SML ISUZU LIMITED (SIL)

September 26, 2012	BUY	MEDIUM RISK	PRICE Rs.387	TARGET Rs.472

AUTOMOBILE

EARLIER RECO (Short Report)

BUY	
Price	Rs.383
Target	Rs.472
Date	Sept. 14, 2012

SHARE HOLDING (%)

Promoters	44.0
FII	-
FI	18.3
Body Corporate#	22.2
Public & Others	15.5

Isuzu's 15% stake included in Body Corporate

STOCK DATA

Reuters Code	SWRJ.BO
Bloomberg Code	SM IN
BSE Code	505192
NSE Symbol	SMLISUZU
Market Capitalization*	Rs. 5,593 mn US$ 104 mn
Shares Outstanding*	14.5 mn
52 Weeks (H/L)	Rs.470 /346
Avg. Daily Volume (6m)	2,602 Shares

Price Performance (%)

1M	3M	6M
(1)	(1)	(2)

200 Days EMA: Rs.393

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STRENGTH: Increasing Presence in Niche Category of MCV, Cushion of High Yielding Passenger Carriers, Healthy Return Ratios **WEAKNESS:** Supply Side Constraints **OPPORTUNITIES:** Strong Operating Leverage, Significant Capacity Expansion at Minimal Capex, Leveraging Isuzu Platform **THREAT:** Rising Competition & Volatility in Raw Material.

Strategically Increasing Presence in Niche Category of MCV

SIL was primarily present in the cargo segment with a blend of 63:37 (FY07) between its cargo (GC) and passenger carriers (PC). Given the volatility in the GC segment and its huge dependence on the economic activities, the company strategically moved towards high margin and less volatile PC in order to improve its margins and thereby protect itself from the downturn in the CV industry. In FY12, the company lost market share due to some supply constraints with regards to chassis frame & bus body availability, which is no more a concern, thus, starting FY13, the company's bus sales (7.5–12 tons) recorded an increase of 43% YTD vs. industry's 23% (+248 bps market share). With challenging macro environment, going forward we expect the share of PC to increase from 48% in FY12 to 54% by FY14E. Overall, we expect the MCV contribution to total sales to increase from 63% in FY12 to 68% by FY14E driven by product up-gradations & innovations.

Capacity Expansion at Minimal Incremental Capex – 'Can Result in Huge Operating Leverage'

SIL incurred a capex of Rs.1,000 mn over FY08-10 to double its capacity from 12,000 to 24,000 units in a phased manner. However, due to unfavorable macroeconomic conditions, company stalled its expansion plans at an increased capacity of 18,000. Since the major capex is already in place, the company does not have to incur significant amount (majorly towards process up-gradation and some equipment purchase) to further expand its capacity from 18,000 to 24,000 and gradually to 30,000 with 1 more shift. Also, as the current capacity is underutilized (78%) and given supply side constraints getting resolved, we expect the company's sales to increase by 2.9% & 8.1% YoY in FY13E and FY14E resulting in better operating efficiencies and margin improvement.

ISUZU Brand – 'Yet to Explore'

Recently, Isuzu Motors, Japan has increased its stake in SIL from 4% to 15% which shows Isuzu's confidence in the company and the country's CV market. Currently, Isuzu branded products account for only 1% of total sales, so SML is yet to see true color of ISUZU platform, which will result in increased share of Isuzu's products in total sales. Infact, SIL is likely to launch a new bus (IS12B) and truck on the Isuzu platform over the next 2 years.

Strong Financials, Healthy Return Ratios & Consistently High Dividend Payout

SIL's Revenues & APAT grew at a CAGR of 11.4% & 21.1% over FY07-12 driven by better product mix. SIL generates healthy cash flows sufficient to take care of future capex and retire debt. The current D/E stands at 0.4 (Working Capital Loan) which is expected to go down further due to effective working capital management. SIL has healthy return ratios with RoE & RoCE of 18.4% & 21.7%. The company also follows a consistent dividend policy with an average payout of ~28%.

OUTLOOK & VALUATION

In the current uncertain macroeconomic conditions, SIL is the best bet in the CV industry given its low base, underutilization of capacity, favorable product mix and low gearing. We believe the company is well placed to reap the benefits of economic revival with its margins only set to improve from current levels due to favorable product mix and potential benefit of huge operating leverage. Introduction of new Isuzu branded products would add to the existing premium offerings of the company. At the CMP of Rs.387, the stock is trading at 11.4x and 9.8x its FY13E & FY14E EPS of Rs.34.0 & Rs.39.3 respectively. We maintain our BUY recommendation on the stock with a price target of Rs.472 (based on 12x FY14E EPS).

