March 19, 2020

Varun Motors: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund Based – Cash Credit	74.00	74.00	[ICRA]BBB+(Stable) reaffirmed
Non Fund Based Limits	1.50	1.50	[ICRA]A2 reaffirmed
Total	**75.50**	**75.50**	

**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 as the Varun Group), given the common promoters and the same line of business.

The reaffirmation of ratings factors 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) in PV segment, Bharat Benz (Daimler India Commercial Vehicles) in CV segment, Bajaj Auto Limited (BAL) in 2W and 3W segment, and J.C. Bamford Excavators Limited (JCB) in CE segment. The ratings consider the Group's strong revenue growth at a CAGR of 15% from Rs. 1,818.55 crore in FY2015 to Rs. 3,184.63 crore in FY2019 owing to an increase in sales volumes and realisation per vehicle over the years. Further, the revenue is expected to be ~Rs. 3200 crore for FY2020 on the back of improved revenues from MSIL and BAL dealership, supported by addition of new showrooms and workshops. The revenue growth is supported by wide sales network with around 165 showrooms and workshops across Andhra Pradesh, Telangana and Karnataka. The ratings factor in its healthy debt coverage metrics with interest coverage at 3.14 times and debt service coverage ratio (DSCR) of 2.00 times for FY2019.

The ratings are, however, constrained by its low operating profitability at 3.64% in FY2019 as margins on vehicles, spares, service and accessories are all controlled by the principal. The ratings note the increase in working capital intensity to 14% in FY2019 from 10% in FY2018, mainly due to increase in inventory days. With increased inventory levels, the working capital borrowings stood at Rs. 414.08 crore as on March 31, 2019, which increased the gearing to 2.09 times as on March 31, 2019 from 1.69 times as on March 31, 2018. Moreover, the working capital borrowings remained high at Rs. 444.82 crore as on January 31, 2020 owing to high inventory levels. However, the inventory levels are likely to reduce by March 2020 with the sale of all BS-IV vehicles. The ratings remain constrained by intense competition from dealers of MSIL and other original equipment manufacturers (OEMs) resulting in increased pressure to pass on 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 states; and weak demand outlook for the automobile industry, which impacted the overall market sentiment.

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, non-cyclical business of PVs and 2Ws contributed to more than 75% of revenues During the past four years**.** VMPL has strong credential as one the largest dealer of PVs of MSIL in Andhra Pradesh and Telangana. It is an authorised dealer of Bharat Benz for 11 districts of Andhra Pradesh. VM is authorised dealer of BAL's 2W and 3W vehicles in five districts in Andhra Pradesh, and three districts in Telangana and 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 165 showrooms, outlets and workshops across Andhra Pradesh, Telangana and Karnataka covering Hyderabad, Ranga Reddy, Kamareddy, Medak, Sangaredy, 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.

Strong revenue growth with healthy debt coverage metrics – The Group's operating income (OI) had increased during the last four years to Rs. 3,184.63 crore in FY2019 from Rs. 1,818.55 crore in FY2015 owing to an increase in sale volumes and realisation per vehicle. Further, the revenue is expected to be ~Rs. 3200 crore for FY2020 on the back of improved revenues from MSIL and BAL dealership supported by addition of new showrooms and workshops. The debt coverage metrics remained healthy with interest coverage at 3.14 times and debt service coverage ratio (DSCR) of 2.00 times for FY2019.

Credit challenges

Thin operating margins inherent to dealership business – The operating margins remained low at 3.64% in FY2019 on account of dealership industry dynamics with margins on vehicles, spares, service and accessories mostly controlled by the principal. Vehicle sales is the main revenue driver for the Group accounting for ~84% of the net income, while the remaining 16% is contributed by spares, service, accessories and other income during the last two years. The profit margins remain higher in case of sale of spares and service income compared to vehicle sales.

Increased working capital intensity resulting in higher gearing levels – The working capital intensity increased to 14% in FY2019 from 10% in FY2018 mainly due to an increase in inventory days. With increased inventory levels, the working capital borrowings increased to Rs. 414.08 crore as on March 31, 2019 and further to Rs. 444.82 crore as on January 31, 2020 from Rs. 246.82 crore as on March 31, 2018. However, the inventory levels are expected to reduce by March 2020 with the sale of all BS-IV vehicles. The increased working capital borrowings increased the gearing to 2.09 times as on March 31, 2019 from 1.69 times as on March 31, 2018.

Intense competition and regional concentration of sales – The Group faces competition from dealers of other original equipment manufacturers (OEMs), along with dealers from the same principal across all four dealerships resulting in increased pressure to pass on price discounts to customers. The sales are regionally concentrated with a predominant share of its revenue from Andhra Pradesh and Telangana. However, the Group received the MSIL's dealership in Bangalore in FY2016, which reduced the geographical concentration risk of revenues to an extent**.**

Risks associated with proprietorship nature of 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 has been at around Rs. 11.00 crore and Rs. 10.32 crore in FY2018 and FY2019.

Liquidity position: Adequate

The Varun Group's liquidity position is **adequate** with expected cash flow from operations of nearly Rs. 58.00 crore for FY2021, undrawn working capital limits of ~Rs. 100.00 crore as on January 31, 2020. In relation to these sources of cash, it has moderate capex plans for the next 12 months and repayment obligations of ~Rs. 9.0 crore in FY2021. Overall, ICRA expects that the Varun Group would be able to meet its near-term commitments comfortably through internal sources of cash.

Rating sensitivities

Positive triggers – ICRA may upgrade the ratings if there is a revival in demand outlook of the automobile industry, improvement in operating margins and overall liquidity profile. Specific credit metrics that may lead to an upgrade include interest coverage ratio of more than 3.7 times on a sustained basis.

Negative triggers – Pressure on the Varun Group's ratings may arise if there is any sustained decline in revenues or profitability or an increase in inventory levels impacting the company's liquidity position and debt metrics. A weakening in interest coverage ratio to below 2.7 times on a sustained basis may exert negative pressure on the company's ratings.

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 combined the business and financial risk profiles of VMPL and its Group entity, Varun Motors (VM), given the common promoters and the same line of business

About the Firm

Founded in 1992 by Mr. Prabhu Kishore as a sole proprietorship firm, Varun Motors (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.

Incorporated in 1996, Varun Motors Private Limited (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, Sangaredy, 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.

Key financial indicators (Varun Group)

	FY2018	FY2019
Operating Income (Rs. crore)	2,843.19	3,184.63
PAT (Rs. crore)	41.11	46.31
OPBDIT/ OI (%)	3.54%	3.64%
RoCE (%)	19.43%	17.10%
Total Debt/ TNW (times)	1.69	2.09
Total Debt/ OPBDIT (times)	3.05	3.94
Interest Coverage (times)	3.68	3.14

Source: Annual reports and ICRA research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

	Instrument	Type	Current Rating (FY2020)				Chronology of Rating History for the past 3 years		
			Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating 19 March 2020	Date & Rating 04 April 2019	Date & Rating in FY2019 05 April 2018	Date & Rating in FY2018 05 July 2017	Date & Rating in FY2017 -
1	Fund Based – Cash Credit Limits	Long Term	74.00	-	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB (Stable)	-
2	Non Fund Based-Bank Guarantee	Short term	1.50	-	[ICRA]A2	[ICRA]A2	[ICRA]A2	[ICRA]A2	-

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 No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Cash Credit				74.00	[ICRA]BBB+ (Stable)
NA	Bank Guarantee				1.50	[ICRA]A2

Source: Varun Motors

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Varun Motors Private Limited	Group Company	Full Consolidation

Source: Varun Motors

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About ICRA Limited:

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