ICRA

August 22, 2017

SML Isuzu Limited

Summary of rated instruments

Instrument*	**Rated Amount (Rs. crore)**	Rating Action
Cash Credit	25.00	[ICRA]AA (Stable); Reaffirmed
Working Capital Demand Loan	120.00	[ICRA]A1+; Reaffirmed
Letter of Credit	20.00 (revised from 28.00)	[ICRA]A1+; Reaffirmed
Bank Guarantee	15.00 (revised from 20.00)	[ICRA]A1+; Reaffirmed
Bill Discounting Facility	5.00	[ICRA]A1+; Reaffirmed
Commercial Paper/ Short Term Debt Programme	50.00	[ICRA]A1+; Reaffirmed
Total	**235.00**	

*Instrument details are provided in Annexure-1

Rating action

ICRA has reaffirmed the long-term rating of [ICRA]AA (pronounced ICRA double A) and the short-term rating of [ICRA]A1+ (pronounced ICRA A one plus) for the Rs. 185 crore bank facilities of SML Isuzu Limited (SML or the company)[1]. The outlook on the long-term rating is 'Stable'. ICRA has also reaffirmed the rating of [ICRA]A1+ for the Rs. 50 crore Commercial Paper/ Short Term Debt Programme of SML.

Rationale

The assigned ratings reflects SML's strong market position in the school and executive bus segment in India. ICRA notes its strong credit metrics reflected by negligible borrowings and healthy cash accruals and its strong parentage (by virtue of being majorly (44%) owned by Sumitomo Corporation, Japan) and technical collaboration with Isuzu Motors Limited, Japan.

The ratings also take into consideration SML's comfortable credit metrics and liquidity profile as reflected by its limited (although increasing to fund ongoing capital expenditure) dependence on external borrowings. Given the higher share of bus sales, especially school & college segment, the company generates majority of its revenues in the first six months of the calendar year (i.e. January-June). While this adds lumpiness to its cash flows, the company maintains adequate cash balances or un-drawn working capital facility to support its liquidity for rest of the year.

After strong results in FY2017, SML's Q1 FY2018 sales have declined sharply on account of pre-buying in March and deferment of demand with expectations of price rationalization on account of Goods and Services Tax (GST). As a result the unit sales in Q1 FY2018 declined 36% to 3,140 units and operating income by 31% over that of Q1 FY2017. On account of lower sales, the operating margins have declined to 5.9% vis-a-vis 13.2% in Q1FY2017. However, going forward, ICRA expects the volumes to pick-up on account of recovery in the industry and the company's ability to stabilise its production related challenges.

[1] *For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications*

Overall, SML Isuzu's business profile is supported by its strong brand equity in the school bus segment, its technology tie-up with Isuzu Motors (who also owns 15% stake in the company) and expanding product-cum-distribution network. SML is also majorly owned by Sumitomo Corporation, which owns 44% stake in the company and provides managerial support and guidance. Although Isuzu's presence in the company was expected to translate into greater technical support, the progress on new model launches (on Isuzu's platforms) has been relatively behind schedule and has not helped SML in expanding its addressable market. With technological advancements in the domestic Commercial Vehicle (CV) industry and the Government's focus on introducing BS-VI emission norms by 2020, the company has increased its focus on research and development.

SML is currently in the process of investing Rs. 220 crore for technology, product development and up-gradation of plant infrastructure to improve manufacturing efficiency. Further, the company is on track to enhance its production capacity from 18,000 units p.a. to 24,000 units pa by setting up an additional assembly line at an estimated cost of Rs. 30 crore. In addition, the company is in the process of revamping its sales and service network. The capital expenditure will be funded through internal accruals and need based long-term fully-hedged External Commercial Borrowings (ECBs). ICRA believes that the company would continue to maintain its strong credit metrics over the medium-term despite recently announced capital expenditure plans.

SML is currently working on plans to expand its distribution presence along with its re-branding and addition of new dealers. Its investments in product development and upgradation of plant infrastructure would enhance marketability and help upgrade its product portfolio, which are likely to support its business growth and help maintain its market position over the medium term. The ability to maintain profitability and debt indicators in lieu of the expected rise in external borrowings to support the ongoing investment plans and expected rise in scale of operations would remain the key rating sensitivities going forward.

The long-term rating is constrained by SML's limited product portfolio in the CV Industry that limits its scale, its relatively small dealership and service network and rising competitive intensity in the domestic CV industry. However, some of these constraints are partially mitigated by the company's ongoing business initiatives which include expanding product range to address portfolio gaps as well as its distribution network.