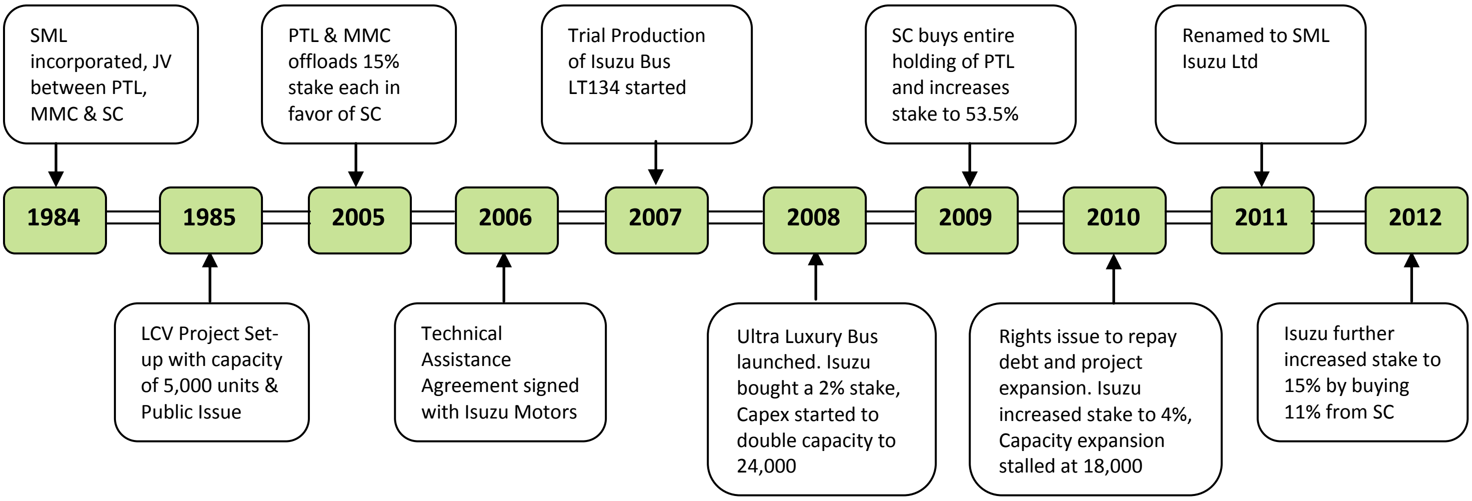
KEY FINANCIALS

Y/E Mar.	Revenue (Rs mn)	RPAT (Rs mn)	AEPS (Rs)	AEPS (% Ch.)	P/E (x)	ROCE (%)	ROE (%)	P/BV (x)
FY11	9,100.0	365.6	25.2	70.3	15.3	20.5	18.2	2.6
FY12	10,358.3	418.7	28.9	14.5	13.4	21.7	18.4	2.3
FY13E	**11,149.2**	**492.6**	**34.0**	**17.7**	**11.4**	**21.1**	**19.0**	**2.0**
FY14E	**12,233.9**	**569.0**	**39.3**	**15.5**	**9.8**	**22.0**	**19.2**	**1.8**

COMPANY OVERVIEW

Incorporated in 1984, SML Isuzu Ltd. (SIL) formerly known as Swaraj Mazda Ltd. (SML) was set up as a joint venture (JV) between Punjab Tractors Ltd (PTL) (29% stake) , Mazda Motor Corporation, Japan (MMC) (15.6% stake) & Sumitomo Corporation, Japan (10.4% stake). SIL has evolved from a small LCV player with 5,000 units to a MLCV player with 18,000 units having a niche in PC. With the gradual shift in ownership in favor of Sumitomo Corporation (SC), SC is now a sole promoter of SIL with 43.96% holding. SC is a Japanese conglomerate present in businesses such as Transportation and Construction systems, Infrastructure, Real Estate, Automobiles, Media, Retail etc.

SIL in 2006 signed a technical collaboration with Isuzu Motors, Japan. In 2008, Isuzu bought a 2% stake in the company gradually increasing it to 15% (bought additional 11% in April 2012 from SC). With the increase in the holding, ISUZU is likely to launch several new Isuzu branded products and thereby enhance its presence in the Indian CV market.



SIL has one factory located at Chandigarh with 2 assembly lines each for SML & Isuzu products and 6 Bus Body building lines. The product portfolio of SIL is as follows:

Product Portfolio

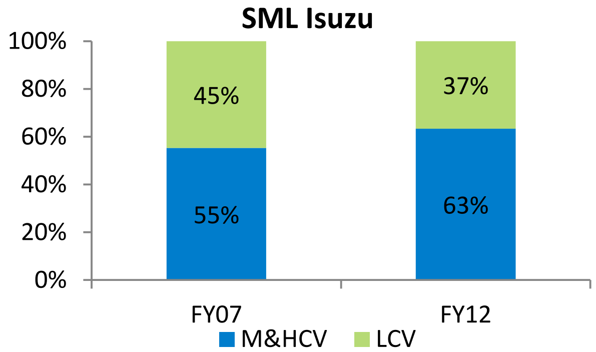
Brands	Trucks	Buses	Special Vehicles
SML	Super	Executive	Tipper
	Samrat	School Bus	Dumper Places
	Super 12	Ambulance	Tanker
	Sartaj	4 WD Ambulance	Police Van
	CNG Truck	Semi Low Floor School Bus	Sky Lifter
	Cosmo	Staff Bus	Troop Carrier
	Dual Cab	Cardiac Ambulance	Recovery Van
	4 WD Truck	CNG School Bus	
	Supreme	Semi Low Floor BRTS & City CNG Bus	
	Prestige		
	Premium		
ISUZU	NQR IS12-TE	LT 134	
		NQR	

