Negative)**	**[ICRA]AA- (Negative)**	-
3	Short-term fund based limits	Short Term	347.00	NA	**[ICRA]A1**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**
4	Commercial Paper	Short Term	-	-	-	**[ICRA]A1+; withdrawn**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**
5	Short-term Non-fund based limits	Short term	-	-	-	-	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**

**Update on the details of lender facilities was released on August 31, 2021*

Complexity level of the rated instruments

Instrument	Complexity Indicator
Cash Credit	Simple
Term Loans	Simple
Fund Based Limits	Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: www.icra.in

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Cash Credit	NA	NA	NA	25.00	[ICRA]A+ (Negative)
NA	Term Loans	FY2019	NA	FY2024	25.00	[ICRA]A+ (Negative)
NA	Short-term fund based limits	NA	NA	NA	347.00	[ICRA]A1

Source: *Company*

Please click here to view details of lender-wise facilities rated by ICRA

Annexure II: List of entities considered for consolidated analysis – Not applicable

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

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