

December 16, 2020

SML Isuzu Limited: Rating assigned to enhanced amount

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Cash Credit	18.00	18.00	[ICRA]A+(Negative); Outstanding
Long term Fund based Term Loan	40.00	40.00	[ICRA]A+(Negative); Outstanding
Short-term Fund-Based Limits	172.00	249.00	[ICRA]A1+; Assigned to enhanced amount
Short-term Non-fund based limits	30.00	30.00	[ICRA]A1+; Outstanding
Commercial Paper	50.00	50.00	[ICRA]A1+; Outstanding
Total	310.00	387.00	

*Instrument details are provided in Annexure-1

Rationale

The rating action continues to factor in the strong presence of SML Isuzu Limited (SML) in the school and executive bus segment in India, and the strong parentage of Sumitomo Corporation, which lends it financial flexibility. Although the domestic Commercial Vehicle (CV) industry has been going through a prolonged period of subdued sales, and SML's key product segment of buses would continue to remain impacted due to closure of schools, comfort is drawn from the fact that the company has been able to secure additional credit facilities (backed by corporate guarantee from Sumitomo Corporation)), supporting its liquidity position in this challenging period.

SML enjoys a strong market position in the school and executive bus segment in India, supported by its strong brand and expanding sales channel. Its presence in the passenger carrier segment is concentrated in the 5–12 tonne sub-segment with around 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.

The ratings also continue to derive comfort from SML's strong parentage from Sumitomo Corporation (owns 43.96% stake in the company as on September 30, 2020). 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 financiers. This has enabled SML to raise funds from financial institutions at competitive rates. The company has also availed additional working capital lines, which are secured by corporate guarantee from Sumitomo Corporation, to support its liquidity during the current period, when cash flows from operations are likely to be deficit.

Despite its established market position in the addressable segment of operations and strong parentage, the ratings remain constrained by the deterioration in its financial risk profile over the past few quarters. The domestic CV industry witnessed several headwinds during FY2020 with a subdued macro-economic environment, surplus capacity in the trucking system, cautious financing environment and regulatory developments related to emission norms. These headwinds were further compounded by the Covid-19 pandemic and consequently demand for CVs declined further sharply in the current fiscal. This has significantly impacted earnings of CV OEMs like SML.

Accordingly, after a relatively weak performance in FY2020, wherein revenues declined by 18% and OPM contracted to 0.8% (PY: 5.2%), SML is likely to witness further earnings contraction in FY2021, on account of challenges brought about by the pandemic. In addition to the lockdown-induced disruptions and macro-economic challenges, coupled with significant price hikes because of transition to BS-VI emission norms, SML would be further impacted by the lackluster demand for buses. Given the aversion to public transportation, and curtailed capex by corporates and education institutes due to the pandemic, bus demand from staff carriers, school/college and bus aggregator segments have remained subdued during the current fiscal and are expected to remain so over the near term. Accordingly, ICRA expects SML's earnings to significantly contract during the current fiscal. Its dependence on working capital borrowings is also likely to increase during the year, given the expected moderation in cash flows from operations.

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 slowdown in the domestic CV industry and resultant pressure on earnings. The outlook on the domestic CV industry also remains negative, given the sharp macro-economic slowdown, current overcapacity in the CV ecosystem and subdued financing environment, with challenges further aggravated by the stress on fleet operators due to the pandemic.

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 an overall market share of 8% in the domestic bus segment in FY2020. The company's strong presence in this segment is supported by its strong brand and expanding sales channel. School bus sales account for 75-76% 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 and FOH buses, which 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, 2020), lending 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 company has also availed additional working capital lines, which is secured by a corporate guarantee from Sumitomo Corporation. The promoters have active representation in the company's board and senior management, including the managing director.