Key rating drivers

Credit strengths

- **Strong market position in the school bus and executive coach segment in India -** The passenger carrier segment's relatively more stable demand pattern mitigates SML's vulnerability to cyclicality associated with the CV industry.
- **Plugging portfolio gaps and expanding sales network to support growth -** SML is currently working on plans to expand its distribution presence along with its re-branding and addition of new dealers, investment to modify cabin designs that would enhance marketability and help upgrade its product portfolio, which are likely to support its business growth and help maintain its market position over the medium term.
- **Strong financial profile characterised by healthy cash flows and low debt levels-** Ratings also take into consideration SML's comfortable credit metrics and liquidity profile as reflected by the company's limited dependence on external borrowings.
- **Strong parentage by virtue of being majority owned by Sumitomo Corporation-** Sumitomo Corporation, which owns 44% stake in the company, provides managerial support and guidance to the

company. The company's CEO, Marketing Head and two directors on its board are from Sumitomo Corporation.

Credit weaknesses

- **Limited product range as compared to large CV OEMs constraints scale-** SML's operates in the niche 5-12t segment, which limits its product portfolio and exposes it to any change in market preference towards other segments.
- **Limited capabilities to effectively compete with established players in new segments, especially bigger vehicles** – SML's presence as a marginal player in the CV industry with concentration in the 5-12 ton segment makes it difficult to compete with bigger players in the industry.
- **Competitive intensity in the bus segment is also increasing with foray of new players -** The entry of new players in the bus segment would adversely impact SML as this segment accounts for more than half of the company's unit sales.
- **Exposed to cyclicality in the CV industry -** The cyclicality of the CV industry leads to volatility in the company's cash flows and profitability margins.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below**.**

Links to applicable criteria:

Corporate Credit Rating Methodology

Rating Methodology for Commercial Vehicle Industry

About the company:

Incorporated in 1983, SML Isuzu Limited (SML Isuzu, formerly Swaraj Mazda Limited) was initially set up as 'Swaraj Vehicles Limited' for the manufacture of Light Commercial Vehicles (LCVs). In 1984, the company was promoted by Punjab Tractors Limited (PTL) in technical and financial collaboration with Mazda Motor Corporation, Japan, and Sumitomo Corporation, Japan.

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 Isuzu entered into a technical collaboration agreement with Isuzu Motors, Japan. SML Isuzu operates in the LCV and Medium Commercial Vehicle (MCV) segments of the automobile industry. The company has a manufacturing facility at Nawanshahar Punjab, with a manufacturing capacity of 18,000 units. SML has a product portfolio of buses, trucks (including tippers) and specific application vehicles.

Key Financial Indicators

	FY2016	FY2017
Operating Income (Rs. crore)	1,164.3	1,369.0
PAT (Rs. crore)	51.16	62.81
OPBDIT/ OI (%)	7.3%	7.9%
RoCE (%)	22.5%	24.5%
Total Debt/ TNW (times)	0.2	0.1
Total Debt/ OPBDIT (times)	0.6	0.4
Interest coverage (times)	16.4	27.0
NWC/ OI (%)	14.5%	10.8%

OI: Operating Income; PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; ROCE: PBIT/Avg (Total Debt + Tangible Net-Worth + Deferred Tax Liability -

Capital Work - in Progress);
NWC: Net Working Capital

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating history for last three years:
Table:

S. No.	Instrument	Current Rating (FY2018)				Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs Crore)	Date & Rating	Date & Rating in FY2017	Date & Rating in FY2016	Date & Rating in FY2015
					Aug 2018	Sep	May	July
1	Cash Credit	Long Term	25.00		[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA- (Stable)	[ICRA]A+ (Stable)
2	WCDL	Short Term	120.00		[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
3	Letter of Credit	Short Term	20.00		[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
4	Bank Guarantee	Short Term	15.00		[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
5	Bill Discounting Facility	Short Term	5.00		[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
6	Commercial Paper/ Short Term Debt Programme	Short Term	50.00		[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+

Complexity level of the rated instrument:
ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1
Instrument Details

Instrument	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
Cash Credit – Canara Bank	-	-	-	18.75	[ICRA]AA (Stable)
Cash Credit – Indian Overseas Bank				6.25	[ICRA]AA (Stable)
WCDL	-	-	-	120.00	[ICRA]A1+
Letter of Credit – Canara Bank				15.00	[ICRA]A1+
Letter of Credit – Indian Overseas Bank				5.00	[ICRA]A1+
Bank Guarantee – Canara Bank				11.75	[ICRA]A1+
Bank Guarantee – Indian Overseas Bank				3.25	[ICRA]A1+
Commercial Paper/ Short Term Debt Programme				50.00	[ICRA]A1+
Bill Discounting – Canara Bank				5.00	[ICRA]A1+

Source: the company

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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.

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