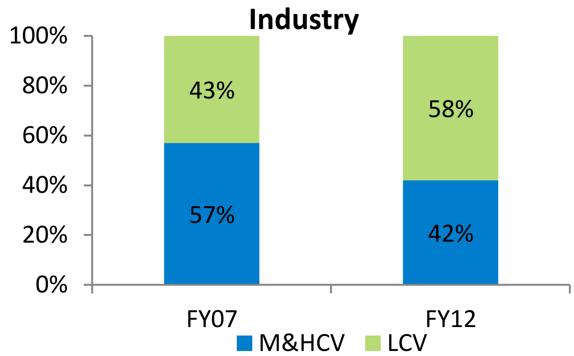
Source: Company

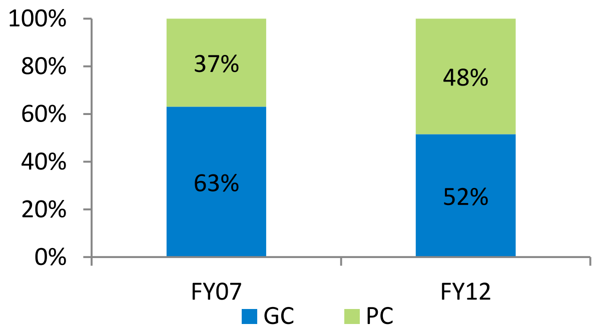
INVESTMENT ARGUMENTS

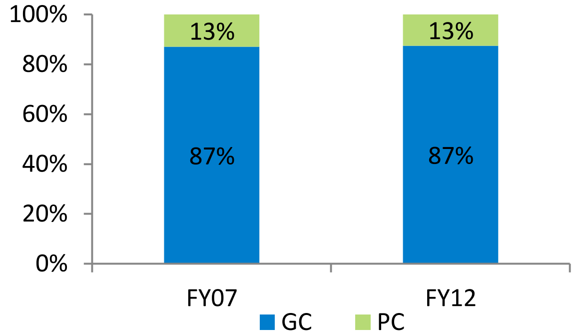
Strategically Increasing Presence in Niche Category of MCV

SIL was initially set-up to cater to the LCV needs of the industry. Later, with the increasing demand for higher tonnage vehicles, the company ventured into MCV (7.5-12T). Against the industry trend where the companies have shifted their focus on LCVs, SIL continued to create its niche within the MCV category by expanding its product portfolio & venturing into lucrative passenger carrier segment (PC). Thus, the contribution from MCV to total sales volume now stands at 63% (FY12) as against 55% in FY07.









Source: Company, SIAM

As depicted in the above chart, SIL was primarily present in the cargo segment with a blend of 63:37 (FY07) between its GC and PC. Given the volatility in the GC segment and its huge dependence on the economic activities, the company strategically moved towards high margin and less volatile PC in order to improve its margins and thereby protect itself from the downturn in the CV industry. In the current challenging macro environment, where GC within MHCV witnessed de-growth of 17% YTD, PC grew by 10% indicating consistent demand for buses. In FY12, the company lost market share due to some supply constraints with regards to chassis frame & bus body availability, which is no more a concern, thus, starting FY13, the company's bus sales (7.5–12 tons) recorded an increase of 43% YTD vs. industry's 23% (+248 bps market share). Going forward, we expect the share of PC to increase from 48% in FY12 to 54% by FY14E. Overall, we expect the MCV contribution to total sales increasing from 63% in FY12 to 68% by FY14E driven by product up-gradations & innovations.

Volumes Could Positively Surprise – WHY?

a) Supply Constraints – 'No More a Concern'

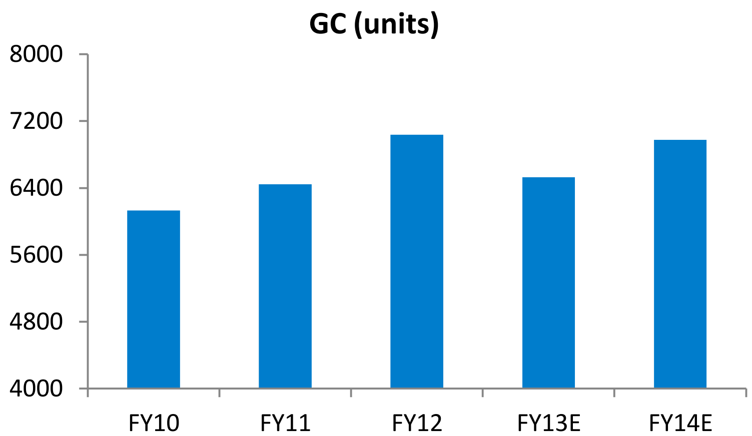
Due to some internal conflict between erstwhile promoters over FY05-10, SIL could not concentrate on expanding its product portfolio, product enhancement and market penetration through dealer expansion. However, post SC taking over full control of SIL, the company concentrated its efforts to increase its product offerings and create a market for itself which is reflected in its sales volume increasing by 16% over FY10-12 as against a de-growth of 4% over FY05-10. The growth was despite of the company grappling under supply issues. In FY12, SIL faced some supply constraints with regards to chassis frame availability due to which it lost few large bus orders to the competitors. The company now has an assured supply of 15,000 chassis frame and is also looking for a second sourcing arrangement to secure for its future needs.

