Initiating Coverage

Suprajit Engineering Ltd.

July 25, 2022

RETAILRESEARCH

Suprajit Engineering Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Auto Ancillaries	Rs 358	Buy in Rs 355-363 band & add more on dips to Rs 315-323 band	Rs 395	Rs 433	2 quarters

HDFC Scrip Code	SUPENG
BSE Code	532509
NSE Code	SUPRAJIT
Bloomberg	SEL IN
CMP Jul 22, 2022	358.4
Equity Capital (Rs cr)	13.8
Face Value (Rs)	1
Equity Share O/S (cr)	13.8
Market Cap (Rs cr)	4960
Book Value (Rs)	78.3
Avg. 52 Wk Volumes	322,000
52 Week High (Rs)	474.9
52 Week Low (Rs)	272.1

Share holding Pattern % (Jun, 2022)	
Promoters	44.6
Institutions	19.8
Non Institutions	35.6
Total	100.0

HDFCsec Retail research stock rating meter

for details about the ratings, refer at the end of the report

* Refer at the end for explanation on Risk Ratings

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Our Take:

Suprajit Engineering Ltd. (SEL) is the leader in manufacturing automotive cables in India. Over the last few years the company has gradually diversified away from cables and automotive business and the recent acquisition would further increase the diversification. Last couple of years have witnessed muted growth for the company due to the impact of Covid pandemic, especially during the second wave where 2W sales were largely impacted. However, automobile sales have been improving and likely to post strong growth in the coming years. Its Non-automotive division (SENA) is doing very well in US and SEL is focusing on going beyond cables into mechanisms, gear boxes and motor cables. It has added many new products to its portfolio like electronics instrument cluster (moving from mechanical to electronic), CBS for electric 2-wheelers, brake shoes, digital speedometer, etc.

SEL is well placed to gain from the revival in automobile demand. Its acquisition of light cable division of Kongsberg would provide it with access to low cost manufacturing facilities as well as a footprint in large markets of China and North America.

Valuation & Recommendation:

SEL would continue to trade at a premium given its market leadership in the cables segment, strong returns profile, strategic acquisitions and diversification of revenues. We expect SEL to report 26% earnings CAGR driven by ~30% revenue CAGR over FY22-FY24E and stable EBITDA/PAT margins. We believe investors can buy the stock in Rs 355-363 band and add more on dips to Rs 315-323 band (16.5x FY24E EPS) for a base case fair value of Rs 395 (20.5x FY24E EPS) and bull case fair value of Rs 433 (22.5x FY24E EPS) over the next two quarters.

Financial Summary

Particulars (Rs cr)	Q4FY22	Q4FY21	YoY (%)	Q3FY22	QoQ (%)	FY21	FY22	FY23E	FY24E
Net sales	506	513	-1.4	479	5.6	1,641	1,840	2,894	3,184
EBITDA	77	82	-6.3	54	41.6	237	260	394	439
APAT	49	58	-15.4	32	53.3	143	173	248	273
Diluted EPS (Rs)	3.5	4.1	-14.5	2.3	53.3	10.2	12.5	17.9	19.7
RoE (%)						15.5	16.7	20.9	19.4
P/E (x)						35.1	28.7	20.0	18.2
EV/EBITDA (x)						20.5	18.6	12.7	11.1

(Source: Company, HDFC sec)

Q4FY22 Result update

SEL reported subdued numbers for Q4FY22. Consolidated revenues of the company decreased by 1.4% yoy to Rs 506cr led by 3.4/5.5% yoy de-growth in Automotive Cable and Phoenix Lamps division. Standalone revenues increased 2.7% yoy to Rs 356cr. EBITDA decreased by 6.3% yoy to Rs 77cr while EBITDA margins contracted by 80bps to 15.1% due to commodity price pressure as there is a lag in passing on higher material costs. Other income declined by 44% yoy to Rs 7cr leading to PAT de-growth by 15.4% yoy and PAT margins compressing by 160bps to 9.6%.

The chip shortage, both in India and globally, continued in Q4 FY22, disrupting production volumes across all the segments. The port congestion, container shortages, shipment delays and related costs continued to be high. The overall automotive volumes were at a multiyear low this year largely due to poor demand in the 2-wheeler segment in India. However 2W volumes are now reviving. PLD, including Trifa and Luxlite, had a challenging year due to steep increase in special gases and other commodity prices and challenging business environment.

