

INDUSTRY	AUTOS
CMP(as on 27 Sep 2017)	Rs 884
Target Price	Rs 1,225
Nifty	9,736
Sensex	31,160

KEY STOCK DATA	
Bloomberg	SM IN
No. of Shares (mn)	14
MCap (Rs bn) / (\$ mn)	13 / 195
6m avg traded value (Rs mn)	40

STOCK PERFORMANCE (%)			
52 Week high / low	Rs 1,388 / 880		
	3M	6M	12M
Absolute (%)	(28.3)	(28.9)	(31.2)
Relative (%)	(28.9)	(35.4)	(41.6)

SHAREHOLDING PATTERN (%)	
Promoters	43.96
FIs & Local MFs	3.11
FPIs	5.43
Public & Others	47.50

Source : BSE

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Bottoming out

We hosted the management of SML Isuzu (SMLI) for a series of investor meetings. We believe that SMLI's growth ahead will be based on (1) Strong brand equity in the school bus segment and debottlenecking of capacity in the peak season, (2) increase in capacity utilisation led by expanding presence in the cargo segment, (3) Technology support from Isuzu Motors (which owns 15% stake in the company), (4) Expanding the product and distribution network, (5) Improvement in margins led by operating leverage. Although FY18 numbers are expected to be dismal owing to a hit in earnings in 1Q (peak season for school buses), we expect 15% volume CAGR for SMLI over FY18-20E, led by strong demand for the school bus segment and expanding presence in the cargo segment. Current valuations at 17/13x for FY19/20 appear attractive. We value SMLI on 20x P/E on Sept-19E EPS. Maintain BUY with a TP of Rs 1225.

Below are key takeaways from these interactions:

- **Strong brand name in the school bus segment:** SMLI is a well-known player in the school bus segment (commands ~20% market share and constitutes ~50% of total revenue). The company also supplies buses for staff, ambulances, tourists and intra-city public transportation. USPs includes low cost of maintenance, longevity and better resale value. SMLI is also gaining strong traction in the truck segment (volume has doubled in last three years from 3.1K to 6.5K units).

- **Supply constraints not a concern:** 1Q is usually a strong quarter for the bus segment, contributing ~60% to the overall profit. However, the company faced several challenges in 1QFY18, including unsold BS3 inventory, insufficient supply of chassis frame components, shortage of BS4 components and uncertainty owing to GST. In the last five months, total volume declined by 39% YoY to 4.4K units. However, most issues have been sorted out, and management expects volumes to be back on track from Sept-17.
- **Capacity expansion:** The company is expanding its capacity from 18K units to 24K units p.a. This will enable it to meet high demand during the peak season, reduce inventory build-up and related costs. The new line will become operational by Jan-18, and the impact is expected to be visible by 1QFY19 (would be able to sell 5-6k buses).
- **ISUZU brand yet to be explored:** Sumitomo Corporation has a stake of 44% in SMLI. Isuzu holds 15% stake in the company, and supports SMLI's R&D in the upgradation of engines, improving cabin design etc. We believe ISUZU's technical assistance would be key for business expansion above the 12-tonne segment and entering into the electric buses space. We believe SMLI is yet to witness the complete benefits of ISUZU's. SMLI's existing range spans 5.5 to 12 tonners in the cargo and bus segments, which are based on the Mazda platform. The long-term game plan is to become a player in the 5.5 to 49 tonne range.

Although the company is expected to report volume decline in FY18(-11% YoY), we expect 15% CAGR volume growth for SML in FY18-20E, owing to strong demand for the school bus segment and expanding presence in the cargo segment

We cut FY18/19E EPS by 22/20%, factoring in weak 5MFY18 numbers. We value FML on 20x P/E on Sept-19E EPS, our TP is Rs 1,225(vs 1,325 earlier)

- **Capex plan:** The Company has a capex plan of Rs. 2.20bn to be spent on technology upgradation, product development (improvement in cabin designing and a new paint shop), and capacity addition. The company has already spent Rs ~1.20bn, and the remaining will be spent over the next two years. Funds will be sourced from a mix of internal accruals and borrowings.
- **Expansion in dealer and service network:** The company has a strong presence in the northern and southern regions, with Bangalore, Chennai, Hyderabad and Delhi NCR being the key markets (contributes 80% to overall volume). SMLI is currently working on plans to expand its distribution presence, along with re-branding and the addition of new dealers. Currently, the company has 127 dealers (including export), and has added 30 dealers in last two years. Its investments

in product development and upgradation of plant infrastructure would help to strengthen its market position in the medium term.

