



JOINDRE CAPITAL SERVICES LTD.

SEBI REGN NO. INH000002061 / INZ000174034

RESEARCH REPORT

27TH Aug 2018

SML ISUZU LIMITED

BSE : SMLISUZU

Sector: AUTOMOBILES

BSE: 505192

View - BUY

CMP : Rs. 874

Target Price: Rs 1239 (In next 12 to 15 mths)

BUSINESS BACKGROUND

SML ISUZU Ltd started in 1983 is an automobile manufacturer whose main product base includes Trucks, Buses and Special application vehicles like that of Ambulance, Military vans, Tipper etc. They can be broadly classified into Light, Medium and Heavy commercial vehicles.

SML Isuzu is mainly concentrated in 5 to 12 tonnes GVW segment. In Buses segment, it focuses on school buses, State transport buses, luxury buses and buses for employees in BPOs, etc. SML Isuzu also exports vehicles to Sri Lanka, Bangladesh, Nepal, and Nigeria including other countries and is exploring market in Africa.

INVESTMENT HIGHLIGHTS

Strong Financial Performance in Q1 for FY19 –

SML Isuzu reported a strong set of Q1FY19 numbers with net sales at Rs 452 crs as compared to a revenue of Rs 358 crs in Q1 last year, with EBIDTA placed at Rs 39.58 crs from Rs 18.26 crs in Q1 last year with the PAT placed at Rs 21.66 crs from Rs 6.21 crs up by 249% YoY.

For FY18 SML Isuzu reported a soft set of numbers with Sales at Rs 1174.1 crs with EBIDTA at Rs 45.27 crs from Rs 109.98 crs last year with PAT at Rs 8.19 crs down from Rs 63.26 crs last year. SML Isuzu paid a dividend of 15% for FY18.

SMIL is a well established player in the niche 5-12 GVW segment –

SMIL manufactures vehicles in 5-12 Gross Value Weight segment. Bus segment contributed around 64% of the total revenue mix of the company in FY18, while the rest is derived from commercial vehicles like pickup trucks, cargo trucks, etc. It is a very strong player in bus segment. The company has plans to launch 3-4 new products every year to create better product mix.

SMIL enjoys technical & financial collaboration with Isuzu Motors

Japan – SMIL Isuzu signed a technical assistance agreement with Isuzu motors in June 2006. Isuzu motors acquired 2% stake in SML in 2008 and further raised it to 15% in 2012 showing its confidence. Isuzu Motors globally is a leading Japanese commercial vehicles and engine manufacturer company with presence in Asia and Africa. With Isuzu, SML gains technological expertise and innovation. Going ahead there are possibilities that Isuzu motors may sell its commercial vehicles in India through SML Isuzu and also increase its stake in SMIL further going ahead.

KEY DATA

FACE VALUE	Rs	10.00
DIVID YIELD %		0.17
52 WK HI/LOW		1090/719
NSE CODE		SMLISUZU
BSE CODE		SMLISUZU
MARKET CAP		RS 1265 CRS

SHAREHOLDING PATTERN

PROMOTERS	-	68%
BANKS, MFs & DIIs	-	4%
FIIs	-	11%
PUBLIC	-	17%

KEY FUNDAMENTALS

YE	FY19	FY20	FY21
Rev Gr%	34	14	13
EBIDTA Gr%	204	14	13
PAT Gr%	748	18	20
EPS Gr%	748	18	20
EPS (Rs)	48.03	57.01	68.21
ROE %	16	17	17
ROCE %	13	14	15
P/E(x)		15	13



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SMIL enjoys a strong market positioning in the school bus passenger segment, which continues to grow rapidly –

SMIL is quite popular and well established in the School/College/Staff bus segment, and has been gaining increased market share here over the years. The overall domestic market share of SML ISUZU in the commercial passenger vehicle segment has increased from 8% in FY14 to 11% in FY16, registering a growth of 24% in the CV segment.

The sustainable market conditions for this growth can be backed up by the increasing number of schools year on year with a CAGR of 5 to 6% since last ten years from FY08-18 and this trend is expected to continue according to Ministry of Human Resource Development.