Company has planned capex of Rs 140cr over the next 12 months. It is consolidating its aftermarket facility at a single location for which it is building a new ~1.4 lakh sq.ft. plant. Phoenix Lamps Division (PLD) completed its expansion during this quarter, to augment certain capacities. Management stated that the outlook for FY23 looks promising with robust business across the Indian OEM and aftermarket along with Automotive and non-Automotive Exports.

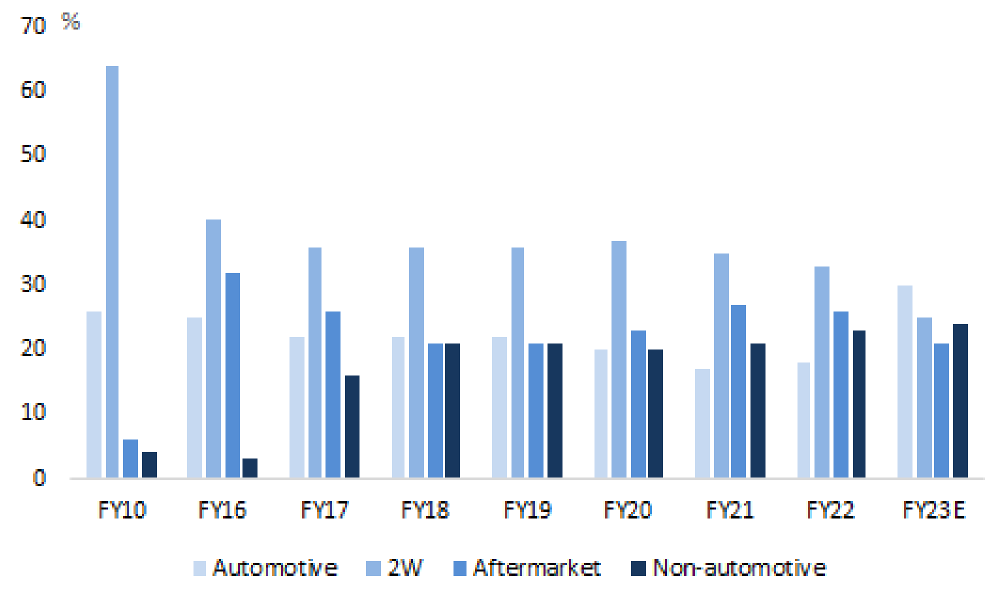
Key Triggers

Diversification and geographical expansion to de-risk portfolio

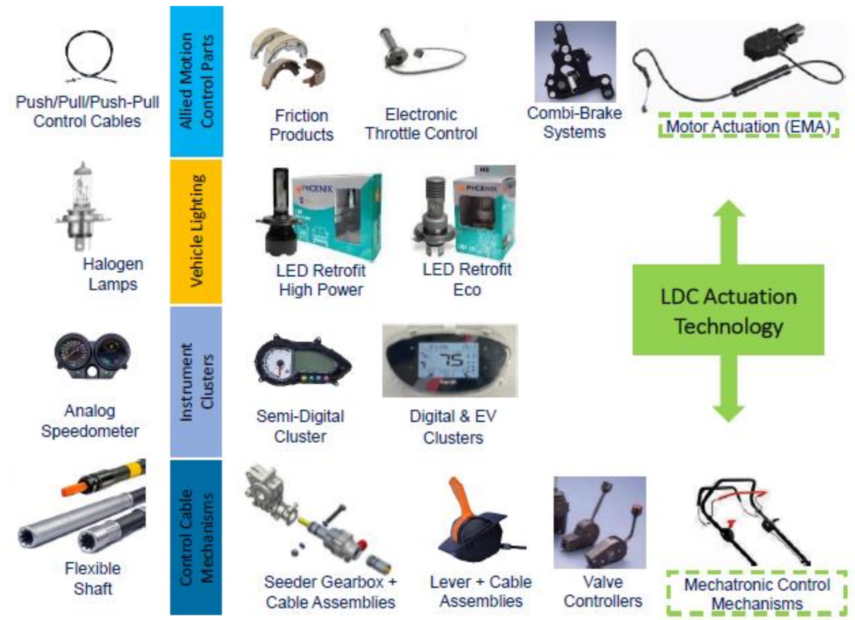
SEL was primarily a supplier of cables to the 2W industry in India having a strong wallet share of ~75% with most of its customers. Over the years SEL has acquired many smaller cable manufacturers and entered into the domestic 4W space. Though relatively a late entrant, it currently enjoys a healthy market share of ~30% in the Indian 4W cables industry. The company aims to deepen its penetration among existing OEMs on the back of its prudent cost structure and value-oriented product portfolio. It is looking to scale up its business with Maruti Suzuki, BMW and Volkswagen amongst others.