- **New launch:** In 2HFY17, the company launched Ecomax Bus, designed for tours and travel operators and staff shuttle operations. This bus will compete with Force Traveler, Tata Motors CityRide, Tata Motors Winger and Mahindra Tourister. The market size of this segment (upto 5 tonnes) is ~2200 buses/ month. The company has also received orders from the Defence sector to supply 500 customized Cargo.
- **BS3 inventory:** The company has converted ~1,200 out of ~1,600 vehicles of BS-III inventory into BS-IV. It has already written off Rs ~140mn towards conversion cost, non-useable components and labour cost, and another Rs ~30mn write off is yet to be made.

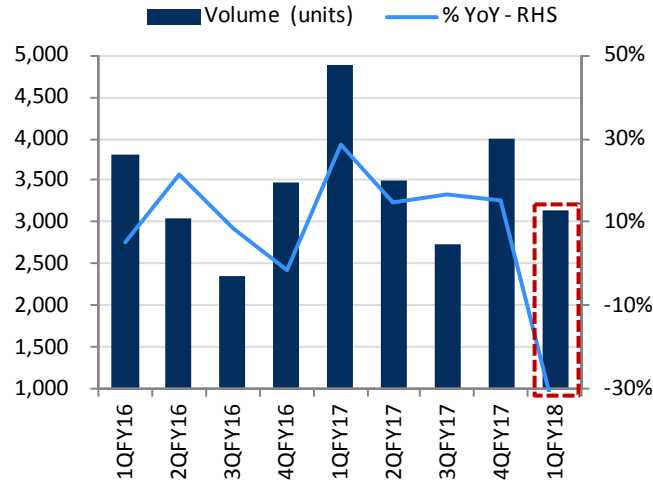
Volume Assumptions

(in units)	FY16	FY17	FY18E	FY19E	FY20E
Buses	6,789	7,836	6,678	7,843	8,891
% YoY	-12.5%	15.4%	-14.8%	17.4%	13.4%
Trucks	5,408	6,520	6,231	7,165	8,008
% YoY	46.5%	20.6%	-4.4%	15.0%	11.8%
Domestic volumes	12,197	14,356	12,909	15,009	16,899
% YoY	6.5%	17.7%	-10.1%	16.3%	12.6%
Exports	503	544	420	602	670
% YoY	35.9%	8.2%	-22.8%	43.3%	11.3%
Total sales	12,700	14,900	13,329	15,611	17,569
% YoY	7.4%	17.3%	-10.5%	17.1%	12.5%

Source: SIAM, HDFC sec Inst Research

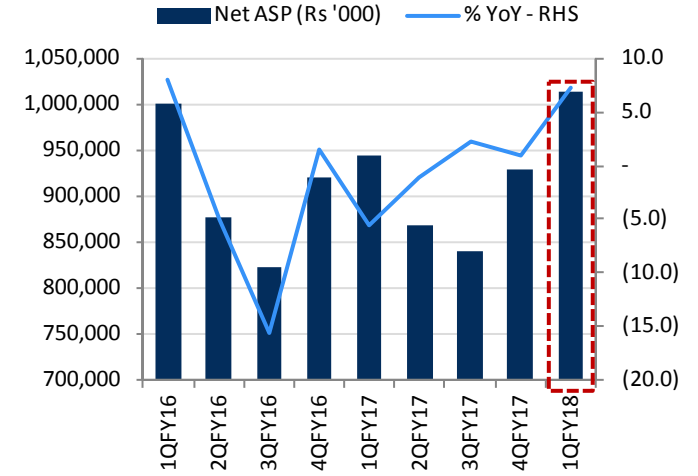
Supply constraint of chassis frame components, shortage of BS4 components and GST related uncertainty

