

December 30, 2019

SML Isuzu Limited: Long-term rating downgraded to [ICRA]AA-; Outlook revised to Negative

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Cash Credit	18.00	18.00	[ICRA]AA-(Negative); Downgraded from [ICRA]AA; Outlook revised from Stable
Short-term Fund-Based Limits	137.00	137.00	[ICRA]A1+; Reaffirmed
Short-term Non-fund based limits	30.00	30.00	[ICRA]A1+; Reaffirmed
Commercial Paper	50.00	50.00	[ICRA]A1+; Reaffirmed
Total	235.00	235.00	

*Instrument details are provided in Annexure-1

Rationale

The rating downgrade factors ICRA's expectation that SML Isuzu's (SML's) financial profile is likely to weaken in the near-term following slowdown in the commercial vehicle (CV) industry, given the slowing economic growth, surplus capacity in the trucking system and credit crunch. The impact on earnings on account of lower unit sales, coupled with recently concluded debt-funded capital expenditure (capex) by the company, is likely to result in weaker RoCE and debt coverage indicators over the next few years.

Despite healthy growth (i.e., 20% in unit sales terms) in FY2019, SML's operating margins at 5.2% remain below steady state levels because of sharp rise in commodity prices and limiting pricing power of the company due to market conditions. The company's earnings have further declined during the current fiscal because of lower sales, coupled with lower per vehicle realisations due to high discount levels prevailing in the markets.

During the current fiscal, SML's volumes are expected to decline significantly due to the ongoing slowdown in the domestic CV industry amid slowing economic growth, overcapacity in the CV parc and tight financing environment. During 8M FY2020, SML's domestic volumes declined by 14% as against the industry volumes decline of 22%. With pressure on the earnings due to lower unit sales and peak discounting levels in the market, coupled with the likely increase in borrowings to support ongoing investments for BS-VI compliant vehicles, the company's profitability and credit metrics such as TD/OPBDITA (PY: 3.4 times) are expected to weaken during the current fiscal. The DSCR is also expected to weaken over the near-term because of debt repayments in this period.

The company's business profile continues to be constrained by its limited presence in the goods carrier segment (trucks). SML's product portfolio is restricted to light commercial vehicles (LCVs) and intermediate commercial vehicles (ICVs) in the range of 3.5–12 tonne, which accounts for only 12-13% of the total CV sales in India. However, the company is taking initiatives to improve its market share in this category by expanding its distribution presence with addition of new dealers and by introducing new products/ variants in the market for different customer segments that would enhance marketability and help upgrade its product portfolio.

The collaboration with Isuzu Motors Limited (which has a 15% stake in SML) was expected to support expansion of SML's product portfolio, especially in the HCV segment. 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.

The rating, however, derives comfort from SML's strong parentage from Sumitomo Corporation (43.96% as on September 30, 2019), strong market position in the school and executive bus segment in India, and healthy, albeit weakening, financial profile. Although SML does not have direct business synergies with Sumitomo Corporation, its ownership lends both managerial as well as strategic support to the company besides supporting its creditworthiness among the financiers. This has enabled SML to raise funds from banks/ financial institutions at competitive rates. The promoters have active representation in the company's board and senior management. At present, four out of 12 members of the board are representatives of Sumitomo Corporation, and the current managing director is also from Sumitomo Corporation.

The company's strong presence in the school and executive bus segment in India is supported by its strong brand and expanding sales channel. Unlike the domestic CV industry, most of SML's sales is generated by the bus segment (60% in FY2019), with school buses driving approximately 70% of its total bus sales. SML's presence in the passenger carrier segment is concentrated in the 5–12 tonne segment with around 16-17% market share in the addressable segment. The company improved its market share in the bus segment in FY2019 owing to its strong brand recall in the schools and colleges segment. Given the significance of the bus segment to its overall business, both in terms of revenue and profitability, the company is working on upgrading its product portfolio to compete more effectively in the staff segment and will be launching front overhang (FOH) diesel buses in the near term.

The Negative outlook on the long-term rating reflects ICRA's opinion that the company's financial risk profile is likely to weaken over the near-term, given the ongoing slowdown in the domestic CV industry and resultant pressure on the earnings. The outlook on the domestic CV industry also remains negative with expectation of limited pre-buying prior to BS-VI, overcapacity in the CV parc following revision in axle-load norms and subdued freight availability due to slowing economic growth.

Key rating drivers and their description

Credit strengths

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 a market share of 9% in the domestic bus segment in FY2019. The company's strong presence in this segment is supported by its strong brand and expanding sales channel. School bus sales account for 70% of SML's total bus sales.

Plugging portfolio gaps and expanding sales network to support growth – The company has taken initiatives to improve its product portfolio, such as launching its Global Series trucks with new improved cabins as well as the upcoming launch of FOH buses in the near term, which would have doors before the front wheel to eliminate the need for a conductor to a large extent. Moreover, in the special application vehicle segment, the company has developed a vehicle for the cold chain market, the demand for which is expected to increase in India. SML is also strengthening its dealership network in neighboring countries like Nepal, which is expected to improve its exports prospects.

Strong parentage by being majority owned by Sumitomo Corporation – The Sumitomo Corporation (rated Baa1 by Moody's) is the majority shareholder of the company (43.96% stake as on September 30, 2019), lending both managerial

as well as strategic support to the company. The promoters have active representation in the company's board and senior management, including the managing director.

