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YEARS

Initiating Coverage Subros Ltd.

16-December-2020





Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Auto Ancillaries	Rs 319.7	Buy on dips to Rs 304-306 band and add more in Rs 280-282 band	Rs 330	Rs 367	2 quarters

HDFC Scrip Code	SUBLTD
BSE Code	517168
NSE Code	SUBROS
Bloomberg	SUBR IN
CMP Dec 15, 2020 (Rs)	319.7
Equity Capital (mn)	130.5
Face Value (Rs)	2
Eq. Share O/S (mn)	65.2
Market Cap (Rs mn)	20855.8
Book Value (Rs)	115.3
Avg.52 Wk Volume	126,000
52 Week High (Rs)	332.0
52 Week Low (Rs)	117.8

Share holding Pattern % (Sep, 2020)	
Promoters	36.79
Institutions	10.73
Non Institutions	52.48
Total	100.0

Fundamental Research Analyst

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Our Take:

Subros is the largest player in Indian passenger vehicle AC segment with a ~45% market share. Subros derives ~3/4th of its revenues from Maruti Suzuki which has given a steady performance despite Covid pandemic as it has a wide portfolio of small vehicles. Besides the company is also scaling up its non-PV segment business which have strong potential of growth. Its contribution from Non-PV segment stood at 18% as on Q2FY21. In this segment its offers home and automotive air-conditioning systems for verticals like Commercial vehicles (CVs), Engine Cooling Modules (ECMs), buses, trains and home ACs. Increasing preference of AC buses, modernisation of railways with higher number of AC coaches and higher transport of goods through roads (AC truck cabins) could enhance the demand for Subros' products. Increased local content in manufacturing has led to significant cost reduction and margin expansion. Technical collaboration with Denso has helped the company in R&D and developing new products. The recent banning of imports of ACs by the Government would give a further boost to domestic manufacturing and benefit Subros.

Valuations & Recommendation:

We expect revenues of the company to grow at 3.8% CAGR FY20-FY23. EBITDA is expected to grow at 9.4% CAGR driven by savings on higher localisation and EBITDA margins are expected to expand ~150bps. PAT is expected to grow by 26% CAGR on back of lower tax rates. Investors can buy the stock in the price band of Rs 304-306 band (25x FY22E EPS) and add more on declines to Rs 280-282 band (23x FY22E EPS) for a base case fair value of Rs 330 (27x FY22E EPS) and bull case fair value is Rs 367 (30x FY22E EPS) in the next two quarters.

Financial Summary

(Rs mn)	Q2FY21	Q2FY20	YoY-%	Q1FY21	QoQ-%	FY20	FY21E	FY22E	FY23E
Revenues	4581	4965	8.4	738	-83.9	19,928	16,198	18,844	22,303
EBITDA	535	441	-17.6	-299	LP	1,890	1,440	2,016	2,476
APAT	177	132	-25.3	-240	LP	563	332	797	1,132
Diluted EPS (Rs)	2.7	2.0	-25.3	-3.7	LP	8.6	5.1	12.2	17.4
RoE (%)						7.9	4.3	9.8	12.7
P/E (x)						37.0	62.9	26.2	18.4
EV/EBITDA (x)						11.2	14.6	10.0	7.7

(Source: Company, HDFC sec)



Recent Triggers

Q2FY21 Financials

Revenues declined by 8% YoY to Rs 4.58bn (contribution from car AC segment was 82%, 13% from ECM and 5% from other segments). However, EBITDA margin at 11.7% expanded 280bps YoY, driven by higher localisation levels, favourable segmental mix and lower revenue from Home AC segment (Rs 50mn). The gross margin expanded 180bps YoY to 30.7% due to backward integration, increase in finished/semi-finished goods and product mix. Reported PAT at Rs 17.7cr grew 34% YoY.

Increasing localisation

The company had opened a new plant – Subros Tool Engineering Centre (STEC)- in Noida (Nov'14) to address captive tool and mould requirements. It specializes in high-tech, niche tooling to meet specialty tool requirements for import substitution and exports. The company is reducing the import content and has achieved 75% localisation levels (including Indian design content). Proportion of indigenous raw material content was at ~42% in FY14. It is further indigenising production and has introduced VA/VE (Value addition / Value Engineering) initiatives for various components. The benefits of these initiatives were visible in the current quarter, and the management believes that the higher margin band (10-12%) is sustainable.

- Over the past quarter, the debt level has been reduced by Rs ~1bn. Further reduction of Rs 200-250mn is expected in the next quarter.
- The company will incur a Capex of Rs 500-600mn, of which Rs 250-300mn is for R&D. Incremental capex of Rs 300-400mn can be incurred in case of new product launches.
- The CV bus industry de-grew by 83% Sep-20 YTD, whereas Subros witnessed a lower decline of 46%. Management believes that the segment could take a few more quarters to reach optimum levels.
- Subros is well prepared for future technologies and has also recently won its first order for M&M's E-Quadricycle and is also bidding for electric bus orders.

