December 15, 2023

Varun Motors Private Limited: Ratings upgraded; rated amount enhanced; removed from rating watch with developing implications and Stable outlook assigned

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term – Fund-based – Cash Credit	678.00	814.00	[ICRA]A- (Stable); upgraded from [ICRA]BBB+ rating watch with developing implications and removed from rating watch; assigned for enhanced limits
Short-term – Non-fund Based Limits	11.00	11.00	[ICRA]A2+; upgraded from [ICRA]A2 rating watch with developing implications and removed from rating watch
Long-term/Short-term – Unallocated Limits	97.00	215.00	[ICRA]A-(Stable)/[ICRA]A2+; upgraded from [ICRA]BBB+/[ICRA]A2 rating watch with developing implications and removed from rating watch; assigned for enhanced limits
Total	**786.00**	**1,040.00**	

**Instrument details are provided in Annexure-I*

Rationale

The ratings upgrade factors in the expected sustained improvement in revenues and earnings of Varun Motors Private Limited (VMPL) on the back of stable demand growth and growth in realisations, leading to an improved credit profile. VMPL's ratings were earlier placed on watch with developing implications on account of uncertainty around the impact of VMPL's takeover of the lending operations of Varun Finance (VF) on its leverage metrics. ICRA notes that VMPL continues to maintain a healthy leverage and coverage metrics as indicated by Total debt/OPBITDA of 2.1 times and interest coverage of 8.6 times despite the takeover of VF's lending operations. VMPL had book debts of Rs. 189.2 crore and a total asset base of Rs. 203.5 crore as on March 31, 2023. VMPL's revenues increased significantly by 25% in FY2023 to Rs. 4619.5 crore with healthy improvement in demand in the Passenger Vehicle (PV) and two-wheeler (2W) segments. The company is expected to record 8-10% revenue growth in FY2024 supported by volume and realisation growth. Although its operating and net margins are expected to moderate in FY2024 with increased discounts and high interest costs (owing to higher inventory holding), its capital structure and debt coverage metrics are expected to be comfortable.

The ratings favourably factor in VMPL's established presence as an automobile dealer in Andhra Pradesh, Telangana and Karnataka, and its diversified presence across four segments –PVs, commercial vehicles (CVs), 2Ws and three wheelers (3Ws), and construction equipment (CE). VMPL is an authorised dealer of Maruti Suzuki India Limited (MSIL) in the PV segment, Bharat Benz (Daimler India Commercial Vehicles) in the CV segment, Bajaj Auto Limited (BAL) in the 2W and 3W segments, and Joseph Cyril Bamford (JCB) in the CE segment. Further, the Varun Group has a wide sales network, with more than 400 touch points (including showrooms, workshops, sales depots, true value and driving schools) across Andhra Pradesh, Telangana and Karnataka.

The ratings are, however, constrained by VMPL's moderate operating profitability, inherent to the dealership nature of its business, as the margins on vehicles, spares, service and accessories are all controlled by the principal. The ratings also remain constrained by the intense competition from dealers of its principals across segments and dealers of other original equipment manufacturers (OEMs), resulting in increased pressure to pass on the price discounts to customers. Further, VMPL faces high geographical concentration risk, with a predominant share of its revenue derived from Andhra Pradesh and Telangana; however, it bagged MSIL's dealership in Bengaluru, which reduced the geographical concentration of revenues to an extent.

The ratings are also constrained by the lending operations, which exposes the company to the pressures arising from asset quality and lack of regulatory oversight for its lending operations.

The Stable outlook on the long-term rating factors in ICRA's expectation that VMPL would continue to maintain its operating performance and comfortable financial profile, given the healthy demand, its established presence as a dealership, and in the absence of any large debt-funded capex.

