

August 18, 2021

SML Isuzu Limited: Ratings reaffirmed; rated amount enhanced; rating withdrawn for commercial paper programme

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Cash Credit	18.00	25.00	[ICRA]A+ (Negative); Reaffirmed
Long term Fund based Term Loan	40.00	25.00	[ICRA]A+ (Negative); Reaffirmed
Short-term Fund-Based Limits	249.00	347.00	[ICRA]A1+; Reaffirmed
Short-term Non-fund based limits	30.00	0.00	-
Total	337.00	397.00	
Commercial Paper	50.00	0.00	[ICRA]A1+; Reaffirmed and withdrawn

*Instrument details are provided in Annexure-1

Rationale

The reaffirmation of ratings considers the established presence of SML Isuzu Limited (SML) in the school and executive bus segment in India, and its strong parentage with its largest shareholder, Sumitomo Corporation (43.96% stake in the company as on June 30, 2021), lending it both managerial as well as strategic support, besides supporting its creditworthiness among financiers. The domestic commercial vehicle (CV) industry has been going through a prolonged period of downturn, and SML's key product segment of buses would continue to remain impacted over the near term due to closure of most educational institutes. Nevertheless, ICRA continues to draw comfort from the strong parentage and healthy financial flexibility it enjoys as reflected by its ability to secure additional credit facilities (backed by corporate guarantee from Sumitomo Corporation for certain facilities), thereby supporting its liquidity position in this challenging period.

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 5–12 tonne sub-segment with ~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 over the recent past.

Despite its established market position in the addressable segment of operations and strong parentage, the ratings remain constrained by the deterioration in SML's financial risk profile since the outbreak of the pandemic. The company's sales were significantly impacted in FY2021 by the lockdown induced disruptions and macro-economic challenges brought about by the pandemic; in particular, the lacklustre demand for buses given the aversion to public transportation, and curtailed capex by corporates and education institutes impacted the company's prospects. Accordingly, SML's bus sales volume declined by ~86% YoY to 955 units in FY2021 (including exports). Given its high dependence on the bus segment, SML witnessed a sharp decline in revenues (52% YoY drop) during FY2021. Nevertheless, the company has managed to increase its market share in the trucks and ambulances segment (aided by acceptability of its new cabin and increased focus of marketing team and dealers on truck sales), thereby supporting its revenues to some extent as well as reducing its dependence on the bus segment.

Although the sales had begun to recover in Q4 FY2021 as some schools had started to reopen, the second wave of Covid-19 again impacted the sales during Q1 FY2022. Going forward, while growth would look optically better in FY2022 due to the low

base, volumes in the bus segment are likely to remain a fraction of the normal levels, given the continued aversion to public transport and closure of institutions. In the LCV goods carrier segment, volumes are expected to pick up sequentially as the macro-economic situation normalises, driven by demand from last-mile transportation and steady demand expected from agriculture and allied sectors. SML's ability to improve its market presence in the LCV goods carrier segment would remain key in supporting its revenue growth prospects over the short-term. Over the medium term, ICRA continues to expect that a pick-up in volumes for the bus segment would aid SML's revenue growth prospects and help mitigate the impact of cyclicity in the CV segment to an extent.

The Negative outlook on the long-term rating reflects ICRA's opinion that the company's financial risk profile is likely to remain weak over the near-term, given the ongoing pandemic and the weak volumes for the domestic CV industry, resulting in pressure on earnings.

The rating assigned to the commercial paper programme of SML has been withdrawn in accordance with ICRA's policy on withdrawal and suspension. The rating has been withdrawn as there is no amount outstanding against the rated instrument and as per the request of the company.

Key rating drivers and their description

Credit strengths

Strong parentage, with large shareholding being held 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 also 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 of Rs. 77 crore from a Japanese Bank, which reflects the promoter's financial support towards 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 an overall market share of ~5% in the domestic bus segment in FY2021 and a market share of 15-16% in the 5-12T bus segment. The company's strong presence in this segment is supported by its strong brand and expanding sales channel. Historically, the school bus sales segment has accounted for 70-75% of the company's total bus sales. Even though the pandemic induced disruptions have significantly impacted the volumes of the segment over FY2021-FY2022, the company is expected to benefit from a recovery in demand in the segment, going forward.

Product launches aiding plugging of 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. In the special application vehicle segment, the company launched new tippers (which have a higher horsepower and a new powertrain), which is witnessing a healthy demand. The company also manufactures ambulances, the sales of which improved in FY2021 because of the pandemic. Moreover, in the special application vehicle segment, the company manufactures a vehicle for the cold chain market, whose demand is expected to increase in India. 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 Africa and Middle-East countries. 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

Prolonged slowdown in CV demand, aggravated by the pandemic, to continue to impact earnings – SML's sales were significantly impacted in FY2021 by the lockdown induced disruptions and 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 education institutes impacted the company's prospects. While SML's bus sales volume declined by ~86% YoY to 955 units in FY2021 (including exports), the company managed to increase its market share in the trucks and ambulances segment, thereby supporting its revenues to some extent as well as reducing its dependence on the bus segment. On a YoY basis, the company's truck sales increased by ~9.8% to 4,088 units in FY2021 over 3,743 units in FY2020, primarily aided by acceptability of its new cabin and increased focus of marketing team and dealers on truck sales.

Although the sales had started to recover in Q4 FY2021 as some schools had started to reopen, the second wave of Covid-19 again impacted the sales during Q1 FY2022. Going forward, given the continued aversion to public transport and closure of education institutions, the company's bus sales are expected to remain weak in the current year as well, with any meaningful recovery delayed till Q4 FY2022. Nevertheless, its ability to improve its market presence in the LCV goods carrier segment could support revenue growth, going forward.

