

SUPRAJIT ENGINEERING

In-line performance

India Equity Research | Automobiles

Suprajit Engineering's (SEL) Q2FY18 consolidated EBITDA at INR560mn, up 20% YoY, came largely in line with our estimate. In the cables business, while the aftermarket business continued to be impacted by GST, margin of the exports business improved as new orders were more profitable. Delay in ramp up of H7 line impacted Phoenix Lamps' (PHLL) revenue. However, we expect revenues to recover from H2FY18 as production ramps up. For Wescon, management reiterated strategy of entering new verticals (agri, construction etc) and maintained FY18 revenue guidance of ~USD40mn. Maintain 'BUY' with TP of INR324.

Good margins helped offset revenue weakness

SEL's INR3.3bn (up 21% YoY) consolidated revenue came 13% below estimate due to GST impact on domestic aftermarket revenue, H7 line ramp up delays and seasonal impact in Wescon. Improved margins for cables exports (high-margin new orders) and strategic margin improvement initiatives at PHLL helped deliver overall in line EBITDA performance. Wescon's revenue of IN513mn missed our estimate 13% and EBITDA at INR54mn missed our estimate 33% due to seasonal impact. We believe, a seasonally stronger H2FY18 is likely to result in an improved revenue and margin trajectory.

Revenue outlook across businesses remains robust

We believe the cables business will continue outperform industry growth by 5-10% led by higher share of business (particularly 4Ws) and rising cable content. We envisage receipt of product certifications and superior product quality post new H7 line to help PHLL recoup market share loss. For Wescon, entry in newer verticals each with potential opportunity of ~USD40-80mn remains key growth driver.

Outlook and valuations: On a firm footing; maintain 'BUY'

We believe, SEL remains well placed to capitalise on recovery in both its domestic and international businesses. Over FY17-19, we estimate consolidated EPS to log CAGR of 19% and RoE to remain stable at ~23%. We maintain 'BUY' with SOTP-based TP of INR324 (25x SEL FY19E core EPS, INR19 cash per share, INR42 for PHLL and INR45 for Wescon). At CMP, the stock trades at 23x FY19E EPS.

EDELWEISS RATINGS

Absolute Rating	BUY
Investment Characteristics	Growth

MARKET DATA (R: SUPE.BO, B: SEL IN)

CMP	: INR 276
Target Price	: INR 324
52-week range (INR)	: 338 / 175
Share in issue (mn)	: 139.9
M cap (INR bn/USD mn)	: 39 / 590
Avg. Daily Vol. BSE/NSE ('000)	: 100.2

SHARE HOLDING PATTERN (%)

	Current	Q1FY18	Q4FY17
Promoters *	44.5	47.4	47.4
MF's, FI's & BKs	4.7	5.1	8.2
FII's	9.7	10.0	7.5
Others	41.1	37.6	37.0
* Promoters pledged shares (% of share in issue)	:		NIL

PRICE PERFORMANCE (%)

	BSE Midcap Index	Stock	Stock over Index
1 month	3.5	(0.6)	(4.1)
3 months	12.3	5.6	(6.7)
12 months	32.6	41.1	8.5

Financials

(INR mn)

Year to March	Q2FY18	Q2FY17	% Chg	Q1FY18	% Chg	FY17	FY18E	FY19E
Net revenues	3,365	2,772	21.4	3,219	4.5	12,138	14,866	17,213
EBITDA	560	466	20.1	459	22.0	2,009	2,458	2,902
Adjusted Profit	313	249	25.5	404	(22.6)	1,115	1,285	1,566
Adjusted Diluted EPS	2.4	1.9	25.5	1.7	38.4	8.5	9.8	11.9
Diluted P/E (x)						32.5	28.2	23.2
EV/EBITDA (x)						19.8	15.4	12.7
ROACE (%)						24.1	25.0	28.2