Also, emphasis laid in providing transportation on educational institutions has necessitated the need to buy/replace buses in regular periods of time. Therefore, the market has adequate space for future growth also. In fact we would like to highlight that since the last 2-3 years most of its passenger bus sales come in the first quarter of the financial year which coincides with the start of academic year for school students, which is mostly in June, hence the sales are bunched largely here from the school bus segment

SMIL has a wide dynamic variation in its bus portfolio which predominantly caters to the school and college bus segment. Mostly these are placed between 5- 7.5 tonnes GVW having a seating capacity of 20 to 32. The buses are preferred based on the requirement like for example; a primary school would prefer either a 20 to 24 seater, while high schools and colleges require a higher 26 or 32 seater.

Moreover, the same school bus model is also facilitated for staff in educational institutes. It is mostly the corporates that prefer special staff buses for their employees.

Out of this SML school/staff buses having GVW between 5-7.5 tonnes are quite active in the market and their sales have increased by over 15% since last 2 years and hence we believe that the demand for school buses is expected to be sustained going ahead also largely on the back of increasing number of schools.

SMIL operates as a niche player in the Goods segment with a wide range of products –

Out of the total number of vehicles sold at SMIL, the goods segment constitutes around 33% in FY18 and the rest was largely from the passenger vehicles segment.

SMIL operates mainly in the 5-12 GVW segments which are mostly run by common fleet operators, vendors and other small scale industries. Since the customer base belongs to different product categories, especially more from the medium and large business segments it is quite fair to assume that SMIL's market share of about 8% might not be as vulnerable to market changes as their big peer companies.

Therefore, GDP growth rate is considered so as to include all the market segments. The GDP (according to new series) has grown 7.4% in FY15 as compared to the previous year 6.6% in FY14 and is expected to grow at 7.5% in FY19E. Here our assessment is that SMIL's sales volume in the goods segment is likely to increase at a CAGR of 10-12% between FY18-20E.

SMIL truck portfolio ranges between 5 - 12 GVW tonnes where models which fall between 5 to 8 GVW are quite high in number wherein 6 models out of the above 9 fall under this segment. The share of MCVs (53%) in total truck volume of SMIL is higher than of the LCVs (47%). Among LCV models, Cosmo, Sartaj and Prestige premium have relatively performed well in FY17 where cosmo sales have increased by 81% in the same year and Sartaj/Prestige has gone up by 20% thus adding to overall sales growth.



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However FY18 was a little hiccup year for SML Isuzu due to change in the BS III norms –

Although the LCV segment grew by 19% in FY18, SML Isuzu was unable to participate in that growth principally due to inadequate availability of vehicles for sale caused by the unexpected and sudden order of the Supreme Court of India on 29th March 2017 banning sale of BS III vehicles with effect from 1st April 2017.

This order rendered the entire inventory of BS III vehicles, built up for the ensuing school bus season of April-July 2017, non-saleable. All such vehicles had to be modified to make them BS IV compliant. In subsequent months, production of vehicles suffered on account of shortage of some critical components. Consequently, sales volumes for the year could reach only 11355 against 14909 sold in the previous year.

However SML Isuzu has bounced back in the current year –

Following the normalcy of production the company has bounced back and both production and sales volumes have gone up significantly. In the first 3 months of the current year starting from April to June 2018 total vehicles sales are placed at 4154 Nos from 3140 nos sold in the previous 3 months of last year. – Up by 32% YoY

In July 2018 also the sales momentum has continued with sales totaling 1130 Nos from 788 Nos sold in July last year – Up by 43% YoY.

Growth Drivers for the Commercial Vehicles industry look strong over the long term –

India has been among the fastest growing countries in Automobile sector. The entry of many foreign players in India and their collaboration with domestic Automobile companies will lead it to be a major player in Automobile market in the world. New and upgraded technology and innovation has increased exports demand to many countries from India.