Exposed to cyclical in the CV industry; although higher share of buses partially mitigates the risk - SML is exposed to cyclical 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 cyclical in the CV segment to an extent over the medium term.

Increase in debt levels to weaken credit metrics over the medium term - The Covid-19 pandemic and the nation-wide lockdowns significantly impacted the company's sales and profitability, leading to build up of inventory, significant operating losses (~Rs. 70 crore in FY2021) and consequently increase in the working capital borrowings (~Rs. 160 crore as on March 31, 2021 compared to ~Rs. 33 crore as on March 31, 2020). The credit and coverage indicators have witnessed a material weakness over the last two years because of lower sales leading to sharp decline in the operating profits. The indicators are expected to remain weak even in the current fiscal, given the pressure on earnings. Accordingly, there is likely to be a further increase in borrowings, given that cash flows from operations are likely to remain low even in FY2022. Although the company's debt levels are likely to increase because of operating losses, it continues to enjoy strong financial flexibility by 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.

Low market share in the CV industry because of limited product range in the goods carrier segment; increasing competition in the bus segment with entry of new players - SML is a niche player in the domestic CV industry because of limited product range compared to large CV 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 MHCV trucks. Nevertheless, with focused efforts, the company has been able to improve its market share in the 3.5–12 tonne goods carrier category to 6.3% in FY2021 from 4.3% in FY2020, aided by acceptability of its new cabin and increased focus of marketing team and dealers on truck sales as the demand for its key product segment, buses, was subdued.

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 bus segment, even when the industry revives.

Liquidity position: Adequate

Despite the expectation of muted cash flows from operations in the near-term, SML's liquidity is expected to remain **adequate** supported by cash and bank balances of Rs. 23.3 crore as on June 30, 2021 and undrawn working capital limits of Rs. 121.0 crore against the sanctioned limits of Rs. 390.0 crore as on June 30, 2021. In relation to these sources of cash, SML has minimal capex plans and debt repayments of Rs. 42.0 crore in FY2022. ICRA also expects the company's liquidity profile to be supported by its healthy financial flexibility with its lenders by being majority owned by Sumitomo Corporation.

Rating sensitivities

Positive factors – Given the negative outlook, a rating upgrade is unlikely in the near-term. However, healthy recovery in CV demand 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 factors - 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 continued weak financial performance. Additionally, negative pressure on the ratings could arise if SML cedes material market share in its addressable segments. 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 Policy on Withdrawal of Credit Ratings Impact of Parent or Group Support on an Issuer’s Credit Rating
Parent/Group Support	Parent Company: Sumitomo Corporation, Japan The rating assigned to SML factors in the very high likelihood of its parent entity, Sumitomo Corporation (43.96% stake), extending financial support to it because of the close business linkages between them. ICRA also expects Sumitomo Corporation 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 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 a healthy market position in the school bus segment. The company was set up as ‘Swaraj Vehicles Limited’ for manufacturing Light Commercial Vehicles (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 43.96% and 15% 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, 2021 (fiscal 2020) amounted to ¥8.1 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 with some of major ones being Motherson Sumi Systems (rated [ICRA]AA+ (Stable)/[ICRA]A1+) and Sumitomo Chemical India.

Key financial indicators (audited)

SML Standalone	FY2020	FY2021	Q1 FY2022
Operating Income (Rs. crore)	1,150.1	589.2	100.0
PAT (Rs. crore)	-21.1	-133.5	-33.4
OPBDIT/OI (%)	0.8%	-11.9%	-17.3%
PAT/OI (%)	-1.8%	-22.7%	-33.5%
Total Outside Liabilities/Tangible Net Worth (times)	1.2	2.1	
Total Debt/OPBDIT (times)	20.6	-3.7	
Interest Coverage (times)	0.6	-3.0	-3.2

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation

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	Current Rating (FY2022)				Chronology of Rating History for the past 3 years				
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of June 30, 2021 (Rs. crore)	Date & Rating in	Date & Rating in FY2021		Date & Rating in FY2020		Date & Rating in FY2019*
						Aug 18, 2021	Dec 16, 2020	Aug 20, 2020	Feb 05, 2020	
1	Cash Credit	Long Term	25.00	NA	[ICRA]A+ (Negative)	[ICRA]A+ (Negative)	[ICRA]A+ (Negative)	[ICRA]AA- (Negative)	[ICRA]AA- (Negative)	[ICRA]AA (Stable)
2	Term Loans	Long Term	25.00	25.00	[ICRA]A+ (Negative)	[ICRA]A+ (Negative)	[ICRA]A+ (Negative)	[ICRA]AA- (Negative)	-	-
3	Short-term fund based limits	Short Term	347.00	NA	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
4	Commercial Paper	Short Term	-	-	[ICRA]A1+ withdrawn	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
5	Short-term Non-fund based limits	Short Term	-	-	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+

*Update on reason for delay in periodic surveillance was published on Sep 21, 2018

Complexity level of the rated instruments

Instrument	Complexity Indicator
Cash Credit	Simple
Long term Fund based Term Loan	Simple
Short-term Fund-Based Limits	Simple
Commercial Paper	Very 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 analyzing 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/Banker Name	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. Crore)	Current Rating and Outlook
NA	Cash Credit	NA	NA	NA	25.00	[ICRA]A+ (Negative)
NA	Term Loans	FY2019	NA	FY2024	25.00	[ICRA]A+ (Negative)
NA	Short-term fund based limits	NA	NA	NA	347.00	[ICRA]A1+
NA	Commercial Paper	No CP Outstanding			50.00	[ICRA]A1+; withdrawn

Source: Company

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

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