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November 13, 2017

Q2FY18 conference call: Key highlights

Cables business

- Margin improvement across standalone, Suprajit Europe and Suprajit Automotive businesses.
- Aftermarket business continued to be impacted by GST; revenue declined YoY during H1FY18. The company is now seeing improving traction in the aftermarket business.
- Exports business: Though revenue was impacted by currency effect, margin improved as new orders were more profitable.
- Over the long term, management estimates margin of the cables business at around 14-16%.
- Electric vehicles (EV): Management expects major disruption in the engine pack, but SEL does not supply cables and lamps for engine/engine components. So it does not anticipate much impact.
- Driverless technology, though still futuristic, could be an opportunity for the cables business.
- Share of business with HMSI was ~50% in Q4FY17 and currently it is marginally higher. Expects it to remain at these levels for a few quarters.
- CBS systems for 2Ws: Has a product for CBS; one of the customers has shown interest. Expects an additional cable requirement with CBS implementation in 2Ws.
- Value-add components in scooters are slightly more than motorcycles.
- 2W cable business to grow in line with industry, but there is scope for market share gains in 4Ws. On consolidated basis, expects to outperform industry growth by 5-10%.

Phoenix Lamps (PHLL)

- Aftermarket business delivered growth despite GST as the company implemented strategic changes (in line with SEL), which helped deliver growth.
- At the time of acquisition, margins were 10-11% and now at similar levels. As H7 line ramps up, expects margin to improve to 13-14%.
- H7 line's capacity utilisation is ~20% currently. May take a year's time to ramp up utilisation to ~70-80%. According to management, regaining a few lost clients is taking more time than expected as those clients have entered into contracts with other suppliers.
- Most of the business was lost to Phillips, Osram and few Korean players.
- In Europe, has received approvals for H7 products and expects to regain lost market share.
- Has high market share in 2Ws (>70%), but there is scope to improve share in cars and specifically the UV segment.
- LED preparedness: Currently, 70% business is in aftermarket. Phoenix is in mass market where a headlamp costs INR600-800. Transition to LED technology will increase the costs to INR6,000-8,000 and the company believes this shift will take long. At best, LED adoption may increase to 20-30% in the higher-end car segment.

Wescon

- Business is highly seasonal in nature with 60% revenue skewed towards H2.
- H1FY18 revenues were flat; the company expects revenue and margin to improve in H2FY18. By year end estimates margins to improve to 16%.
- H1 margins were impacted as new branch opening costs and overheads were transferred from SEL to Wescon's books.
- Reiterated FY18 revenue guidance of USD40mn (7-8% YoY growth).
- Over medium term, expects Wescon business to see good growth coupled with good margin.
- Has rolled out a new strategy—Suprajit Engineering Non Automotive (SENA)—to enter new verticals like agri and construction, which will also lower seasonality of the business. Each one of those sectors has an addressable opportunity size ranging from USD40mn-80mn.
- As per company, lead times for converting new clients could be lesser compared to the automotive business.

Others

- For identifying acquisition targets, SEL looks at parameters like product range, technological focus and good margin profile.

Table 1: SOTP

SEL FY19 Core EPS	8.7
Target Multiple	25
SEL value per share	218
Surplus cash per share	19
PHLL value per share	42
Wescon value per share	45
Target price	324

Source: Edelweiss research

Financial snapshot

(INR mn)

