

June 29, 2021

Varun Motors Private Limited: Ratings reaffirmed at [ICRA]BBB+/[ICRA]A2; Outlook revised to Positive and rated amount enhanced

Summary of rating action

Instrument	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based Cash Credit/Working Capital	168.00	527.50	[ICRA]BBB+ reaffirmed; Outlook revised to Positive
Short-term Non-fund Based Limits	27.00	2.00	[ICRA]A2 reaffirmed
Long-term/Short-term-Unallocated Limits	-	1.50	[ICRA]BBB+/[ICRA]A2 reaffirmed; Outlook revised to Positive
Total	195.00	531.00	

*Instrument details are provided in Annexure-1

Rationale

For arriving at the ratings, ICRA has combined the business and financial risk profiles of Varun Motors (VM) and its Group entity, Varun Motors Private Limited (VMPL), collectively referred to as the Varun Group, given the common promoters and management, and the same line of business.

The revision in the outlook factors in the Group's expected improvement in performance with healthy scale of operations, and sustained margins leading to healthy debt protection metrics. The group's revenues declined marginally by 6.3% in FY2021 to Rs. 3,122.8 crore, despite much larger contraction in the auto sector due to Covid-19 pandemic and subdued demand, on the back of group's established presence in Telangana and Andhra Pradesh. Moreover, improvement in margins because of cost cutting measures undertaken by the group, and lower debt levels resulted in improved capital structure and coverage indicators in FY2021. The ratings favorably factor in the diversified presence of the Varun Group across four segments – passenger vehicles (PV), commercial vehicles (CV), two wheelers and three wheelers (2W and 3W) and construction equipment (CE). The Group is an authorised dealer of Maruti Suzuki India Limited (MSIL) (continued market leader with market share of 47.7% in FY2021 as the largest domestic passenger car manufacturer) in the PV segment, Bharat Benz (Daimler India Commercial Vehicles) in the CV segment, Bajaj Auto Limited (BAL) in the 2W and 3W segment, and J.C. Bamford Excavators Limited (JCB) in the CE segment. Further, the Varun Group has a wide sales network with 159 showrooms and workshops across Andhra Pradesh, Telangana and Karnataka.

The ratings are, however, constrained by its moderate operating profitability 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 MSIL and other original equipment manufacturers (OEMs), resulting in increased pressure to pass on the price discounts to customers. Further, the Group faces high geographical concentration risk with a predominant share of its revenue derived from Andhra Pradesh and Telangana; the Group got MSIL's dealership in Bangalore, which reduced the geographical concentration risk of revenues to an extent.

Key rating drivers and their description

Credit strengths

Diversified presence with dealership of MSIL, BAL, JCB and Bharat Benz – The Varun Group is the authorised dealer for PVs (MSIL), CVs (Bharat Benz), 2Ws and 3Ws (BAL) and CE (JCB). Further, the non-cyclical business of PVs and 2Ws accounted for more than 70.0% to its revenues during the past four years. Varun Motors Private Limited (VMPL) has strong credential as one

the largest dealers of PVs of MSIL (continued market leader with market share of 47.7% in FY2021 as the largest domestic passenger car manufacturer) in Andhra Pradesh and Telangana. It is an authorised dealer of Bharat Benz for 11 districts of Andhra Pradesh. Varun Motors (VM) is authorised dealer of BAL's 2W and 3W vehicles in five districts in Andhra Pradesh, and three districts in Telangana and is the sole authorised dealer of JCB in seven districts in Andhra Pradesh including Vijayawada and Vishakhapatnam.

Wide sales network – The Varun Group has a wide sales network with around 159 showrooms, outlets and workshops across Andhra Pradesh, Telangana and Karnataka covering Hyderabad, Ranga Reddy, Kamareddy, Medak, Sangareddy, Vikarabad, Nizamabad, Krishna, Khotagudam, Vishakhapatnam, Vizianagaram and Srikakulam districts, and Bangalore. The increase in number of showrooms, outlets and workshops and strong market position in Andhra Pradesh and Telangana supported the revenue growth over the years.

Improved capital structure and healthy debt protection metrics – The improvement in the margins because of cost cutting measures undertaken by the group, and lower debt levels resulted in improved capital structure and coverage indicators in FY2021. The Group's gearing stood low at 0.9 times as on March 31, 2021 and the healthy debt protection metrics with interest coverage of 4.7 times, NCA/total debt of 27.2%, DSCR of 4.1 times and total debt/OPBDITA of 1.9 times in FY2021.

Credit challenges

Modest margins inherent to dealership business – The Group's operating margins have been low in the past on account of the dealership industry dynamics, wherein margins on vehicles, spares, service and accessories mainly controlled by the principal. However, the operating margins improved to 4.6% in FY2020 owing to lesser discount offered to the customers on the diesel vehicles, and the margins further improved to over 5.0% in FY2021 owing to conscious reduction in costs (rentals, employee expenditure and discounts). The vehicle sale is the main revenue driver for the Group, which accounted for ~81.0-83.0% of the net income while the remaining 17.0-19.0% was contributed by spares, services, accessories and other income over the last two years. The profit margins are higher for sale of spares and service income compared to vehicle sales.