All segments of Commercial vehicle industry have shown revival in FY18. According to ICRA, M&HCV are likely to register a growth of 8-9% in FY 18 driven by continuing trend towards replacement of ageing fleet and expectations of pick-up in demand from infrastructure, mining and industrial sectors in view of various reforms being initiated by the Government.

LCV segment has grown at a growth of 19% in FY18 with the Bus segment which contributed 13% to the overall commercial industry has shown pickup in demand in 2018 on back of new orders from State Transportation Undertakings. The bus industry has witnessed export demand from Sri Lanka, Bangladesh, Middle East and African countries.

Again the trend now seems to have reversed wherein the MCVs are gaining in their share, as there is an overall improvement in Mining, Construction and Manufacturing industries, where such vehicles would be extensively preferred.

Long term prospects of commercial vehicle industry are secular. Economic growth in the medium to long term would be driven by infrastructure investments in areas such as – roads, bridges, power generation, information technology, civil aviation, sea-ports, health, education etc. This trend would generate increased demand for commercial vehicles in coming years.

As per IMF Forecast – July 2018, India's GDP growth in 2018 is estimated at 7.3% against world average estimate of 3.9%. International ratings agency Moody's Investor Service has upgraded India's sovereign bond rating to "Baa2" from "Baa3" with a stable outlook. Also as per GIA study on Commercial Vehicles (CV), Asia-Pacific is expected to emerge as the fastest growing hub for CV production led by shifting of automobile production bases to low cost Asian countries.



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As per CRISIL, long term prospects of the Commercial Vehicle industry are positive. Apart from macro-economic factors, implementation of emission & anti-overloading norms, scrapping regulations for older vehicles and changing landscape of the logistics industry towards an organized one would continue to support demand for CVs.

As per ICRA, the Government's focus on infrastructure projects, higher demand from consumption driven sectors and from e-commerce logistic service providers, preference for hub-n-spoke model etc., are expected to drive volumes in truck segment. Based on these factors, M&HCV truck segment is likely to register a growth of 7-9% during 2018-19 whereas LCV truck segment is expected to register a growth of 10-12%.

As per ICRA, Bus segment will witness a growth of 12-14% during 2018-19 supported by replacement led demand and government thrust on improvement of transport systems in urban as well as rural sector with focus on the smart city initiatives.

On the other hand relative to the domestic CV industry, SMIL has done better as compared to the overall industry performance for the last five years. However, the trend now seems to have been upturned where, during FY18, the industry has grown by 19% while the SML average sales in the last 3 years have surged by 15% barring FY18 which was an exceptional year.

Steady improvement financial performance expected – Revenue growth and margin expansion to continue –

We estimate SMIL's earnings to witness a CAGR of 15-19% over FY18-20E. This will be driven by steady revenue growth (14-15% CAGR over FY18-20E) and a steady EBITDA margin expansion over the same period.

We expect a significant improvement in both ROCE and ROE over the next 2 years as we expect both the domestic and export markets to grow at a healthy clip where there is good scope for margin improvement and revenue growth.

SMIL has already undertaken a big capex over the next 2-3 years to augment its capacity –

The company has started its capex plan of investing Rs.220 crs by the year 2017 mainly in product development and in improving its technology apart from this it will increase its capacity from its current levels of 18000 nos annually. This investment plan would fuel the growth of the company and thus increase the top line of the company

Company's capex project envisaging an outlay of Rs. 220 crores towards technological advancement, product up-gradation /development and up-gradation of plant infrastructure to improve manufacturing efficiency is in its final stages of completion.

An amount of Rs 191.3 crores has been incurred till 31st March, 2018. For this capex spending, the Company has drawn Rs.140.0 crores External Commercial Borrowings (ECB), designated in US Dollars (fully hedged), and the balance is from internal accruals.

Already from August 2018 onwards the company has stated that its installed capacity has increased from 1500 vehicles a month to 2000 nos per month taking its total annual capacity to 24000 nos currently. This will give enough operating leverage of increasing volumes comfortably for the next 2-3 years ahead.



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SML Isuzu enjoys a strong balance sheet with huge scalability potential going ahead –

SML Isuzu runs a strong business model covering multiple product segments with a efficient working capital management while it continues to invest on a sustained basis largely from its internal accruals.