Volumes Fell In 1QFY18



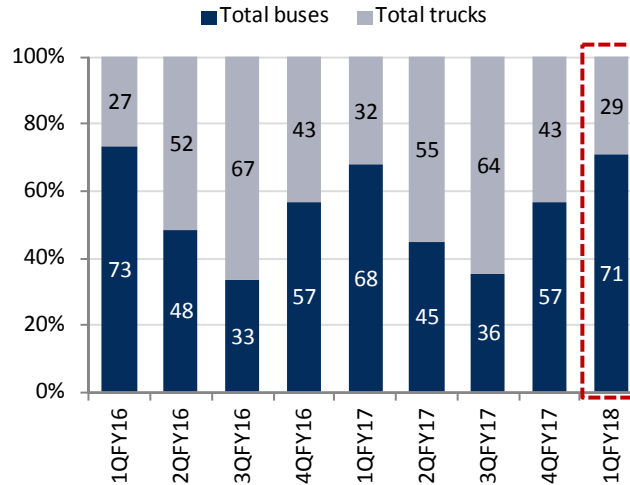
Source: Company, HDFC sec Inst Research

Net ASP Witnessed Improvement YoY



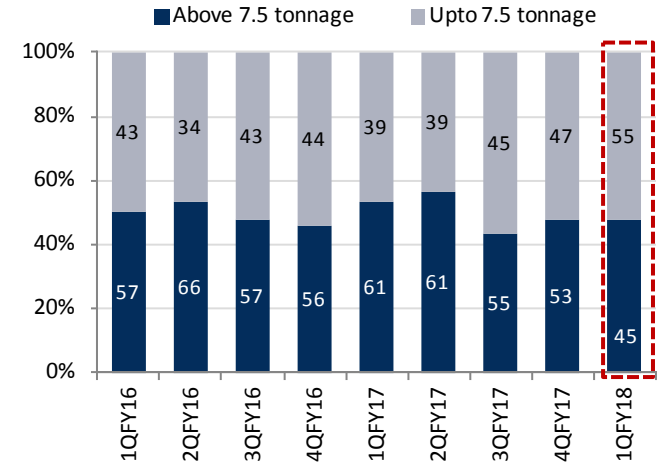
Source: Company, HDFC sec Inst Research

Product Mix



Source: SIAM, HDFC sec Inst Research

Tonnage Mix



Source: SIAM, HDFC se Inst Research

We believe Isuzu Motors may ultimately sell commercial vehicles in India through SML Isuzu, and also increase stake in the company over the medium term

Income Statement Standalone

(Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
Net Revenues	11,663	13,690	13,012	15,472	17,725
Growth (%)	5.5	17.4	(4.9)	18.9	14.6
Material Expenses	8,479	10,018	9,525	11,295	12,939
Employee Expenses	1,249	1,411	1,496	1,556	1,680
Other Operating Expenses	1,068	1,180	1,192	1,240	1,351
EBITDA	868	1,080	799	1,382	1,754
EBITDA Margin (%)	7.4	7.9	6.1	8.9	9.9
EBITDA Growth (%)	32.4	24.5	(26.0)	72.9	26.9
Depreciation	196	235	261	334	376
EBIT	672	845	539	1,049	1,378
Other Income (Including EO Items)	62	42	40	55	56
Interest	52	40	49	42	28
PBT	683	847	530	1,062	1,406
Tax (Incl Deferred)	172	218	143	297	394
APAT	511	628	387	764	1,012
APAT Growth (%)	38.4	22.9	(38.5)	97.7	32.4
Adjusted EPS (Rs)	35.3	43.4	26.7	52.7	69.8
RPAT	38.4	22.9	(54.4)	166.4	32.3

Source: Company, HDFC sec Inst Research

Balance Sheet Standalone

(Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
SOURCES OF FUNDS					
Share Capital - Equity	145	145	145	145	145
Reserves	3,257	3,880	4,031	4,591	5,225
Total Shareholders' Funds	3,401	4,025	4,176	4,737	5,371
Long Term Debt	-	335	500	400	200
Short Term Debt	550	51	200	200	200
Total Debt	550	386	700	600	400
Net Deferred Taxes	56	56	56	56	56
Long Term Provisions & Others	869	733	880	1,056	1,267
TOTAL SOURCES OF FUNDS	4,876	5,200	5,811	6,449	7,096
APPLICATION OF FUNDS					
Net Block	1,711	2,117	2,557	3,123	3,397
CWIP	403	782	700	300	300
Investments	-	-	-	-	-
LT Loans & Advances	378	747	772	797	822
Total Non-current Assets	2,492	3,646	4,028	4,220	4,518
Inventories	3,385	2,946	3,072	3,438	3,939
Debtors	1,028	1,148	1,157	1,375	1,576
Other Current Assets	-	-	-	-	-
Cash & Equivalents	361	76	297	605	674
Total Current Assets	4,775	4,170	4,526	5,418	6,189
Creditors	1,719	1,907	1,952	2,321	2,659
Other Current Liabilities & Provns	671	719	791	870	957
Total Current Liabilities	2,390	2,626	2,743	3,191	3,615
Net Current Assets	2,384	1,544	1,783	2,228	2,573
Total Application of Funds	4,876	5,199	5,811	6,449	7,096

Source: Company, HDFC sec Inst Research

Cash Flow Standalone

(Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
Reported PBT	683	847	530	1,062	1,406
Non-operating & EO items	-	-	-		
Interest expenses	52	40	49	42	28
Depreciation	196	235	261	334	376
Working Capital Change	(691)	51	103	14	(90)
Tax Paid	(172)	(218)	(143)	(297)	(394)
OPERATING CASH FLOW (a)	67	955	799	1,154	1,327
Capex	(664)	(1,021)	(618)	(500)	(650)
Free cash flow (FCF)	(597)	(66)	181	654	677
Investments	-	-	-		
Non-operating Income	(59)	(179)	(94)	(255)	(366)
INVESTING CASH FLOW (b)	(723)	(1,199)	(712)	(755)	(1,016)
Debt Issuance/(Repaid)	327	(164)	314	(100)	(200)
Interest Expenses	(52)	(40)	(49)	(42)	(28)
FCFE	(322)	(269)	445	512	449
Share Capital Issuance	-	-	-	-	-
Dividend	(136)	(136)	(136)	(202)	(375)
FINANCING CASH FLOW (c)	140	(339)	129	(344)	(603)
NET CASH FLOW (a+b+c)	(516)	(583)	216	55	(292)
Closing Cash & Equivalents	361	76	297	605	674