Year to March	Q2FY18	Q2FY17	% change	Q1FY18	% change	YTD18	FY18E	FY19E
Net revenues	3,365	2,772	21.4	3,219	4.5	6,584	14,866	17,213
Raw material costs	1,835	1,640	11.9	1,760	4.2	3,595	8,719	10,114
Staff costs	626	411	52.5	630	(0.6)	1,256	2,051	2,340
Other expenses	344	256	34.7	370	(6.9)	714	1,638	1,858
EBITDA	560	466	20.1	459	22.0	1,018	2,458	2,902
Depreciation	64	52	22.1	118	(45.8)	182	417	433
EBIT	496	414	19.8	341	45.5	836	2,041	2,469
Other income	35	114	(69.3)	82	(57.2)	116	214	225
Interest	75	69	8.4	66	13.4	141	239	228
Add: Exceptional items	-	60	(100.0)	-	-	-	-	-
Profit before tax	456	458	(0.6)	356	27.9	812	2,016	2,466
Provision for taxes	143	175	(18.2)	130	9.8	273	559	667
Minority interest	-	(26)	(100.0)	-	-	-	-	-
Reported net profit	313	309	1.1	226	38.4	539	1,457	1,799
Adjusted Profit	313	249	25.5	404	(22.6)	717	1,285	1,566
Diluted shares (mn)	131	131	-	131	-	263	131	131
Adjusted Diluted EPS	2.4	1.9	25.5	1.7	38.4	4.1	9.8	11.9
Diluted P/E (x)	-	-	-	-	-	-	28.2	23.2
EV/EBITDA (x)	-	-	-	-	-	-	15.4	12.7
ROACE (%)	-	-	-	-	-	-	25.0	28.2

As % of net revenues

Raw material	54.5	59.1	-	54.7	-	109.2	58.7	58.8
Employee cost	18.6	14.8	-	19.6	-	38.2	13.8	13.6
Other expenses	10.2	9.2	-	11.5	-	21.7	11.0	10.8
EBITDA	16.6	16.8	-	14.3	-	30.9	16.5	16.9
Adjusted net profit	9.3	9.0	-	12.6	-	21.9	8.6	9.1
Reported net profit	9.3	11.2	-	7.0	-	16.3	9.8	10.5
Tax rate	31.3	38.1	-	36.5	-	67.9	27.7	27.0

Company Description

SEL, incorporated in 1985, is India's largest automotive cable maker with an annual cable capacity of 150mn. The Suprajit Group has 15 plants—14 in India and 1 in the UK, which also operates as a tech centre. The company's customer list includes most Indian automotive majors. It also exports to many marquee global customers. Currently, it is the market leader in 2W with ~65% market share and commands ~30% share in 4W

Investment Theme

Enviably track record: SEL has a robust (>20%) revenue/APAT CAGR record over past decade further complemented by best-in-class RoCEs (>30%) driven by customer diversification, prudent cost control, market share gain and high capital efficiency

Suprajit 1.0: Diversification spring board for growth: SEL's strategy to diversify customer base and geography has been key catalyst for above industry growth over past decade.

Suprajit 2.0: After market, exports key growth drivers: Replacement market (INR 5bn industry; SEL's share ~9%) holds immense potential. Its pricing/quality will drive growth. Advent of GST can be a key growth catalyst. Exports (globally >USD3bn industry; SEL's share <1%) key focus area—well entrenched clients, superior quality, expanding footprint and attractive value proposition to accelerate client addition and new business orders

New product development/acquisition provide option value: Set up a dedicated team to identify acquisition targets (with proprietary technology) and new product development (parking brake lever, gear shifter etc), not factored in our estimates

Leader in 2Ws, further penetration in 4Ws to drive revenue: SEL supplies ~60% of 2W industry's cable requirements; ramp up in supplies to Honda and replacement market to drive growth. 4W potential remains huge (SEL only ~30% share).

Key Risks

Slowdown in demand

SEL derives ~90% revenue from OEMs. Hence, any slowdown in the overall industry can impact the company's revenue. Similarly slowdown in demand in US/Europe can impact SEL's revenue

Commodity risk

Steel is a major raw material for SEL which is sourced both locally and from China. While any steep changes in input costs are passed on to domestic OEMs (with a lag), the arrangement in exports markets are different with risk largely taken by SEL.

Currency risk

SEL derives ~17% revenue from exports (of which ~7% revenue is billed in INR). Also, it imports ~10% of revenue and thus has a natural hedge. With exports becoming a key growth driver, we believe natural hedge will become non-existent and SEL will be exposed to currency risks.