SIL has also increased the bus body building capacity from 450 p.m. to 600 p.m. (outsourced capacity) and has started in-house manufacturing of Fully Built Vehicle for SML branded buses with an initial capacity of 50 p.m. to be gradually increased to 100 p.m. by FY13E.

b) GC Volumes to Improve from H2FY13 – 'Driven by New Product Launch and Product Improvement'

SIL's GC sales dipped by 7.0% YTD'13 mainly on account of sand mining ban imposed during Q1FY13 in key markets like Himachal Pradesh (HP), Kerala and Goa. SIL tippers are quite popular in the hilly terrain areas and narrow landscapes where heavy duty tippers are difficult to pass. With the lifting of ban in HP and likely action in other states, we expect tipper sales to be better in H2FY13.

As a part of its product up-gradation initiatives, SIL has increased the length of its Supreme truck (10T) from 17ft to 19ft while keeping the Gross Vehicle Weight (GVW) constant. Also, within the LCV, SIL has increased the GVW of Sartaj truck (6-7.5T) by 500kgs to 7.2T by way of increase in the tyre rating. These measures will increase the pay-load capacity of the trucks and would result in higher efficiencies at low cost.



Source: SIAM, Sushil Finance Research Estimates

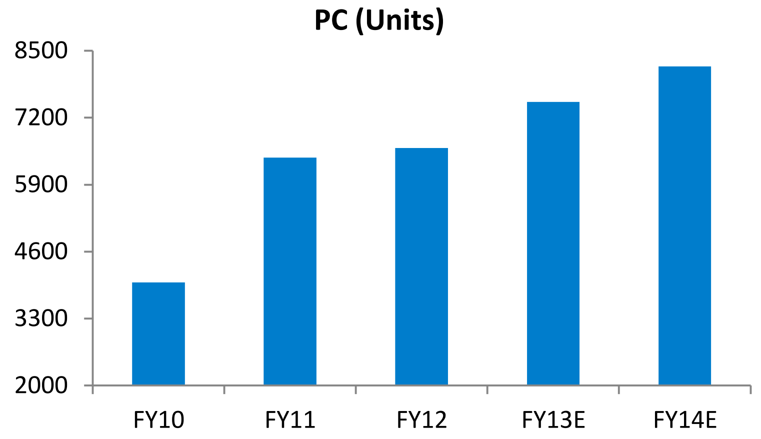
Apart from the above measures, SIL is looking to re-launch its Super 12 truck (10-12T) with improved clutch panel. In the erstwhile model, there was a problem in clutch panel due to which the product was not very well accepted in the market and hence, the company had to withdraw the same. It has now increased the dimension of the clutch panel from

285mm to 310mm and is looking to re-launch the vehicle in Q3FY13. The company is targeting sales of at-least 100 Super 12 trucks a month (~500 trucks target for FY13) which is likely to drive the GC volumes higher in H2FY13.

c) Bus Volumes to Remain Strong – 'Amidst Changing Preferences & Improving Infrastructure Facilities'

With the increase in the bus body building capacity and strong demand, we expect the bus volumes to grow by 11.3% over FY12-14E. The Government is making it mandatory for schools to provide transportation services in order to do away with private transportation for better safety of students. With the increase in the number of schools and changing preferences of parents in favor of luxury buses, we believe, SML being a strong player in school bus category is well positioned to capture the growth opportunity.

Also with the increasing tourism, the demand for luxury buses will increase. The corporate houses, in order to provide comfort to their employees are increasingly opting for small executive buses. SML being one of the leaders in the luxury and executive bus segment, will benefit in huge way given that the supply constraints & technical issues have been addressed. To add to the growth of PC segment, Government is considering working on PPP model for State Transport Undertakings (STUs) in order to improve efficiencies and reduce costs. With the improvement in the infrastructure facilities and change in Government strategy, we expect a sustainable growth in bus sales going ahead.



