

August 14, 2023

SML Isuzu Limited: Ratings reaffirmed; outlook revised to Stable; rated amount enhanced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Cash Credit	75.00	85.00	[ICRA]A+ (Stable); Reaffirmed and outlook revised to Stable from Negative; assigned to enhanced amount
Term Loans	38.00	75.50	[ICRA]A+ (Stable); Reaffirmed and outlook revised to Stable from Negative; assigned to enhanced amount
Short-term Fund Based Limits	377.00	377.00	[ICRA]A1; Reaffirmed
Total	490.00	537.50	

*Instrument details are provided in Annexure-I

Rationale

The revision in outlook to Stable from Negative factors in an expectation of improvement in the financial performance of SML Isuzu Limited (SML), going forward, aided by revival in the commercial vehicle (CV) industry, especially in the bus segment, wherein SML has a strong presence. Aided by the re-opening of schools/ colleges and offices following the Covid-19 pandemic, SML reported strong growth in bus sales in FY2023 (~347% YoY growth in bus sales volume) and a healthy recovery in revenues to Rs. 1,822 crore in FY2023 (98% YoY growth), aided by both volume and realisation growth. Additionally, the company's debt coverage indicators improved with total debt (excluding lease liability)/ OPBDITA at 3.2 times¹ in FY2023, aided by both improvement in profitability, on the back of operating leverage benefits, and reduction in debt levels (Rs. 258 crore as of March 31, 2023¹ from Rs. 291 crore as of March 31, 2022¹). Going forward, even though the company's debt levels are expected to increase because of capex requirements (which are expected to be partly funded by debt) and expectation of increase in working capital borrowings in line with the increasing scale of operations, an improved demand outlook for the CV industry is expected to help improve the company's earnings further and aid in a gradual improvement in the debt coverage indicators.

The reaffirmation of the ratings factors in 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 the 5–12 tonne sub-segment, with ~20% market share in its addressable segment in FY2023. 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 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

¹ Excluding lease liabilities

3.5–12.0 tonne, which accounts for only 7-9% of the total CV sales in India. Nevertheless, with focused efforts, the company has been able to improve its market share over the last two years in this category to 5.6% in FY2023 from 4.3% in FY2020, aided by acceptability of its new cabin and increased focus of marketing team and dealers on truck sales.

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 electric buses (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 company faces risk of acceleration in debt repayment in case there is a breach of financial and/or rating linked covenants and is not able to get waivers from the lenders/ investors in a timely manner.

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 a market share of ~20% in the 5-12T bus segment in FY2023. The company's strong presence in this segment is supported by its strong brand and expanding sales channel. Historically, school bus sales have accounted for 75-80% of the company's total bus sales. Aided by the re-opening of schools/ colleges and offices after the Covid-19 pandemic, SML reported strong growth in bus sales in FY2023 and an improvement in the overall market share to 10% in FY2023 from 5% in FY2022 in the domestic bus segment.

Product launches aimed at 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. Moreover, in the special application vehicle segment, the company manufactures 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

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. ICRA expects the bus segment to continue to help SML mitigate the impact of cyclicity 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 carriers and intense competition in buses from several large players – SML is a niche player in the domestic CV industry because of its limited product range compared to large CV original equipment manufacturers (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 medium and heavy CV (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 5.6% in FY2023 from 4.3% in FY2020, aided by acceptability of its new cabin and increased focus of its marketing team and dealers on truck sales.

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, going forward. 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, SML is expected to maintain its strong market position in its addressable segment.

Prolonged slowdown in CV demand weakened credit metrics; credit metrics gradually improving – SML's sales were significantly impacted in FY2021–FY2022 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 led to significant erosion in net worth, besides increased dependence on working capital borrowings. Accordingly, the company's return and credit indicators remained weak in FY2021 and FY2022. Nevertheless, the company's total debt reduced to ~Rs. 258 crore in FY2023 from ~Rs. 291 crore in FY2022, aided by low working capital intensity, low capex and improvement in cash flows. Coupled with improvement in profitability, the credit metrics improved with Total Debt/ OPBDITA at 3.3 times in FY2023. Going forward, the company's debt levels are expected to increase because of regulatory capex requirements and likely increase in working capital borrowings in line with increasing scale of operations. Nevertheless, an improved demand outlook for the CV industry is expected to help improve the company's earnings and aid in a gradual improvement in the debt coverage indicators. 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 the company's ability to raise unsecured short-term borrowings from Japanese banks at competitive interest rates.