Even after the expansion SML Isuzu has reasonable debt of Rs 188 Crs as on FY18 as compared to a tangible networth of Rs 400 crs.

We expect that going ahead overall bottomline growth in the next 3 years starting FY18 onwards should easily increase at a CAGR of 23-25% and with capex funded largely from internal cash flows. Hence going ahead we expect both the ROCE and ROE to improve to 15% and 17% by FY20 from 5% and 2% in FY18.



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Business Outlook & Stock Valuation –

On a rough cut basis, in FY19, Topline will see a steady rise and is expected to touch Rs 1572 crs.

On the bottomline level we expect the company to record a PAT of Rs 69.50 crs in FY19E. Thus on a conservative basis, SMIL should record a EPS of Rs around Rs 48 for FY19E. For FY20E and FY21E our expectation is that earnings traction for SMIL would continue to be strong wherein we expect a EPS of Rs 57 and Rs 68 respectively.

Also another attractive point for SMIL is that EPS growth over the next three years between FY19 to FY21 is expected to average 20% plus YoY and to add to this at the current market cap of SMIL at Rs 1263 crs, the SMIL stock trades a market cap to sales multiple of just 0.80x on FY19E which looks quite low if looks at the topline potential over the the next 2 years.

SMIL is poised to benefit from the revival in the Commercial vehicles industry. The company has surplus capacity to meet the growing demand with confident and efficient management. On operational front, SML Isuzu has been able to manage its working capital efficiently and generate positive cash flows.

Volumes are likely to improve led by economic recovery and SML Isuzu's plan to launch 3-4 products every year with new and enhanced technology. With better product mix and efficient operations the company can grow annually at 14-15% in next 2-3 years. SMIL's current market share is 8% while Tata Motors and Ashok Leyland together have 80% of the market share.

We expect SML Isuzu to benefit from economic revival, falling finance cost, replacement demand, government's proposal to replace vehicles older than 15 years of age and high demand from bus segment. Bus volumes will improve on back of orders from State Transportation Undertakings, Tourism operators, school and colleges, executive buses for offices. Special vehicles like Ambulances, Police vans, Tipper, Dumper placer, etc. will improve with support from private and government expenditure.

At current price of Rs 874, SMIL is trading at FY19E P/E of 18x and FY20E PE of 15x. We expect SMIL to report better profits with increase in sales volume and operational efficiency in FY19 after a disappointing show on the back of a strong volume push leading to better EBIDTA and net margins.

Looking at SMIL's steady financial track record, strong product domain and dominant market share and strong promoters we expect the stock to get re rated in future.

Hence we believe that the SMIL's stock should be purchased at the current price for a price target of around Rs 1239 over the next 12 to 15 months.



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FINANCIALS

For the Year Ended March RsCr	FY17A	FY18A	FY19E	FY20E	FY21E
Net Sales	1502.61	1174.13	1572.1	1792.23	2025.22
EBIDTA	109.98	45.27	137.56	157.17	177.81
EBIDTA %	7.32	3.86	8.75	8.77	8.78
Interest	6.17	10.52	16.00	17.00	18.00
Depreciation	23.82	28.4	36.00	43.00	48.00
Non Operational Other Income	4.15	3.11	3.00	3.00	3.00
Profit Before Tax	84.14	9.46	88.56	100.18	114.81
Profit After Tax	63.26	8.19	69.5	82.5	98.7
Diluted EPS (Rs)	43.72	5.66	48.03	57.01	68.21
Equity Capital	14.47	14.47	14.47	14.47	14.47
Reserves	389.31	383.58	445.08	519.58	606.28
Borrowings	40.1	188.00	190.00	200.00	210.00
GrossBlock	286.00	379.91	404.91	429.91	459.91
Investments	0.00	0.00	0.00	0.00	0.00

Source Company our Estimates

KEY CONCERNS

Competition from Automobile players namely Ashok Leyland, Tata motor and Eicher Motors (Volvo).

Increase in raw material prices will impact its margins.

Slowdown in new investment and economic activities.



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