Financial Statements

Key Assumptions

Year to March	FY16	FY17	FY18E	FY19E
Macro				
GDP(Y-o-Y %)	7.9	6.6	6.8	7.4
Inflation (Avg)	4.9	4.5	4.0	4.5
Repo rate (exit rate)	6.8	6.3	5.8	5.8
USD/INR (Avg)	65.5	67.1	65.0	66.0
Sector				
4W - domestic vol (% YoY)	8.0	4.0	8.0	10.0
2W - domestic vol (% YoY)	3.0	8.0	10.0	10.0
Company				
4W	19.8	12.0	15.0	18.0
2W	10.4	5.0	12.0	16.0
Aftermarket - Revenue assumptions	13	12	15	18
Non-Auto	(6.2)	10.0	10.0	12.0
Export - Revenue assumptions	15	24	18	15
Avg. Interest rate (%)	9.7	8.8	14.8	14.1
Depreciation rate (%)	3.6	3.0	-	-
Tax rate (%)	33.4	28.7	27.7	27.0
Dividend payout (%)	16.4	12.9	16.5	17.0
Net borrowings (INR mn)	2,895	2,895	875	(433)
Capex (INR mn)	1,789	2,864	300	300
Debtor days	64	68	60	56
Inventory days	67	83	71	66
Payable days	49	54	50	51
Cash conversion cycle	82	97	82	71

Income statement

(INR mn)

Year to March	FY16	FY17	FY18E	FY19E
Income from operations	9,525	12,138	14,866	17,213
Materials costs	5,635	6,863	8,719	10,114
Manufacturing expenses	1,093	1,279	1,638	1,858
Employee costs	1,253	1,988	2,051	2,340
Total operating expenses	7,982	10,129	12,408	14,312
EBITDA	1,543	2,009	2,458	2,902
Depreciation	158	219	417	433
EBIT	1,386	1,789	2,041	2,469
Add: Other income	155.26	240.07	214.22	225.02
Less: Interest Expense	250	289	239	228
Add: Exceptional items	(57)	(15)	-	-
Profit Before Tax	1,234	1,726	2,016	2,466
Less: Provision for Tax	431	499	559	667
Reported Profit	803	1,227	1,457	1,799
Exceptional Items	(38)	(11)	-	-
Adjusted Profit	841	1,115	1,285	1,566
Shares o/s (mn)	131	131	131	131
Adjusted Basic EPS	6.4	8.5	9.8	11.9
Diluted shares o/s (mn)	131	131	131	131
Adjusted Diluted EPS	6.4	8.5	9.8	11.9
Adjusted Cash EPS	7.6	10.2	13.0	15.2
Dividend per share (DPS)	1.1	1.1	1.6	2.0
Dividend Payout Ratio(%)	19.2	15.1	19.3	19.8

Common size metrics

Year to March	FY16	FY17	FY18E	FY19E
Operating expenses	83.8	83.5	83.5	83.1
Materials costs	59.2	56.5	58.7	58.8
Staff costs	13.2	16.4	13.8	13.6
S G & A expenses	11.5	10.5	11.0	10.8
Depreciation	1.7	1.8	2.8	2.5
Interest Expense	2.6	2.4	1.6	1.3
EBITDA margins	16.2	16.5	16.5	16.9
Net Profit margins	8.8	9.2	8.6	9.1

Growth ratios (%)

Year to March	FY16	FY17	FY18E	FY19E
Revenues	55.7	27.4	22.5	15.8
EBITDA	60.7	30.1	22.4	18.0
PBT	65.1	39.8	16.8	22.3
Adjusted Profit	67.3	32.5	15.3	21.8
EPS	52.9	32.5	15.3	21.8