Key rating drivers and their description

Credit strengths

Diversified presence with dealership of MSIL, BAL, JCB and Bharat Benz – VMPL is the authorised dealer for MSIL's PVs, Bharat Benz's CVs, BAL's 2Ws and 3Ws, and JCB's CE. Further, the non-cyclical business of PVs and 2Ws accounted for more than 80% of its revenues during the past three years. VMPL has strong credentials as one the largest dealers of PVs for MSIL, which is a leader in the PV segment with a market share of 43.5% in H1 FY2024, in Andhra Pradesh and Telangana. It is an authorised dealer of Bharat Benz for 11 districts in Andhra Pradesh and has authorised dealerships of BAL's 2Ws and 3Ws in five districts of Andhra Pradesh and three districts in Telangana, along with being the sole authorised dealer of JCB in seven districts in Andhra Pradesh, including Vijayawada and Visakhapatnam.

Wide sales network – VMPL has a wide sales network with more than 400 touch points (including showrooms, sales depots, workshops, true value and driving schools) across Andhra Pradesh, Telangana and Karnataka, covering Hyderabad, Ranga Reddy, Kamareddy, Medak, Sangareddy, Vikarabad, Nizamabad, Krishna, Khotagudam, Visakhapatnam, Vizianagaram and Srikakulam districts, as well as Bengaluru. The increase in number of showrooms, outlets and workshops, along with its strong market position in Andhra Pradesh and Telangana, has supported VMPL's revenue growth over the years.

Comfortable capital structure and debt protection metrics – The Group's gearing stood low at 0.9 times as on March 31, 2023, and debt protection metrics were healthy with interest coverage of 8.6 times, NCA/total debt of 34.8%, DSCR of 8.7 times and total debt/OPBDITA of 2.1 times in FY2023. Although the company's margins are expected to moderate in FY2024 owing to higher discounts, its debt indicators are expected to be comfortable.

Credit challenges

Modest margins inherent to dealership business – VMPL's operating margins have been low in the past, on account of the dealership industry dynamics, wherein margins on vehicles, spares, service, and accessories are mainly controlled by the principal. The company's margins declined to 4.8% in FY2023 from 5.7% in FY2022 owing to increase in proportion of new vehicles sales, higher discounts offered to its customers, and increase in employee expenses. The company's margins are expected to moderate further in FY2024 owing to increased discounts, especially in the PV segment, with an improved supply situation. The vehicle sales are the main revenue driver for the company, which accounted for ~80-81% of the net income, while the remaining 19-20% came from spares, services, accessories, and other income over the last two years. The profit margins are higher for spares and service income than vehicle sales.

Intense competition and regional concentration of sales – VMPL faces competition from dealers of other OEMs and the same principal across all four dealerships, resulting in increased pressure to pass on price discounts to customers. Sales are regionally concentrated with the major portion of its revenue coming from Andhra Pradesh and Telangana. However, the company bagged MSIL's dealership in Bengaluru, which reduced its geographical concentration of revenues to an extent.

Risks related to lending operations – VMPL's lending operations exposes it to the risk from the asset quality of its loan portfolio, lack of regulatory supervision for its lending operations, and increased debt levels. Any material increase in lending operations leading to stretch in capital structure or coverage metrics would be a key monitorable.

Liquidity position: Adequate

The liquidity of VMPL remains **adequate**, with over Rs. 177.0 crore buffer available in working capital limits, and free cash and bank balances of Rs. 19.1 crore as on March 31, 2023, against no repayment obligations. The company is expected to incur ~Rs. 50.0 crore of capex in FY2024 for the launch of new showrooms and expansion of existing workshops, which would be funded through internal cash flows.

Rating Sensitivities

Positive factors – The ratings could be upgraded if the Group demonstrates a healthy revenue growth while sustaining healthy margins.