Source: SIAM, Sushil Finance Research Estimates

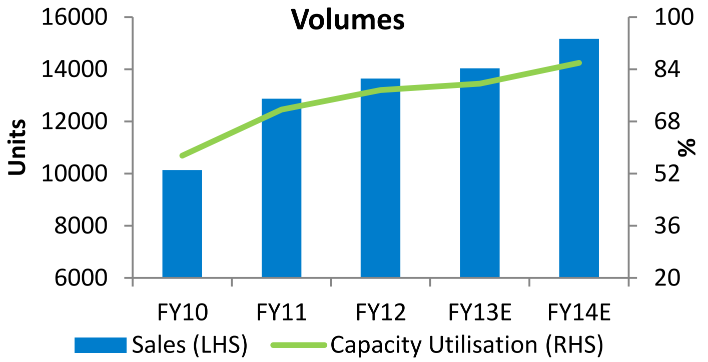
d) Expansion in Dealer & Service Network

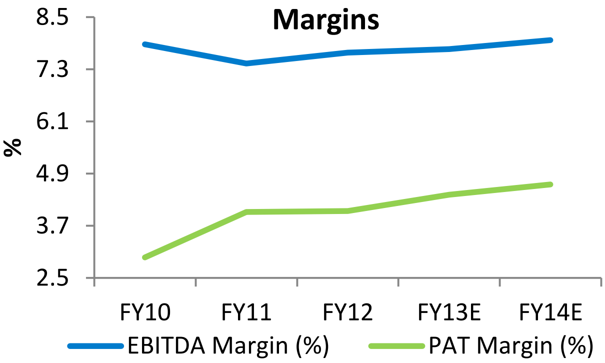
SIL currently has a network of 100 dealers (& 120 service networks) evenly spread across North (27), South (27), East (28) and West (18). The company has a strong presence in the northern and southern regions with Kerala, Delhi NCR and HP being the key markets. It is planning to increase its dealership network in order to strengthen its distribution reach and gain market share. It is targeting to achieve a dealer network of 25 in the western region by FY13E.

Considering the current macro environment, we have factored in a low volume growth of 5.4% over FY12-14E against the management guidance of 11.6%. However, considering the recent bold initiatives taken by the government to bring the economy back on growth trajectory coupled with the above measures taken by the company like overcoming supply constraints, new product offerings and expansion into new geographies, we believe SIL can outperform our estimated volume growth.

Capacity Expansion at Minimal Incremental Capex – 'Can Result in Huge Operating Leverage'

SIL incurred a capex of Rs.1,000 mn over FY08-10 to double its capacity from 12,000 to 24,000 units in a phased manner. However, due to unfavorable macroeconomic conditions, internal conflicts and supply concerns, company stalled its expansion plans at an increased capacity of 18,000. Since the major capex is already in place, the company does not have to incur significant amount to further expand its capacity to 24,000. SIL has to incur a minimal capex of ~Rs.50-60mn towards purchase of balancing equipments in addition to a maintenance capex of Rs.200-220mn to increase its capacity from 18,000 to 24,000. The capacity can be further ramped up to 30,000 by way of additional shift.





Source: Company, Sushil Finance Research Estimates

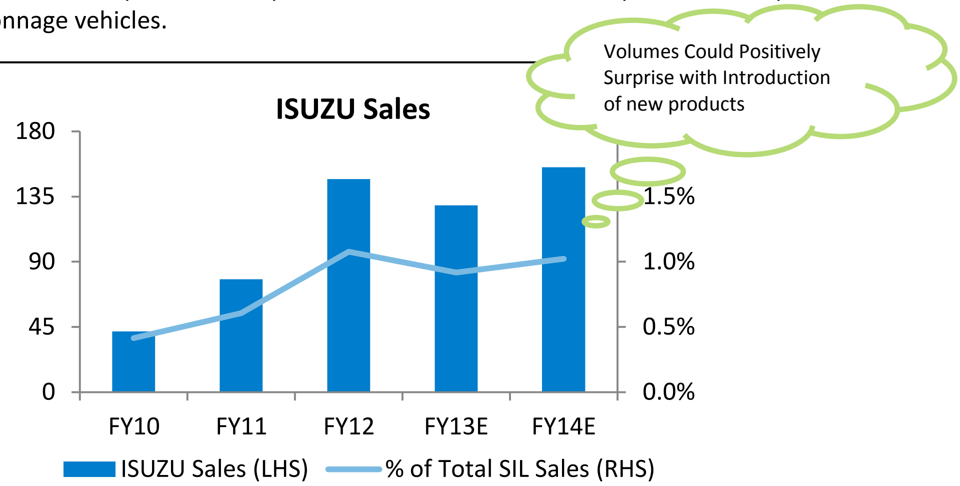
Given the current underutilization of capacity, any volume increase will give a huge operating leverage and in turn would result in margin improvement. Though we are factoring in a low volume growth of 2.9% & 8.1% YoY in FY13E and FY14E, our operating margins are expanding by 8bps and 21bps respectively. Assuming that the company achieves its targeted volume growth of ~11.6% over FY12-14E, we believe the operating margins would expand by 127 bps over the same period. Also, given that the new capacities could be commissioned at a minimal incremental capex, the margins only stand to improve from the current levels of 7.7% (FY12).