With the acquisition of Phoenix Lamps in 2015, SEL gained a foothold in lighting in the automotive aftermarket segment in Europe and India. Moreover, with the acquisition of Wescon in 2016, SEL increased its presence in the North American market in the non-automotive control cables segment. Wescon is a market leader in North America in OPE (outdoor power equipment) segment and this acquisition is a significant sectoral de-risk for SEL from its core business of cables. Consequently, the revenue contribution from the 2W segment reduced to ~35% from ~53% in FY15 while exports increased to ~40% in FY21 from ~18% in FY15.

Revenue becoming more diversified

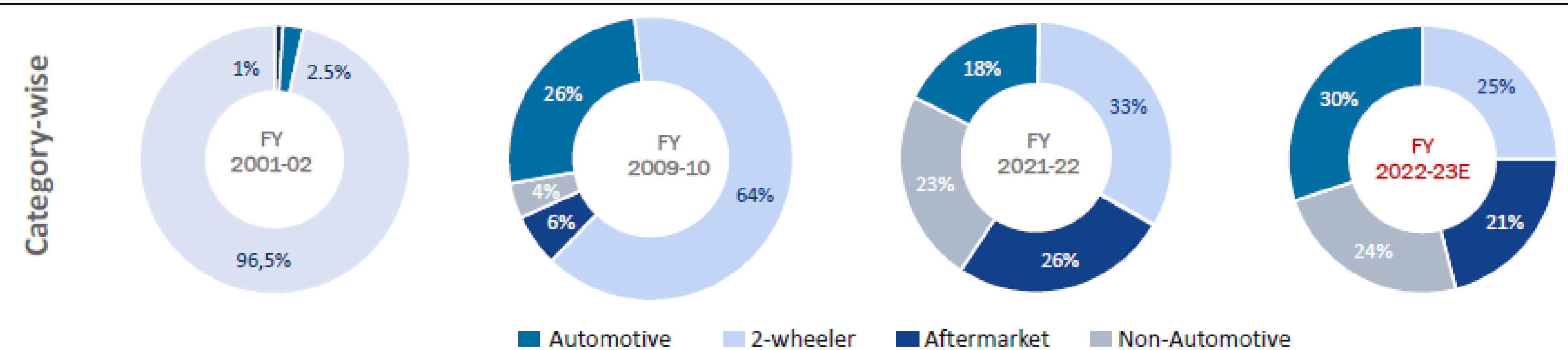


Product Range



(Source: Company, HDFCsec)

Category-wise revenue breakup



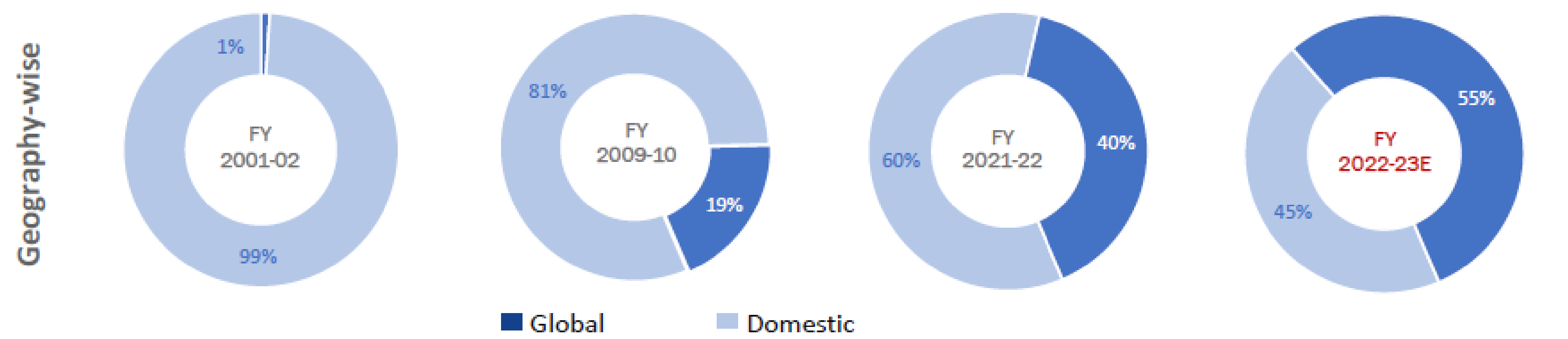
(Source: Company, HDFCsec)