Negative factors – The rating may be downgraded if significant decline in scale of operations or profitability, due to subdued demand or high discounts, adversely affects its debt metrics or liquidity position on a sustained basis. Any material increase in lending operations leading to stretch in capital structure or coverage metrics could also lead to a rating downgrade. A specific credit metrics that could lead to a rating downgrade is interest coverage of less than 4.5 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating Methodology for Automobile Dealers
Parent/Group support	Not applicable
Consolidation/Standalone	Standalone

About the company

Incorporated in 1996, Varun Motors Private Limited is involved in the business of automobile dealership. The company is the dealer of Maruti Suzuki India Limited across Andhra Pradesh, Telangana and Karnataka, covering Hyderabad, Ranga Reddy, Kamareddy, Medak, Sangaredy, Vikarabad, Nizamabad, Krishna, Khotagudam, Visakhapatnam, Vizianagaram and Srikakulam districts, as well as Bengaluru with around 64 showrooms, service centers and True Value outlets. VMPL is the sole MSIL dealer in Nizamabad and Srikakulam districts, while it has a non-exclusive dealership in other districts. VMPL is also the sole Bharat Benz dealer for 11 districts in Andhra Pradesh. The company is also an authorised 2W and 3W dealer of Bajaj Auto Limited for five districts in Andhra Pradesh (Visakhapatnam, Vizianagaram, Srikakulam, Krishna, West Godavari) and three districts in Telangana (Rangareddy, Vikarabad and Sangareddy), and an exclusive JCB dealer for seven districts in Andhra Pradesh — Guntur, Krishna, West Godavari, East Godavari, Visakhapatnam, Vizianagaram and Srikakulam with around 13 showrooms and outlets, and two workshops.

In July 2022, VMPL took over the lending operations of Varun Finance, which was a proprietorship concern involved in financing 2Ws and 3Ws.

Key financial indicators (audited)

VMPL Consolidated	FY2022	FY2023
Operating income	3,686.8	4,619.5
PAT	129.5	174.2
OPBDIT/OI	5.7%	4.8%
PAT/OI	3.5%	3.8%
Total outside liabilities/Tangible net worth (times)	1.2	1.2
Total debt/OPBDIT (times)	1.8	2.1
Interest coverage (times)	8.0	8.6

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2024)				Chronology of rating history for the past 3 years		
		Type	Amount rated (Rs. crore)	Amount outstanding as on March 31, 2023	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021
					Dec 15, 2023	Sept 30, 2022	Jun 29, 2021	May 26, 2020
1	**Fund Based – Cash Credit**	Long term	814.00	-	**[ICRA]A- (Stable)**	**[ICRA]BBB+; rating watch with developing implications**	**[ICRA]BBB+ (Positive)**	**[ICRA]BBB+ (Stable)**
2	**Non-Fund Based Limits**	Short term	11.00	-	**[ICRA]A2+**	**[ICRA]A2; rating watch with developing implications**	**[ICRA]A2**	**[ICRA]A2**
3	**Unallocated Limits**	Long term and short term	215.00	-	**[ICRA]A- (Stable)/ [ICRA]A2+**	**[ICRA]BBB+ /[ICRA]A2; rating watch with developing implications**	**[ICRA]BBB+ (Positive)/ [ICRA]A2**	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Fund Based – Cash Credit	Simple
Non-Fund Based Limits	Very Simple
Unallocated Limits	Not Applicable

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: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Fund Based – Cash Credit	NA	NA	NA	814.00	[ICRA]A- (Stable)
NA	Non-Fund Based Limits	NA	NA	NA	11.00	[ICRA]A2+
NA	Unallocated Limits	NA	NA	NA	215.00	[ICRA]A- (Stable)/[ICRA]A2+

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

ANALYST CONTACTS

Shamsher Dewan
+91 124 4545328
shamsherd@icraindia.com

Srikumar Krishnamurthy
+91 44 4596 4318
ksrikumar@icraindia.com

Nithya Debbadi
+91 40 4547 4829
nithya.debbadi@icraindia.com

Etikala Ravi Teja
+91 40 4547 4829
etikala.teja@icraindia.com

RELATIONSHIP CONTACT

L. Shivakumar
+91 22 6114 3406
shivakumar@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

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

ICRA Limited

Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001
Tel: +91 11 23357940-45

Branches