Credit challenges

Prolonged slowdown in CV demand, aggravated by the Covid-19 pandemic, to impact earnings significantly – The domestic CV industry witnessed several headwinds during FY2020 with a subdued macro-economic environment, tight financing availability, regulatory developments and surplus capacity in the trucking system. These headwinds were compounded by the Covid-19 pandemic and ensuing lockdowns in the country for an extended period, adding production constraints to the existing set of challenges. Additionally, aversion to public transportation, and curtailed

capex by corporates and education institutes have impacted bus demand from staff carriers, school/college and bus aggregator segments. Accordingly, SML's sales volumes are expected to decline significantly during the current fiscal.

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 – Although the company continues to maintain a comfortable financial profile with gearing ratio at 0.5x in FY2020, 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 since the cash flows from operations are likely to be deficit.

Low market share in the CV industry because of limited product range – SML is a niche player in the domestic CV industry because of limited product range compared to large CV OEMs. 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.

Increasing competition 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 too. Apart from the incumbents, Volvo Eicher and Force Motors have also been gaining ground in the bus segment. As a result, SML is likely to face higher competition in the 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 and has launched FOH diesel buses.

Liquidity position: Adequate

Despite expectations of weak financial performance in FY2021, SML's liquidity is **adequate** supported by cash and bank balances of Rs. 45.9 crore as on September 30, 2020 and undrawn working capital limits of Rs. 28 crore against the sanctioned limits of Rs. 238.0 crore as on September 30, 2020. Apart from this, the company has also availed additional working capital facilities of Rs. 77.0 crore to support its liquidity during the current period, when cash flows from operations are likely to be deficit. In relation to these sources of cash, SML has minimal capex plans and debt repayments of Rs. 42.0 crore in FY2021.

Rating sensitivities

Positive triggers – Given the negative outlook, a rating upgrade is unlikely in the near-term. However, healthy recovery in CV demand from H2 FY2021 onwards, coupled with SML's efforts to raise equity capital 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 triggers – Negative pressure on the rating could arise in case of inability to correct asset-liability mismatch position or significant weakening of financial risk profile because of prolonged slowdown, which results in further

deterioration in financial performance. Additionally, negative pressure on the ratings could arise if SML cedes significant market share in its addressable segment. 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
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 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 (formerly Swaraj Mazda Limited) is a commercial vehicle OEM with healthy market position in the school bus segment. With annual volumes of 6,581 units, the company had a market share of 8% in the domestic bus segment in FY2020. 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 this time, SML entered into a technical collaboration agreement with Isuzu Motors, Japan.

At present, SML operates in the LCV and medium commercial vehicle (MCV) segments of the automobile industry with 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)

	FY2019	FY2020
Operating Income (Rs. crore)	1,407.0	1,150.1
PAT (Rs. crore)	19.6	-21.1
OPBDIT/OI (%)	5.2%	0.8%
PAT/OI (%)	1.4%	-1.8%
Total Outside Liabilities/Tangible Net Worth (times)	1.6	1.2
Total Debt/OPBDIT (times)	3.4	19.4
Interest Coverage (times)	4.5	0.6

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2021)					Rating History for the Past 3 Years			
		Type	Amount Rated	Amount Outstanding*	Current Rating	Earlier Rating	FY2020		FY2019	FY2018
					16-Dec-2020	20-Aug-2020	5-Feb-2020	30-Dec-2019	29-Nov-2018	22-Aug-2017
1	Cash Credit	Long Term	18.00	NA	[ICRA]A+ (Negative)	[ICRA]A+ (Negative)	[ICRA]AA- (Negative)	[ICRA]AA- (Negative)	[ICRA]AA (Stable)	[ICRA]AA (Stable)
2	Long term Fund based Term Loan	Long Term	40.00	40.00	[ICRA]A+ (Negative)	[ICRA]A+ (Negative)	[ICRA]AA- (Negative)	-	-	-
3	Short-term fund based limits	Short Term	249.00	NA	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
4	Short-term Non-fund based limits	Short Term	30.00	NA	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
5	Commercial Paper	Short Term	50.00	NA	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+

Amount in Rs. crore; *As on March 31, 2020

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]A+ (Negative)
NA	Long term Fund based Term Loan	FY2019	NA	FY2024	40.00	[ICRA]A+ (Negative)
NA	Short-term fund based limits	NA	NA	NA	249.00	[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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