Intense competition and regional concentration of sales – The Group faces competition from dealers of other original equipment manufacturers (OEMs) and from dealers of 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 Group got MSIL's dealership in Bangalore, which reduced the geographical concentration risk of revenues to an extent.

Risks associated with proprietorship nature of the firm – VM is a sole proprietorship firm founded by Mr. Prabhu Kishore and faces risks such as capital withdrawal. The capital withdrawal from the firm stood at Rs. 20.8 crore and Rs. 24.1 crore in FY2020 and FY2021, respectively.

Liquidity position: Adequate

The Group's liquidity position is **adequate** with unencumbered cash of ~Rs. 33.0 crore as on March 31, 2021 and healthy undrawn working capital limits of around Rs. 70.0-75.0 crore against the debt repayment obligation is ~Rs. 9.0-10.0 crore for FY2022. The company has capex plans of Rs. 17.0-20.0 crore in FY2022. The projected cash flow operations and available cash balances are estimated to be adequate to meet the margin for capex and the debt obligations.

Rating sensitivities

Positive factors – The ratings could be upgraded if the group demonstrates a healthy revenue growth while sustaining healthy margins. Specific credit metric that could lead to an upgrade is interest coverage ratio of more than 3.7 times on a sustained basis.

Negative factors – The rating may be downgraded if significant decline in scale of operations or profitability, due to subdued demand or the impact of the second / third wave of Covid-19, adversely affects its debt metrics or liquidity position on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Automobile Dealerships
Parent/Group Support	Not Applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of VMPL and VM, given their common promoters and the same line of business as enlisted in Annexure-2.

About the company

Incorporated in 1996, VMPL is involved in the business of automobile dealership. The company is the dealer of Maruti Suzuki India Limited (MSIL) across Andhra Pradesh, Telangana and Karnataka covering Hyderabad, Ranga Reddy, Kamareddy, Medak, Sangareddy, Vikarabad, Nizamabad, Krishna, Khotagudam, Vishakhapatnam, Vizianagaram and Srikakulam districts, and Bangalore with around 64 showrooms, service centres and True Value outlets. VMPL is the sole MSIL dealer in Nizamabad and Srikakulam districts, whereas in other districts, it has a non-exclusive dealership. VMPL is also a Bharat Benz dealer for 11 districts in Andhra Pradesh.

Founded in 1992 by Mr. Prabhu Kishore as a sole proprietorship firm, VM is the authorised 2W and 3W dealer of Bajaj Auto Limited (BAL) for five districts in Andhra Pradesh (Visakhapatnam, Vizianagaram, Srikakulam, Krishna, West Godavari) and three districts in Telangana (Rangareddy, Vikarabad and Sangareddy). VM has 95 showrooms, outlets and workshops for BAL spread across its territory. VM is an exclusive JCB dealer for seven districts in Andhra Pradesh — Guntur, Krishna, West Godavari, East Godavari, Visakhapatnam, Vizianagaram and Srikakulam—and has around 13 showrooms and outlets, with two workshops for JCB across Andhra Pradesh.

Key financial indicators

Consolidated	FY2020	FY2021
Operating Income (Rs. crore)	3,333.0	3,122.8
PAT (Rs. crore)	71.5	81.3
OPBDIT/OI (%)	4.6%	5.0%
PAT/OI (%)	2.1%	2.6%
Total Outside Liabilities/Tangible Net Worth (times)	1.9	1.3
Total Debt/OPBDIT (times)	2.3	1.9
Interest Coverage (times)	3.2	4.7

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; Source: Company; FY2021 financials are provisional

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2022)				Chronology of Rating History for the past 3 years			
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of March 31, 2021 (Rs. crore)	Date & Rating in	Date & Rating in FY2021	Date & Rating in FY2020		Date & Rating in FY2019
					June 29, 2021	May 26, 2020	March 19, 2020	April 04, 2019	April 05, 2018
1	Cash Credit/Working Capital	Long-term	527.50	-	[ICRA]BBB+ (Positive)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)
2	Bank Guarantee	Short Term	2.00	-	[ICRA]A2	[ICRA]A2	[ICRA]A2	[ICRA]A2	[ICRA]A2
3	Unallocated	Long-term/Short Term	1.50	-	[ICRA]BBB+ (Positive) [ICRA]A2	-	-	-	-

Complexity level of the rated instrument

Instrument	Complexity Indicator
Long Term - Fund Based- Cash Credit/Working Capital	Simple
Short Term – Non-Fund Based- Bank Guarantee	Very Simple
Long Term / Short Term – Non-Fund Based	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, is available on ICRA's website: www.icra.in

Annexure-1: Instrument details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Cash Credit/Working Capital	-	-	-	527.50	[ICRA]BBB+ (Positive)
NA	Bank Guarantee	-	-	-	2.00	[ICRA]A2
NA	Unallocated				1.50	[ICRA]BBB+ (Positive)/[ICRA]A2

Source: Company

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Varun Motors	Group Company	Full Consolidation

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