The focus of the Company is to ensure that going forward, the content per 2-wheeler will increase significantly with addition of products "Beyond Cables".

Exports to drive next leg of growth

The management of SEL has been upbeat about increasing prospects of automotive cable exports. SEL supplies automotive cables to foreign OEMs such as BMW, VW, John Deere, MTD, Kubota and Honda. Exports currently account for ~18% of the automotive cable revenue. SEL has been gaining new business from these customers and new model platforms, thereby increasing its wallet share with these customers. Further, the acquisition of LDC would help SEL to get access to complimentary customers and also the technological know-how of next gen products and systems. Many OEMs are looking to de-risk their reliance on China which could benefit SEL. Globally, the automotive cable markets size is estimated to be ~Rs 20,000cr.

Geography-wise revenue breakup

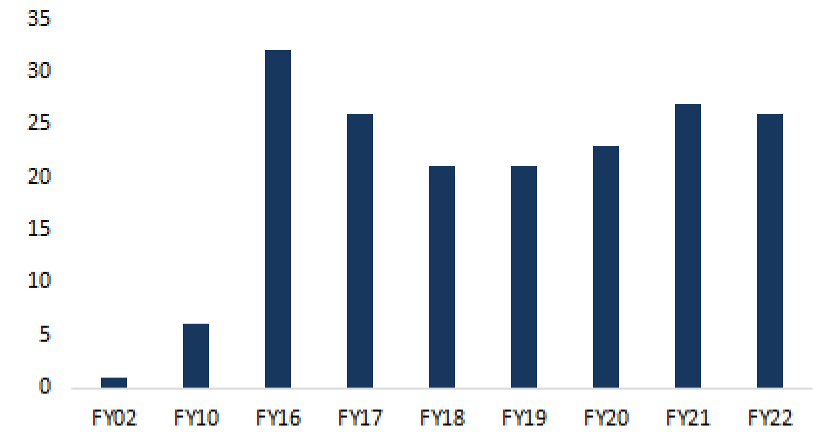


(Source: Company, HDFCsec)

Large replacement market potential

SEL is gradually trying to increase its reach domestically to tap the large replacement market potential. Aftermarket sales have been growing at a faster rate of ~15-20% and its contribution has increased to 27% in FY21 from ~21% in FY19. The growth in the aftermarkets sales is expected to remain high and its share of revenues in the overall pie is likely to increase to ~30% in the next 3-4 years. This would also aid in margin expansion for the company.

Share of aftermarket business in total revenue - %



(Source: Frost & Sullivan, HDFCsec)

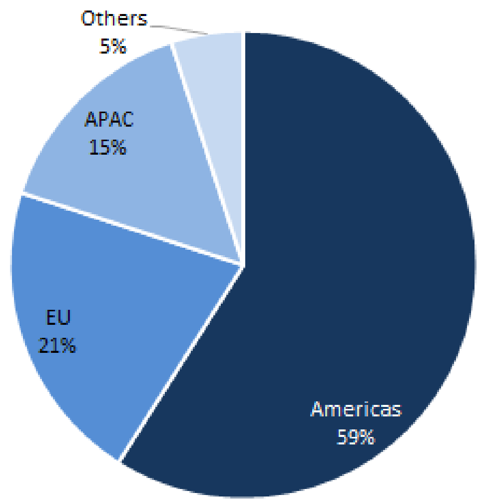
SEL consolidating the disparate manufacturing facilities, which we were using for our aftermarket cable business and overall aftermarket business as such to a centralised facility to manufacture, store and service and cater to the aftermarket business. For this purpose it is building a new 1.4 lakh sq.ft. plant at Bommsandra Indl. Area. This would help the company to streamline its aftermarket business.