Balance sheet		(INR mn)			
As on 31st March	FY16	FY17	FY18E	FY19E	
Share capital	131	131	131	131	
Reserves & Surplus	4,344	5,208	6,246	7,501	
Shareholders' funds	4,476	5,339	6,377	7,632	
Minority Interest	542	637	809	1,043	
Short term borrowings	1,829	1,368	1,155	1,155	
Long term borrowings	757	1,927	458	458	
Total Borrowings	2,586	3,295	1,613	1,613	
Def. Tax Liability (net)	86	245	245	245	
Sources of funds	7,690	9,516	9,044	10,533	
Gross Block	4,441	7,305	7,605	7,905	
Net Block	3,474	6,111	6,002	5,869	
Capital work in progress	7	7	7	7	
Total Fixed Assets	3,481	6,118	6,009	5,876	
Cash and Equivalents	1,676	400	738	2,046	
Inventories	1,669	2,018	2,036	2,311	
Sundry Debtors	2,096	2,442	2,444	2,830	
Loans & Advances	628	595	407	472	
Other Current Assets	10	78	13	13	
Current Assets (ex cash)	4,404	5,134	4,900	5,625	
Trade payable	944	1,074	1,303	1,509	
Other Current Liab	926	1,061	1,300	1,505	
Total Current Liab	1,870	2,135	2,603	3,014	
Net Curr Assets-ex cash	2,534	2,998	2,297	2,611	
Uses of funds	7,690	9,516	9,044	10,533	
BVPS (INR)	34.1	40.7	48.6	58.1	

Free cash flow		(INR mn)			
Year to March	FY16	FY17	FY18E	FY19E	
Reported Profit	803	1,227	1,457	1,799	
Add: Depreciation	158	219	417	433	
Interest (Net of Tax)	166	206	173	166	
Others	(15)	(142)	(148)	(164)	
Less: Changes in WC	1,398	465	(701)	314	
Operating cash flow	(286)	1,045	2,600	1,921	
Less: Capex	1,789	2,864	300	300	
Free Cash Flow	(2,075)	(1,819)	2,300	1,621	

Cash flow metrics					
Year to March	FY16	FY17	FY18E	FY19E	
Operating cash flow	(286)	1,045	2,600	1,921	
Investing cash flow	(2,003)	(1,313)	(236)	(225)	
Financing cash flow	2,016	251	(2,169)	(538)	
Net cash Flow	(273)	(18)	196	1,158	
Capex	(1,789)	(2,864)	(300)	(300)	
Dividend paid	161	169	248	311	

Profitability and efficiency ratios					
Year to March	FY16	FY17	FY18E	FY19E	
ROAE (%)	21.6	22.3	22.1	22.7	
ROACE (%)	26.4	24.1	25.0	28.2	
Inventory Days	67	83	71	66	
Debtors Days	64	68	60	56	
Payable Days	49	54	50	51	
Cash Conversion Cycle	82	97	82	71	
Current Ratio	3.3	2.6	2.2	2.5	
Gross Debt/EBITDA	1.7	1.6	0.7	0.6	
Gross Debt/Equity	0.5	0.6	0.2	0.2	
Adjusted Debt/Equity	0.5	0.6	0.2	0.2	
Net Debt/Equity	0.2	0.5	0.1	-	
Interest Coverage Ratio	5.5	6.2	8.5	10.9	

Operating ratios					
Year to March	FY16	FY17	FY18E	FY19E	
Total Asset Turnover	1.6	1.4	1.6	1.8	
Fixed Asset Turnover	3.6	2.5	2.5	2.9	
Equity Turnover	2.6	2.2	2.3	2.2	

Valuation parameters					
Year to March	FY16	FY17	FY18E	FY19E	
Adj. Diluted EPS (INR)	6.4	8.5	9.8	11.9	
Y-o-Y growth (%)	52.9	32.5	15.3	21.8	
Adjusted Cash EPS (INR)	7.3	11.0	14.3	17.0	
Diluted P/E (x)	43.1	32.5	28.2	23.2	
P/B (x)	8.1	6.8	5.7	4.8	
EV / Sales (x)	4.0	3.3	2.6	2.1	
EV / EBITDA (x)	24.4	19.8	15.4	12.7	
Dividend Yield (%)	0.4	0.4	0.6	0.7	