ISUZU Brand – 'Yet to Explore'

SML signed a technical collaboration with Isuzu in June 2006 with a view to leverage Isuzu brand & expertise in the Indian CV market. Globally Isuzu is a leading manufacturer of commercial vehicles and diesel engines, offering heavy, medium and light-duty trucks, buses, pick-up trucks and sports utility vehicles. In Japan, Isuzu boasts of being the no. 1 player in Light-Duty (LD) truck market and is the second largest player in the Medium-and-Heavy Duty (MHD) truck segment. The success of the company is also attributed to the low cost of maintenance and better fuel efficiency. Isuzu products are sold in more than 100 countries worldwide. Isuzu, in its Mid-term Business plan (April 2011 – March 2014) has identified a Global 3 core business strategy wherein one of the strategy includes the expansion and development of a CV business for the emerging markets where we believe India would also play a key role.

As a part of its strategy, Isuzu increased its stake in SIL from 4% to 15% in order to strengthen its partnership with SIL and boost the market penetration of Isuzu branded commercial vehicles in India. Going forward, Isuzu will launch products designed specifically for the Indian market with Isuzu components, dispatch development & sales personnel and rebuild its dealership network by 2016 with an aim of significantly improving its market share.

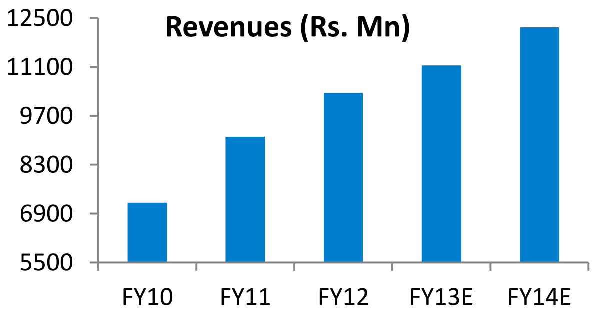
Currently, Isuzu branded products account for only 1% of total sales, so SIL is yet to see true color of ISUZU platform, which will result in increased share of Isuzu's products in total sales. Infact, SIL is likely to launch a new bus (IS12B) and truck on the Isuzu platform over the next 2 years. The launch of Isuzu products will provide SIL the much needed exposure and experience in the higher tonnage vehicles.

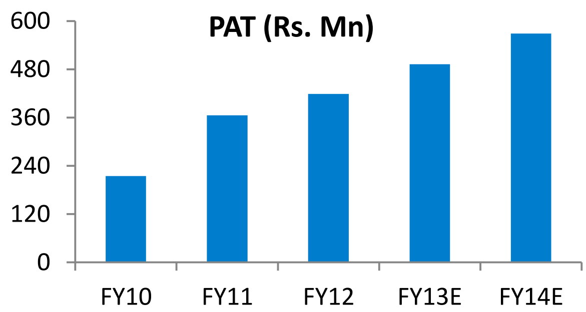


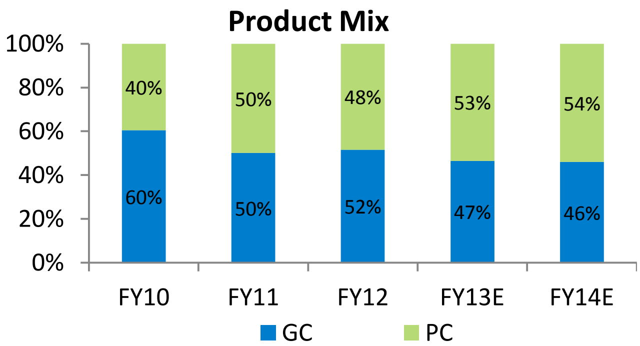
Source: SIAM, Sushil Finance Research Estimates

Strong Financials, Healthy Return Ratios & Consistently High Dividend Payout

SIL's Revenues & PAT grew at a CAGR of 11.4% & 21.1% over FY07-12 driven by better product mix. We expect SIL's volumes to grow by 5.4% over FY12-14E resulting in revenue growth of 8.7% on account of higher contribution from high value PC segment. The PAT is expected to grow at 16.6% over the same period driven by better capacity utilization and product mix.