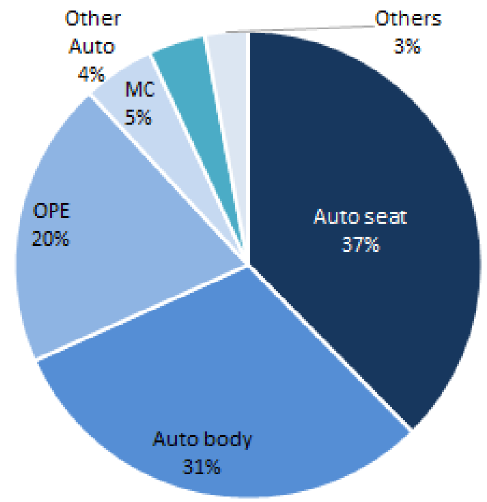
LDC acquisition would provide access to global platforms

SEL acquired the light duty cable division (LCD) of Kongsberg, Norway in Oct'21 for $42 million on a debt free and cash free basis. The company's is expected to have a turnover of $90mn in current year and ~$100mn next year with double digit EBITDA margins. The acquisition would give access to low cost manufacturing centres in China, Hungary and Mexico alongwith a footprint in major markets like China and North America making SEL one of those global leaders in the cable business.

LDC has the capacity to manufacture ~106mn cables per annum through its 3 production facilities in Mexico, China and Hungary (low cost manufacturing locations) while it also has 9 sales offices located in close proximity to major customers. The combined entity is the world's second largest cable manufacturer with a diversified geographic presence and greater cost competitiveness. The acquisition would also provide SEL access to complementary products and technologies and cross-selling opportunities. LDC has a major share in automotive seat related products (~38% of revenue) and Electro-Mechanical Actuators (15% of revenue) where SEL has a limited presence.

LDC revenue mix *Geographical* *Product*





(Source: Company, HDFCsec)

Acquisition of Osram India facility - positive for exports

SEL entered into an agreement to acquire the halogen bulb manufacturing facility near Chennai from Osram India (owned by Osram Gmbh) in FY20. With this acquisition its halogen bulb manufacturing capacity has increased from 87mn to about 110mn per annum. The company plans to use the additional capacity to cater to exports. SEL has also become a part of the global supply chain to Osram and will supply halogen bulbs from its plants in India including the plant near Chennai. Osram is a global brand and owned by Osram Gmbh.

Dedicated product development centre

SEL uses its diverse knowledge and experience in manufacturing processes to leverage the best out of all its manufacturing facilities and research centres. It has a dedicated R&D unit as Suprajit Technology Centre (STC) headquartered in Bangalore and supported by experienced R&D centres in US and UK. The ultimate goal of STC is to rapidly conceptualise design, prototype, test and validate new products that become the next cornerstone product line of the company. STC helps support satellite development centres across all the individual plants. There are more than 70 qualified and dedicated engineers across these centres. STC has developed multiple products anticipating future needs of customers and trends in the industry. STC has developed many new products like digital speedometer, rotary sensor, electronic grip, brake actuation, etc. Many of these products can be used for EVs as well. Initial businesses won and orders expected on the aforementioned products, and others, are in excess of Rs 100cr/year on an annualised basis.

Restructuring completed - Margins expected to improve

SEL's margins were impacted due to restructuring operations of Luxlite and Trifa. It is also restructuring its North American operations and improve operational performance. Although there may be cost impact in the short term due to write down in the value of investments it is expected to yield medium and long term benefits for the company.

Risks & Concerns

Slowdown in automobile industry

SEL primarily caters to the automobile industry which is emerging from a major slowdown. Although the improving trends are encouraging, a large part of the growth was on account of pent-up demand. Sustenance of demand would be key monitorable in the coming years.

Volatility in raw material prices

Steel is a major raw material for SEL which is sourced locally as well as 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 borne by SEL.