Peer comparison valuation

Name	Market cap (USD mn)	Diluted P/E (X)		EV / EBITDA (X)		ROAE (%)	
		FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
Suprajit Engineering	590	28.2	23.2	15.4	12.7	22.1	22.7
Amara Raja Batteries	2,058	28.2	21.9	15.0	11.9	17.1	19.0
Exide Industries	2,618	23.7	19.2	13.5	11.2	13.9	15.2
Motherson Sumi Systems	11,353	34.8	23.9	14.4	10.5	25.2	31.1
Median	-	28.2	22.5	14.7	11.6	19.6	20.8
AVERAGE	-	28.7	22.0	14.6	11.6	19.6	22.0

Source: Edelweiss research

Additional Data

Directors Data

Mr K Ajith Kumar Rai	Chairman & MD	Dr. C Mohan	Executive Director
Mr Diwakar S Shetty	Director	Mr Ian Williamson	Director
Mr B S Patil	Director	Mr M Jayarama Shetty	Director

Auditors - Messrs Varma & Varma

**as per last available data*

Holding – Top10

	Perc. Holding		Perc. Holding
Rai k ajith kumar	31.65	Rai supriya a	10.26
Sundaram clayton ltd	4.13	Dsp blackrock invest	2.59
Tvs motor company lt	2.07	Bajaj allianz life i	1.42
Punja shobita	1.38	Rai kula ramaprasad	1.29
Malabar india fund l	1.25	Mondrian em mrk sm c	1.07

**as per last available data*

Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
No Data Available				

**as per last available data*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
No Data Available			

**as per last available data*

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Coverage group(s) of stocks by primary analyst(s): Automobiles

Ashok Leyland, Amara Raja Batteries, Bajaj Auto, Ceat Ltd, Eicher Motors, Exide Industries, Hero MotoCorp, Minda Corporation, Mahindra & Mahindra Ltd, Maruti Suzuki India Ltd, Motherson Sumi Systems, Suprajit Engineering, Tata Motors Ltd

Recent Research

Date	Company	Title	Price (INR)	Recos
10-Nov-17	Motherson Sumi Systems	Gaining revenue traction; margin uptick awaited; <i>Result Update</i>	355	Hold
10-Nov-17	Amara Raja Batteries	Strong uptick in margin; <i>Result Update</i>	752	Buy
10-Nov-17	Mahindra & Mahindra	Impressive margin performance; <i>Result Update</i>	1,393	Buy

Distribution of Ratings / Market Cap

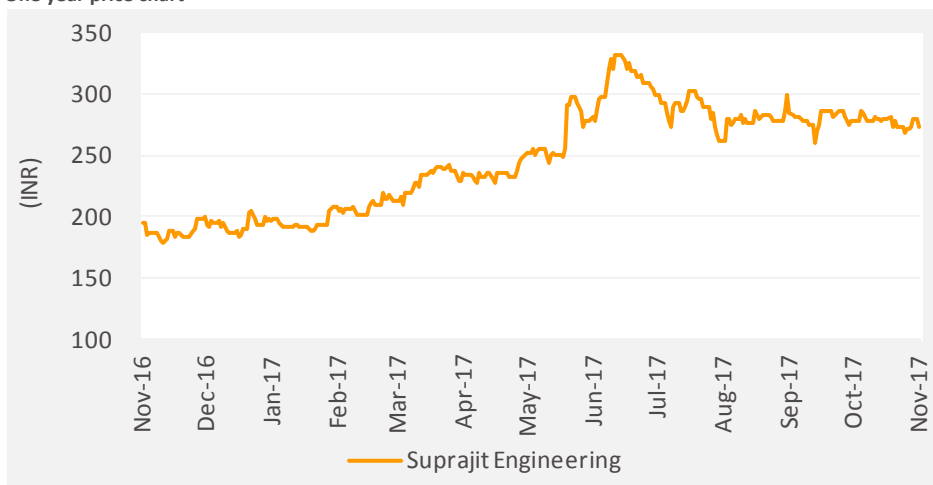
Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	161	67	11	240
* 1stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	156	62	11	

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

One year price chart



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