Long term Triggers

Increasing PV sales

The Indian automotive industry has been experiencing steady growth in the demand for and sales of passenger cars, owing to improvement in economic condition and rise in the consumers' disposable incomes. The country has witnessed a gradual shift from transportation to comfortable/convenient transportation, and from convenient transportation to luxurious and safe transportation. The



industry has shifted from just being a components manufacturer, to an assembler and manufacturer of complete vehicles, including passenger cars. However, the past couple of years have seen a slowdown due to lower economic growth and Covid pandemic.

The last few months have witnessed robust growth in passenger vehicle sales post the gradual lifting of lockdowns. Going forward, the Indian automotive component industry is expected to witness healthy growth owing to increasing domestic demand, rising exports, and the increasing flow of investments in the automotive components sector. Thus, it makes India a key automotive components sourcing hub.

Covid pandemic could drive higher sales of smaller vehicles

The coronavirus pandemic, however, has had an encouraging impact on the auto sector. The automobile industry, once considered a luxury, is now a necessity; people want to have independent conveyance whether it is a small car or a two-wheeler. Maruti with a wide portfolio of small cars is the prime beneficiary in terms of increasing sales of small cars. Consequently, Subros which gets ~3/4th of its revenues from Maruti could see increased sales in the coming years.

Subros to benefit from the 'Make in India' theme

The company is expanding in the home AC and railways segments. After the acquisition of Zamil in the previous year, it has a capacity of ~250k-300k units. The government has recently banned imports of ACs with refrigerants to promote domestic manufacturing. Subros has recently developed the condenser for outdoor units and is in the process of developing the complete outdoor unit and components for the indoor unit as well. The company is targeting sales of Rs 2.0-2.5bn (~10% of revenues) over the next 2-3 years from this segment. Similarly, for railway coaches, Subros expects a revenue of Rs 250-300mn under the Make in India theme

Strong Client base

Subros is a leading automotive AC manufacturer in the domestic market. It manufactures compressors, condensers, HVAC and all connecting elements required to complete the AC loop. Despite intense competition in the segment, it has successfully maintained a strong market position (an estimated market share of ~45% in the addressable product range in the PV industry), benefitting from its integrated manufacturing operations and strong product development capabilities (aided by a technical collaboration with Denso Corporation). It caters to all segments viz. PVs, buses, trucks, refrigeration transport, off-roaders and railways. Its main clientele include Maruti Suzuki, Tata Motors, Mahindra & Mahindra, Force Motors, Ashok Leyland, Nissan, Whirlpool for home ACs and Indian Railways.



Subros is supplying ~60-70% of the total AC requirement of Maruti and has all the three high selling models Baleno, Brezza and Ignis under its belt. Apart from Maruti, the company also supplies to other high selling models like Kwid (Renault), KUV 100 (M&M) and Tiago (Tata Motors).

Major clients of Subros



(Source: Company, HDFC sec)

Diversification to expand range of products and reduce dependence on passenger vehicles

Over the last few years, Subros has ventured into newer segments and diversified its product portfolio. These segments are expected to grow at a faster rate due to the low base effect and reduce the dependence on passenger vehicles segment sales.



Preference for AC in bus is rising: Rising urbanisation and growing infrastructure is creating a big market for buses. AC buses are no longer looked upon as costly alternatives compared to conventional non-AC buses. Travellers are ready to pay for comfort and state transport undertakings and city bus operators are expanding their fleet of AC buses. Schools and colleges are seeing an exponential rise in the number of new extensions, and the demand for high end AC school buses is growing rapidly.

AC cabin for trucks: The Road Transport Ministry had mandated the use of AC in truck cabins. However the regulation was diluted to blowers or AC. Nevertheless, with the increasing use of road transport on account of better roads, the use of ACs in truck cabins is expected to increase.

Railways: Subros entered the Railway segment in FY14 by developing import substitute for driver cabin AC for diesel locomotives. It has also been shortlisted by two major Tier 1 suppliers of Indian Railways i.e. Bombardier India and Medha Servo Drives Pvt Ltd. With the modernisation of Indian Railways underway, the company expects regular orders to flow. Most of Railway tenders have been put on hold because of Chinese participation. Once these tenders reopen (expected in 2-3 months); Subros has good chances to get more orders.

Home AC: Subros forayed into the Home AC segment in FY17 by supplying 50k condensers to Whirlpool. It is looking to tie up with others players. Current Home AC unit capacity is 2.5-3.0 lacs. Subros targets to generate Rs200 cr revenues in next 2-3 years' time.