Rapid adoption of EV could impact cable demand

Cables account for 75-80% of SEL's revenue of which supply to automotive OEMs and automotive aftermarket account for major chunk. Requirement of cables in EVs reduces drastically and its rapid adoption could impact revenue.

Preference for LEDs to impact halogen revenues

Increasing preference for LED lamps in 2W/4W headlights could impact the revenues of Phoenix Lamps division. Scaling up of production at the new Dodaballapur plant could take time and impact its profitability.

Chip shortage could impact vehicle supply

Although automobile demand remains strong, OEMs are unable to supply vehicles due to chip shortages. Lower vehicle production could impact the demand for cables.

Foreign exchange risk

The company derives ~40% of its revenues from global operations and thus volatility in the exchange rates could impact its profits. As of FY21 it had ~Rs 26cr worth of unhedged foreign currency exposure.

Higher input cost prices

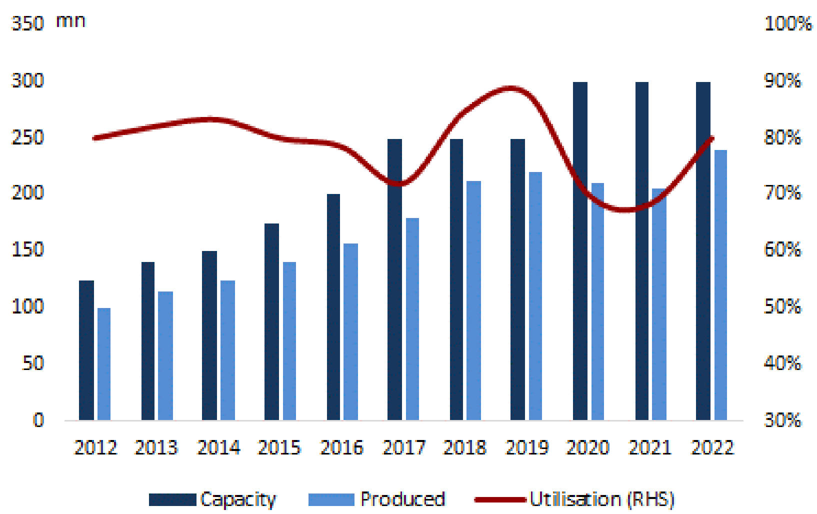
Any steep increase in raw material prices is passed on to the OEMs with a lag. Steel is major raw material of SEL.

Company Background:

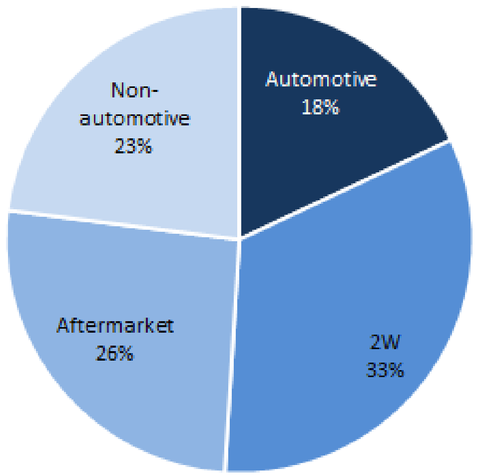
Incorporated as a Private Limited Company in 1985, SEL is currently the largest manufacturer of automotive cables in India with the capacity to manufacture about 300mn cables per annum and amongst the top five cable manufacturers in the world. It recently acquired light duty cable (LDC) division of a Norway based company, Kongsberg, increasing its cable manufacturing capacity to over 400mn post the conclusion of the transaction. Through Phoenix Lamps (acquired in 2015) it is also the largest manufacturer of halogen lamps with a manufacturing capacity of about 110mn halogen lamps per annum. Apart from being an auto cable specialist, SEL also specialises in the production of instruments, speedometers and other parts. SEL has 19 manufacturing facilities (including a technology centre in the UK) across the globe catering to the automotive as well as the non-automotive business.