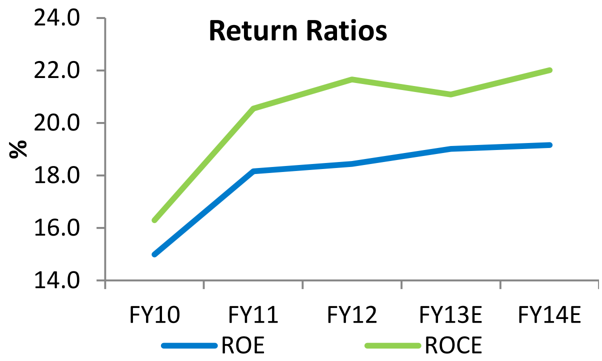


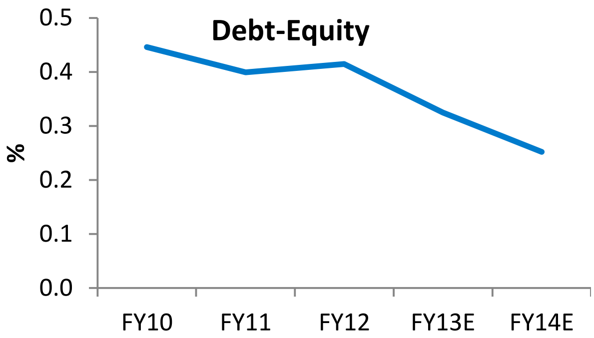


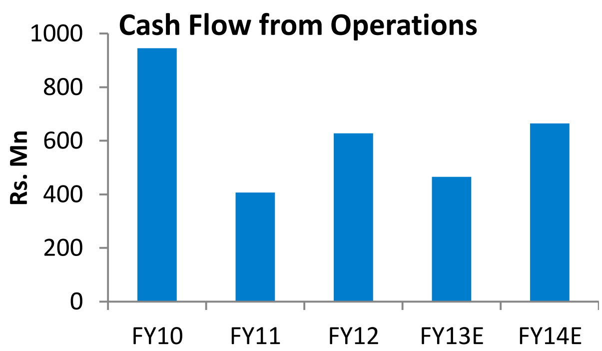


Source: Company, SIAM , Sushil Finance Research Estimates

Driven by higher profitability and effective receivable management, SIL generates healthy cash flows sufficient to take care of future capex and retire debt. The current D/E stands at 0.4 (Working Capital Loan) which is expected to go down further. SIL has healthy return ratios with RoE & RoCE pegged at 18.4% & 21.7% which we expect to improve going forward amid better working capital management and optimal utilization of assets.

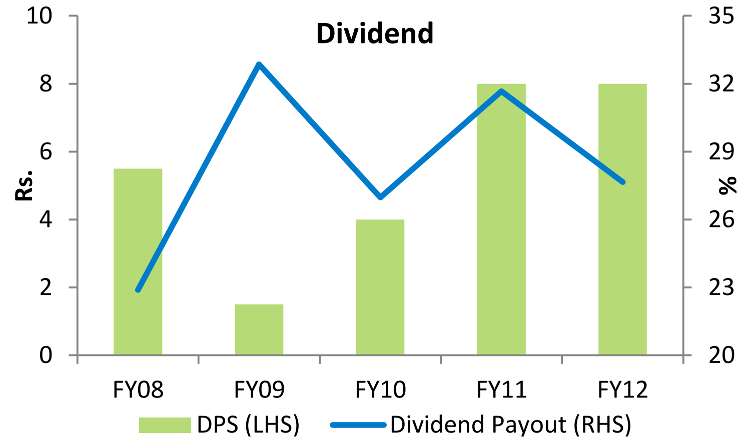






Source: Company, Sushil Finance Research Estimates

SIL follows a consistent dividend policy with an average payout of ~28% which reflects its attitude towards minority shareholders.



Source: Company

RISK & CONCERN

- Volatility in raw material prices could significantly impact the margins as raw material cost accounts for ~83% of the total costs.
- More than expected slowdown in CV industry.
- Entry of new players to impact the market share of the company.

OUTLOOK & VALUATION

In the current uncertain macroeconomic conditions, SIL is the best bet in the CV industry given its low base, underutilization of capacity, favorable product mix and low gearing. We believe the company is well placed to reap the benefits of economic revival with its margins only set to improve from current levels due to favorable product mix and potential benefit of huge operating leverage. Introduction of new Isuzu branded products would add to the existing premium offerings of the company. At the CMP of Rs.387, the stock is trading at 11.4x and 9.8x its FY13E & FY14E EPS of Rs.34.0 & Rs.39.3 respectively. We maintain our BUY recommendation on the stock with a price target of Rs.472 (based on 12x FY14E EPS).

PROFIT & LOSS STATEMENT

(Rs.mn)

Y/E March	FY11	FY12	FY13E	FY14E
Revenues	**9,100.0**	**10,358.3**	**11,149.2**	**12,233.9**
Raw Materials	7,068.7	7,917.9	8,499.7	9,289.2
Personnel Cost	599.4	678.6	747.0	831.9
Other expenses	755.1	965.4	1,036.9	1,137.8
EBITDA	**676.8**	**796.4**	**865.6**	**975.0**
Depreciation	89.1	104.4	119.0	134.0
Interest charges	103.9	106.2	109.3	96.1
Other Income	29.9	63.9	56.3	56.5
PBT	**513.8**	**649.6**	**693.8**	**801.4**
Tax	148.2	182.0	201.2	232.4
RPAT	**365.6**	**467.5**	**492.6**	**569.0**
APAT	**365.6**	**418.7**	**492.6**	**569.0**

BALANCE SHEET STATEMENT

(Rs.mn)