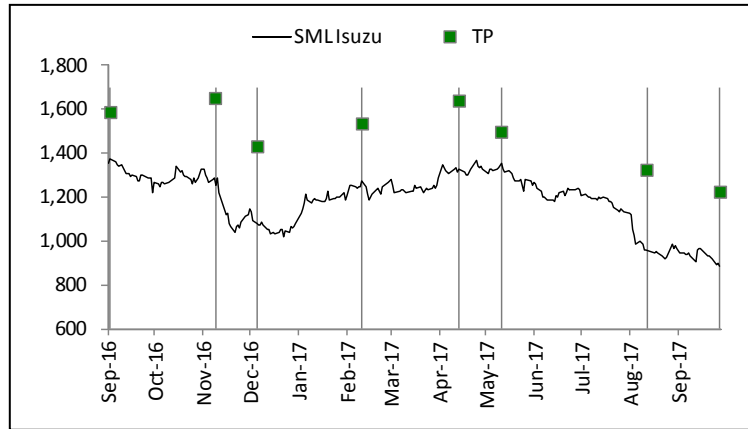
Source: Company, HDFC sec Inst Research

Key Ratios Standalone

	FY16	FY17	FY18E	FY19E	FY20E
PROFITABILITY (%)					
GPM	27.3	26.8	26.8	27.0	27.0
EBITDA Margin	7.4	7.9	6.1	8.9	9.9
APAT Margin	4.4	4.6	3.0	4.9	5.7
RoE	15.9	16.9	9.4	17.2	20.0
RoIC (or Core RoCE)	16.7	15.6	8.7	16.0	20.0
RoCE	15.1	15.5	9.0	15.4	18.4
EFFICIENCY					
Tax Rate (%)	25.1	25.8	27.0	28.0	28.0
Fixed Asset Turnover (x)	4.1	4.0	3.1	3.1	3.1
Inventory (days)	105.9	78.5	86.2	81.1	81.1
Debtors (days)	32.2	30.6	32.4	32.4	32.4
Payables (days)	53.8	50.8	54.8	54.8	54.8
Other Current Liab & Provns (days)	21.0	19.2	22.2	20.5	19.7
Cash Conversion Cycle (days)	63.3	39.1	41.7	38.3	39.1
Debt/EBITDA (x)	0.6	0.4	0.9	0.4	0.2
Net D/E (x)	0.1	0.1	0.1	(0.0)	(0.1)
Interest Coverage (x)	13.0	21.1	11.0	25.0	49.2
PER SHARE DATA (Rs)					
EPS	35.3	43.4	26.7	52.7	69.8
CEPS	48.8	59.7	44.7	75.8	95.9
Dividend	8.0	8.0	8.0	12.0	12.0
Book Value	234.9	278.0	288.4	327.2	371.0
VALUATION					
P/E (x)	25.0	20.3	33.1	16.7	12.7
P/BV (x)	3.8	3.2	3.1	2.7	2.4
EV/EBITDA (x)	14.9	12.1	16.5	9.2	7.1
EV/Revenues (x)	1.1	1.0	1.0	0.8	0.7
OCF/EV (%)	0.5	7.3	6.1	9.0	10.6
FCF/EV (%)	(4.6)	(0.5)	1.4	5.1	5.4
FCFE/Mkt Cap (%)	(2.5)	(2.1)	3.5	4.0	3.5
Dividend Yield (%)	0.9	0.9	0.9	1.4	1.4

Source: Company, HDFC sec Inst Research

RECOMMENDATION HISTORY



Date	CMP	Reco	Target
2-Sep-16	1,353	BUY	1,588
9-Nov-16	1,285	BUY	1,652
5-Dec-16	1,090	BUY	1,432
10-Feb-17	1,272	BUY	1,536
13-Apr-17	1,317	BUY	1,640
11-May-17	1,350	BUY	1,498
11-Aug-17	963	BUY	1,325
28-Sep-17	884	BUY	1,225

Rating Definitions

BUY : Where the stock is expected to deliver more than 10% returns over the next 12 month period
 NEUTRAL : Where the stock is expected to deliver (-)10% to 10% returns over the next 12 month period
 SELL : Where the stock is expected to deliver less than (-)10% returns over the next 12 month period

INSTITUTIONAL RESEARCH

Disclosure:

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