Environmental and Social Risks

Environmental considerations – Automotive manufacturers remain exposed to climate transition risks emanating from a likelihood of tightening emission control requirements, with the Government focused on reducing the adverse impact of automobile emissions. Accordingly, an OEM's prospects remain linked to its ability to meet tightening emission requirements. The companies in the sector may need to invest materially to develop products to meet regulatory thresholds or expected transition to alternative fuel vehicles, which may have a moderating impact on their return and credit metrics. The exposure to litigation/penalties arising from issues related to waste and water management for the OEM remains relatively low.

Social considerations – Automotive OEMs have a healthy dependence on human capital and retaining human capital, maintaining healthy employee relations as well as supplier ecosystem remain essential for disruption free operations. Another social risk that automotive OEMs face pertains to product safety and quality, wherein instances of product recalls and high warranty costs may not only lead to a financial implication, but could also harm the company's reputation and create a more long-lasting adverse impact on demand. Entities like SML also remain exposed to any major shift in consumer preferences/demographics, which are a key demand driver and, accordingly, may need to make material investments to realign their product portfolio.

Liquidity position: Adequate

SML's liquidity is **adequate**, supported by expected net cash accruals of Rs. 90 to 110 crore p.a., average buffer of ~Rs. 213 crore in the fund based working capital limits over the sanctioned limits of Rs. 512.0 crore in the 12-month period ending in May 2023 and undrawn term loans of ~Rs. 43.5 crore as of May 2023. In relation to these sources of cash, SML has capex requirements of ~Rs. 90-100 crore in FY2024 and debt repayments of ~Rs. 30 crore in FY2024.

Rating sensitivities

Positive factors – ICRA could upgrade SML's ratings in case of sustained improvement in its profitability and credit metrics with Total Debt/ OPBDITA below 2.0 times on a sustained basis. 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, could also lead to a rating upgrade.

Negative factors – Negative pressure on the rating could arise in case of inability to correct asset-liability mismatch or weakening in the financial risk profile due to a large debt-funded capex or slowdown in demand. Additionally, negative pressure on the ratings could arise if SML cedes material market share in its addressable segments. The ratings could also be downgraded in case of significant weakening in the credit profile of its parent company, Sumitomo Corporation, or weakening of financial and operational linkages with the parent company.

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 ICRA expects the parent entity, Sumitomo Corporation (43.96% stake), 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 three 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 commercial vehicle OEM with healthy market position in the school bus segment. It operates in the light commercial vehicle (LCV) and medium CV (MCV) segments of the automobile industry and has a product portfolio comprising 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.

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. Sumitomo Corporation and Isuzu Motors own 43.96% and 15.00% 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, 2023, amounted to ¥10 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 & 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	FY2022	FY2023
Operating income	921.5	1,819.9
PAT	-99.8	19.8
OPBDIT/OI	-4.7%	4.4%
PAT/OI	-10.8%	1.1%
Total outside liabilities/Tangible net worth (times)	4.0	4.2
Total debt/OPBDIT (times)	-6.9	3.3
Interest coverage (times)	-2.0	3.2

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	Type	Current rating (FY2024)		Chronology of rating history for the past 3 years			
		Amount rated (Rs. crore)	Amount outstanding as of July 5, 2023 (Rs. crore)	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022*	Date & rating in FY2021
				Aug 14, 2023	Aug 1, 2022 Jul 18, 2022	Aug 18, 2021	Dec 16, 2020 Aug 20, 2020
1 Cash Credit	Long term	85.00	-	[ICRA]A+ (Stable)	[ICRA]A+ (Negative)	[ICRA]A+ (Negative)	[ICRA]A+ (Negative)
2 Term Loans	Long term	75.50	75.50	[ICRA]A+ (Stable)	[ICRA]A+ (Negative)	[ICRA]A+ (Negative)	[ICRA]A+ (Negative)
3 Short Term Fund based Limits	Short term	377.00	-	[ICRA]A1	[ICRA]A1	[ICRA]A1+	[ICRA]A1+
4 Commercial Paper	Short term	-	-	-	-	[ICRA]A1+; withdrawn	[ICRA]A1+
5 Short-term Non-fund based limits	Short term	-	-	-	-	-	[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
Short-term 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: [Click Here](#)

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loan-I	May 2022	NA	April 2025	9.50	[ICRA]A+(Stable)
NA	Term Loan-II	October 2021	NA	March 2025	4.00	[ICRA]A+(Stable)
NA	Term Loan-III	October 2022	NA	December 2025	12.00	[ICRA]A+(Stable)
NA	Term Loan-IV	March 2023	NA	January 2028	50.00	[ICRA]A+(Stable)
NA	Cash Credit	NA	NA	NA	85.00	[ICRA]A+(Stable)
NA	Short-term Fund Based Limits	NA	NA	NA	377.00	[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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