Refrigerated vehicles: Subros provides a complete range of transport refrigeration for storage volume upto 50 cu.m. The company sources the chassis of Super Ace from Tata Motors, fitting the refrigerated container in it and supplying it back to the OEM. The company has also tied up with Ashok Leyland for Dost and M&M for Bolero.

Collaboration with Denso strengthens product development capabilities

Subros has a technical collaboration with Denso Corporation, a leading automotive manufacturer in the global market. The company's strong product development capabilities, coupled with its considerable scale of operations and low-cost structure, has enabled it to sustain a strong market position over the years. Its strong parentage (SMC and Denso Corporation hold ~12% and ~20% equity stakes, respectively) has also helped it to maintain strong business relations with its primary customer, MSIL, while aiding in establishing relationships with new customers. Subros in the ECM (Engine cooling module) manufactures radiators for Denso Corp .Denso is a strategic partner which will enable the company to transition to next generation products. It manufactures radiators for Denso exclusively. Denso in turn supplies these in the domestic market to clients such as Suzuki Motors and M&M.



Higher localisation content to minimise foreign exchange impact

Subros is focussed on increasing the local content in its manufacturing to minimise the impact of foreign exchange fluctuations. It has initiated various VA/VE along with active participation of suppliers to improve efficiency of operations. The efforts have contributed greatly in reduction of material cost and exposure to foreign exchange fluctuation. Few major localisation projects are in implementation stage which should help in increasing the local content and reduce material cost thereby expanding profitability.

What could go wrong

Slowdown in economy

Economic slowdown witnessed in the recent past is likely to impact car sales and in turn the demand for Subros' products.

High dependence on Maruti

More than 3/4th of Subros' revenues comes from a single client i.e. Maruti Suzuki. Slowdown in sales of Maruti vehicles could hurt its revenues significantly. Subros remains focussed on reducing its segment and client concentration risk through business gains from new segments, such as CVs, home ACs and the railways.

Volatility in raw material prices

Fluctuation in commodity price in global market affects directly and indirectly the price of raw material and components used by Subros in its various products segment.

Currency fluctuation

Subros imports 25% of its raw materials and fluctuations in currency could impact its earnings.

About the company

Founded in 1985, Subros is the leading manufacturer of thermal products for automotive applications in India, in technical collaboration with Denso. It is a JV between Suri family of India (36.79%), Denso Corporation (20%) and Suzuki Motor Corporation (11.96%). The company has grown from a capacity of 15,000 AC units in 1985 comprising of largely an assembly operation, into the largest and only integrated manufacturing unit in India for Auto Air Conditioning systems.

Subros manufactures compressors, Condensers, Heat Exchangers and all connecting elements required to complete AC loop and caters to all segments viz. Passenger Vehicles, Buses, Trucks, Refrigeration Transport, off- roaders & Railways. The company has manufacturing plants at Noida (2 nos.), Manesar, Pune, Chennai and Sanand with an annual capacity of 1.5 Million AC Kits per annum beside a well-equipped R&D Center and Tool Room at Noida. Japanese players Kansei and Sanden have JVs in India manufacturing Car ACs and compete with Subros.

Journey so far

THREE DECADES OF BUILDING TRUST



(Source: Company, HDFC sec)

Subros in April 2019 acquired certain assets (plant & machinery) from Zamil Air Conditioners Pvt Ltd for Rs 115mn for manufacturing of Home AC components. This will strengthen Subros position in Home AC where it would be supplying the entire assembled unit (indoor, outdoor & window AC) to OEMs. It would source compressor and some other parts from the 3rd party while manufacture condenser, evaporator, etc. in-house. Through this initiative, Subros Ltd will create capacity of 500,000 units per year.

Financials

Income Statement

(Rs mn)	FY19	FY20	FY21E	FY22E	FY23E
Net Revenues	21,245	19,928	16,198	18,844	22,303
Growth (%)	11.1	(6.2)	(18.7)	16.3	18.4
Operating Expenses	18,963	18,038	14,758	16,828	19,827
EBITDA	2,282	1,890	1,440	2,016	2,476
EBITDA Margin (%)	10.7	9.5	8.9	10.7	11.1
Growth (%)	8.7	(17.2)	(23.8)	40.0	22.8
Depreciation	788	903	901	936	968
Other Income	70	613	124	144	158
EBIT	1,563	1,600	663	1,224	1,666
Interest expenses	422	363	214	168	156
Exceptional item	-	-	-	-	-
PBT	1,141	1,237	448	1,056	1,510
Tax	378	391	117	259	377
PAT	763	846	332	797	1,132
Adj. PAT	785	563	332	797	1,132
Growth (%)	27.0	(28.2)	(41.1)	140.3	42.0
EPS	12.0	8.6	5.1	12.2	17.4