Credit challenges

Marginal player in the domestic CV industry because of limited product range as compared to large CV OEMs – SML is a marginal player in the domestic CV industry because of limited presence in the 3.5–12 tonne segment. The company has limited capabilities to compete with incumbents in the goods carrier segments, especially in the HCV category. Its product offerings in the goods carrier segment are limited to the niche 3.5–12 tonne category, with no presence in larger segments such as pick-up trucks, mini-trucks and trucks heavier than 12 tonne.

Increasing competitive intensity in the bus segment with foray of new players – The competition in the bus segment is steadily increasing with a slew of feature-packed new model launches by existing as well as new players. Like the goods carrier segment, incumbents such as Tata Motors and Ashok Leyland have a significant share of the market in the bus segment. Apart from the incumbents, Volvo Eicher and Force Motors have also been gaining presence in the bus segment. As a result, SML is likely to face higher competition in the bus segment, going forward. Given the importance of this segment to its overall business, the company is working on upgrading its product portfolio to compete more effectively in the segment and will be launching FOH diesel buses in the near term.

Exposed to cyclicity in the CV industry; although higher share of buses partially mitigates the risk – SML is exposed to cyclicity 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.

Increase in debt levels to weaken credit metrics over the medium term – SML had undertaken significant capex (Rs. 196 crore) in the last three years towards capacity expansion and development of new cabins, which was funded through external commercial borrowings (ECB) of Rs. 140 crore designated in US dollars (fully hedged) and the balance from internal accruals. Although the company continues to maintain a comfortable financial profile despite the increase in debt levels with gearing ratio at 0.6x in FY2019, the coverage indicators witnessed a material weakness in the last two years because of lower sales leading to sharp decline in the OPBDIT. This is expected to further weaken in the current fiscal, given the pressure on earnings and likely increase in borrowings to support ongoing investments for BS-VI compliant vehicles. SML's volumes are expected to decline significantly during the current fiscal due to the ongoing slowdown in the domestic CV industry. During 8M FY2020, SML's domestic volumes declined by 14% as against the industry volumes decline of 22%. Accordingly, the company's revenues are expected to decline by 8-9% during the current fiscal.

Liquidity position: Adequate

SML's liquidity is **adequate** with expected cash flow generation of Rs. 45-50 crore in FY2020, cash and bank balances of Rs. 15.5 crore as on September 30, 2019 and average undrawn working capital limits of Rs. 73.5 crore as against the average drawing power of Rs. 141.0 crore in the 12-month period ending in October 2019. In addition, the company had unutilised term loan of Rs. 30 crore as on March 31, 2019. In relation to these sources of cash, SML has minimal capex plans and its debt repayments at Rs. 30–42 crore p.a. over the medium term also remain moderate. Overall, ICRA expects SML to be able to meet its near-term commitments through internal as well as external sources of cash and yet be left with sufficient cash surpluses.

Rating sensitivities

Positive triggers – Any upside in the rating is restricted at present. 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. In addition, improvement in ROCE above 15% on a sustained basis, supported by its ability to pass on increasing raw material prices to customers and cost control initiatives as well as improvement in credit metrics would also be critical for a favourable rating action.

Negative triggers – Negative pressure on the rating could arise if SML cedes significant market share in its addressable segment. Additionally, weakening of financial risk profile with continued deterioration in the credit metrics like interest cover below 5x on a sustained basis and weakening of profitability could also lead to a downward rating revision.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Commercial Vehicle Manufacturers
Parent/Group Support	Parent Company: Sumitomo Corporation, Japan The rating of SML Isuzu assumes an implicit support from Sumitomo Corporation, as it owns majority stake (43.96%) in the company and provides managerial and strategic support. The managing director and four other board members of SML Isuzu are representatives of Sumitomo Corporation.
Consolidation/Standalone	The rating for SML Isuzu Limited is based on the standalone financials.

About the company

Incorporated in 1983, SML Isuzu Limited (formerly Swaraj Mazda Limited) is a commercial vehicle OEM with healthy market position in the school bus segment. With annual volumes of 7,827 units, the company had a market share of 9% in the domestic bus segment in FY2019. The company was set up as 'Swaraj Vehicles Limited' for manufacturing 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 44% and 15% stake, respectively, in the company.

Key financial indicators (audited)

	FY2018	FY2019
Operating Income (Rs. crore)	1,132.9	1,407.0
PAT (Rs. crore)	8.5	19.6
OPBDIT/OI (%)	3.9%	5.2%
RoCE (%)	4.3%	6.6%
Total Outside Liabilities/Tangible Net Worth (times)	1.5	1.7
Total Debt/OPBDIT (times)	4.8	3.4
Interest Coverage (times)	4.2	4.5
DSCR	4.0	1.9

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2020)				Rating History for the Past 3 Years		
		Type	Amount Rated	Amount Outstanding	Rating	FY2019	FY2018	FY2017
					30-Dec-2019	29-Nov-2018	22-Aug-2017	03-Oct-2016
1	Cash Credit	Long Term	18.00	NA	[ICRA]AA-(Negative)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)
2	Short-term fund based limits	Short Term	137.00	NA	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
3	Short-term Non-fund based limits	Short Term	30.00	NA	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
4	Commercial Paper	Short Term	50.00	NA	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+

Amount in Rs. crore

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

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Cash Credit	NA	NA	NA	18.00	[ICRA]AA-(Negative)
NA	Short-term fund based limits	NA	NA	NA	137.00	[ICRA]A1+
NA	Short-term Non-fund based limits	NA	NA	NA	30.00	[ICRA]A1+
NA	Commercial Paper	NA	NA	7-365 days	50.00	[ICRA]A1+

Source: SML Isuzu Limited

Annexure-2: List of entities considered for consolidated analysis – Not Applicable

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