As on 31st March	FY11	FY12	FY13E	FY14E
Equity Share Capital	144.8	144.8	144.8	144.8
Reserves	1,983.1	2,267.2	2,625.3	3,026.1
Net worth	**2,127.9**	**2,412.0**	**2,770.1**	**3,170.9**
Total loans	**850.0**	**1,000.0**	**900.0**	**800.0**
Deferred Tax Liab.	80.1	101.2	108.2	116.2
Capital Employed	**3,058.0**	**3,513.3**	**3,778.2**	**4,087.1**
Net block	**1,328.6**	**1,350.2**	**1,474.4**	**1,545.4**
CWIP	24.3	83.6	60.5	75.5
Investments	-	-	-	-
Inventories	2,101.6	2,263.9	2,562.2	2,772.5
Sundry debtors	1,165.1	1,210.2	1,302.6	1,429.2
Cash and bank	410.2	879.6	890.5	1,067.8
Loans and advances	403.4	384.8	430.4	475.1
Total Current Liab. & Provisions	**2,375.1**	**2,659.1**	**2,942.4**	**3,278.3**
Net Current assets	**1,705.1**	**2,079.4**	**2,243.3**	**2,466.2**
Capital Deployed	**3,058.0**	**3,513.3**	**3,778.2**	**4,087.1**

FINANCIAL RATIO STATEMENT

Y/E March	FY11	FY12	FY13E	FY14E
Growth (%)				
Net Sales	26.1	13.8	7.6	9.7
EBITDA	19.1	17.7	8.7	12.6
APAT	70.3	14.5	17.6	15.5
Profitability (%)				
EBITDA Margin	7.4	7.7	7.8	8.0
Net Profit Margin	4.0	4.0	4.4	4.7
ROCE	20.5	21.7	21.1	22.0
ROE	18.2	18.4	19.0	19.2
Per Share Data (Rs.)				
EPS	25.2	28.9	34.0	39.3
CEPS	32.7	41.0	42.7	49.1
BVPS	147.0	166.6	191.4	219.1
Valuations (x)				
PER (x)	15.3	13.4	11.4	9.8
P/BV (x)	2.6	2.3	2.0	1.8
EV/EBITDA (x)	8.9	7.2	6.5	5.5
EV/Net Sales (x)	0.7	0.6	0.5	0.4
Turnover days				
Debtor Days	51	42	41	41
Creditor Days	98	95	98	98
Gearing Ratio				
D/E	0.4	0.4	0.3	0.3

Source: Company, Sushil Finance Research Estimates

CASH FLOW STATEMENT

(Rs.mn)

Y/E March	FY11	FY12	FY13E	FY14E
Profit After Tax Available to Shareholders	**365.6**	**418.7**	**492.6**	**569.0**
Depreciation	84.2	92.4	119.0	134.0
Chg. in Deferred Tax Liability	18.4	21.1	6.9	8.0
Chg. in Working Capital	(60.9)	95.1	(153.0)	(45.6)
Cash Flow from Operations	**407.2**	**627.3**	**465.5**	**665.5**
Chg. in Gross PP&E	(168.1)	(167.6)	(243.1)	(205.0)
Chg. in Work in Prog.	(18.1)	(5.7)	23.1	(15.0)
Chg. in Investments	-	-	-	-
Cash Flow from Investing	**(186.2)**	**(173.3)**	**(220.0)**	**(220.0)**
Change in Debt	3.7	150.0	(100.0)	(100.0)
Dividend	(135.0)	(134.6)	(134.6)	(168.2)
Cash Flow from Financing	**(131.3)**	**15.4**	**(234.6)**	**(268.2)**
Cash at the End of the Year	**410.2**	**879.6**	**890.5**	**1,067.8**

Rating Scale

This is a guide to the rating system used by our Institutional Research Team. Our rating system comprises of six rating categories, with a corresponding risk rating.

Risk Rating

Risk Description	Predictability of Earnings / Dividends; Price Volatility
Low Risk	**High predictability / Low volatility**
Medium Risk	**Moderate predictability / volatility**
High Risk	**Low predictability / High volatility**

Total Expected Return Matrix

Rating	Low Risk	Medium Risk	High Risk
Buy	**Over 15 %**	**Over 20%**	**Over 25%**
Accumulate	**10 % to 15 %**	**15% to 20%**	**20% to 25%**
Hold	**0% to 10 %**	**0% to 15%**	**0% to 20%**
Sell	Negative Returns	Negative Returns	Negative Returns
Neutral	Not Applicable	Not Applicable	Not Applicable
Not Rated	Not Applicable	Not Applicable	Not Applicable

Please Note

- Recommendations with "Neutral" Rating imply reversal of our earlier opinion (i.e. Book Profits / Losses).
- ** Indicates that the stock is illiquid With a view to combat the higher acquisition cost for illiquid stocks, we have enhanced our return criteria for such stocks by five percentage points.
- **Stock Review Reports:** These are Soft coverage's on companies where Management access is difficult or Market capitalization is below Rs. 2000 mn. Views and recommendation on such companies may not necessarily be based on management meeting but may be based on the publicly available information and/or attending Company AGMs. Hence Stock Reviews may be just one-time coverage's with an occasional Update, wherever possible.