Balance Sheet

As at March (Rs mn)	FY19	FY20	FY21E	FY22E	FY23E
SOURCES OF FUNDS					
Share Capital - Equity	130	130	130	130	130
Reserves	6,669	7,392	7,638	8,318	9,310
Total Shareholders Funds	6,799	7,523	7,769	8,449	9,440
Total Debt	1,878	1,227	1,175	1,158	1,141
Net Deferred Taxes	12	164	-	-	-
TOTAL SOURCES OF FUNDS	8,753	9,024	9,054	9,717	10,692
APPLICATION OF FUNDS					
Net Block	7,128	7,917	7,312	7,126	6,908
CWIP	633	397	535	535	535
Investments	16	18	18	18	18
Other non-current assets	454	141	155	170	187
Total Non-current Assets	8,230	8,472	8,020	7,849	7,648
Cash & Equivalents	904	909	1,049	1,784	2,825
Inventories	2,492	2,342	2,041	2,375	2,811
Debtors	1,673	1,893	1,509	1,755	2,078
Other Current Assets	504	269	296	325	358
Total Current Assets	5,574	5,413	4,894	6,239	8,071
Creditors	3,899	3,852	2,840	3,304	3,911
Other Current Liabilities & Provns	1,152	1,009	1,020	1,067	1,116
Total Current Liabilities	5,051	4,861	3,860	4,371	5,027
Net Current Assets	523	552	1,035	1,868	3,044
TOTAL APPLICATION OF FUNDS	8,753	9,024	9,054	9,717	10,692

Cash Flow Statement

(Rs mn)	FY19	FY20	FY21E	FY22E	FY23E
Reported PBT	1,141	1,237	448	1,056	1,510
Non-operating & EO items	(70)	(613)	(124)	(144)	(158)
Interest Expenses	422	363	214	168	156
Depreciation	788	903	901	936	968
Working Capital Change	(715)	(24)	(343)	(98)	(135)
Tax Paid	(366)	(240)	(280)	(259)	(377)
OPERATING CASH FLOW (a)	1,201	1,626	816	1,659	1,963
Capex	(954)	(1,456)	(434)	(750)	(750)
Free Cash Flow	247	170	382	909	1,213
Investments	94	358	(14)	(15)	(17)
Non-operating income	70	613	124	144	158
INVESTING CASH FLOW (b)	(791)	(485)	(325)	(622)	(609)
Debt Issuance / (Repaid)	(1,277)	(650)	(52)	(17)	(17)
Interest Expenses	(422)	(363)	(214)	(168)	(156)
FCFE	(1,452)	(844)	116	724	1,041
Share Capital Issuance	2,094	(60)	0	0	(0)
Dividend	(102)	(63)	(86)	(117)	(141)
FINANCING CASH FLOW (c)	294	(1,136)	(352)	(302)	(314)
NET CASH FLOW (a+b+c)	704	5	140	735	1,041

Key Ratios

	FY19	FY20	FY21E	FY22E	FY23E
Profitability (%)					
EBITDA (%)	10.7	9.5	8.9	10.7	11.1
EBIT (%)	7.0	5.0	3.3	5.7	6.8
APAT (%)	3.7	2.8	2.0	4.2	5.1
RoE (%)	14.5	7.9	4.3	9.8	12.7
RoCE (%)	13.4	9.1	5.4	9.8	12.2
Solvency Ratio					
Debt/EBITDA (x)	0.4	0.2	0.1	(0.3)	(0.7)
Net D/E (x)	0.1	0.0	0.0	(0.1)	(0.2)
PER SHARE DATA (Rs)					
EPS	12.0	8.6	5.1	12.2	17.4
CEPS	23.8	26.8	18.9	26.6	32.2
BV	104.2	115.3	119.1	129.5	144.7
Dividend	1.3	0.8	1.1	1.5	1.8
Turnover Ratios (days)					
Inventory	43	43	46	46	46
Debtor	29	35	34	34	34
Creditors	67	71	64	64	64
VALUATION (x)					
P/E	26.6	37.0	62.9	26.2	18.4
P/BV	3.1	2.8	2.7	2.5	2.2
EV/EBITDA	9.6	11.2	14.6	10.0	7.7
EV / Revenues	1.0	1.1	1.3	1.1	0.9
Dividend Yield (%)	0.4	0.3	0.3	0.5	0.6

(Source: Company, HDFC sec Research)

598.71	685.65	38.56	1.10%	203.88	118.92	118.92
(+2.11)	(-14.51)	(-7.74)	(-1.95%)	(-1.05)	(-1.67)	(-1.44)
142.09	167.29	154.12	393.13	-62.95	-187.58	-42.38
(-3.51)	(-17.46)	(-7.84)	(-7.58)	(-11.88)	(-71.40)	(-15.88)

Price Chart





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