SEL's customer profile comprises reputed OEMs in the 2W space such as Bajaj Auto Limited (BAL), Hero MotoCorp Limited (HMCL), TVS Motor Company Limited (TVS) and Honda Motorcycle & Scooter India (HMSI) among others. In the 3W segment, SEL caters to customers such as Atul Auto Limited (AAL), Piaggio Vehicles Private Limited (PVPL) and TVS while its customers under the 4W segment include Mahindra & Mahindra (M&M), BMW AG (BMW) and Volkswagen AG (VW) among others. Under its non-automotive vertical, the company's customers include John Deere (JD), Whirlpool Corporation (WC), Kubota Corporation (Kubota) and Club Car LLC (Club car).

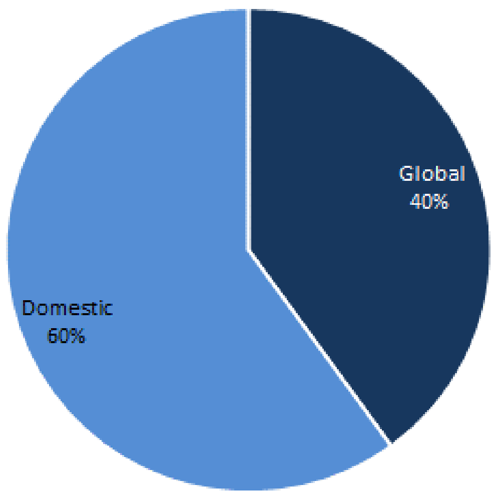
Cable production and utilisation trend



Revenue breakup Category wise



Geography wise

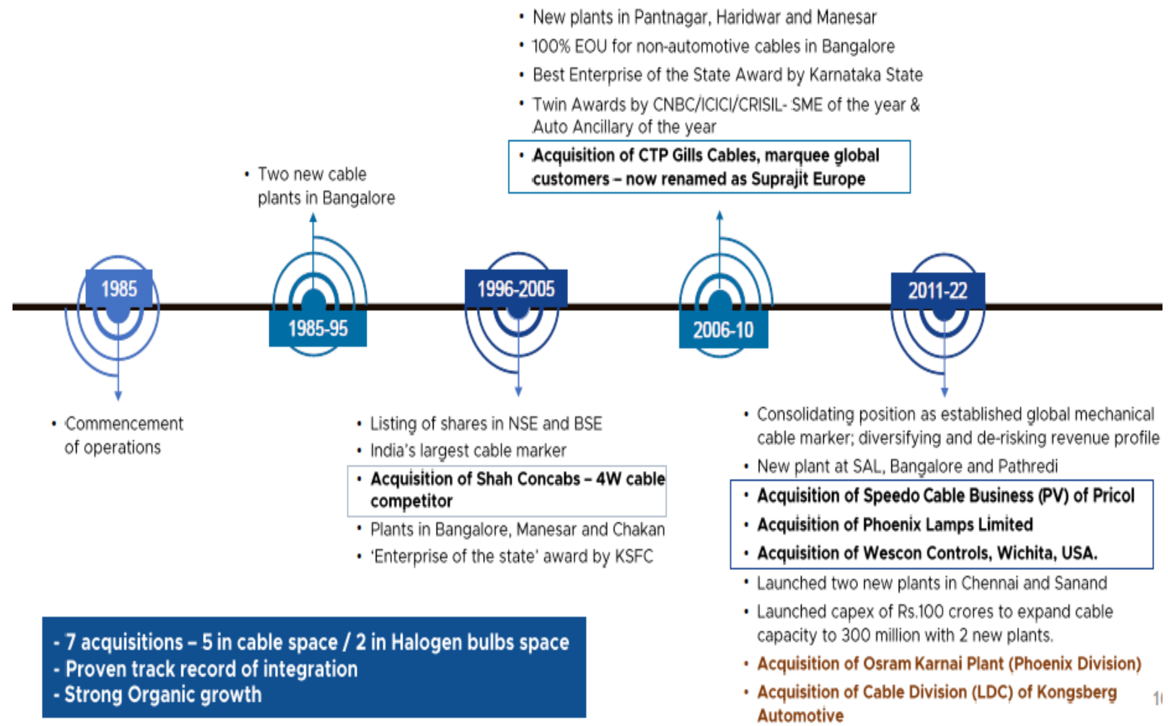


(Source: Company, HDFCsec)

SEL's growth

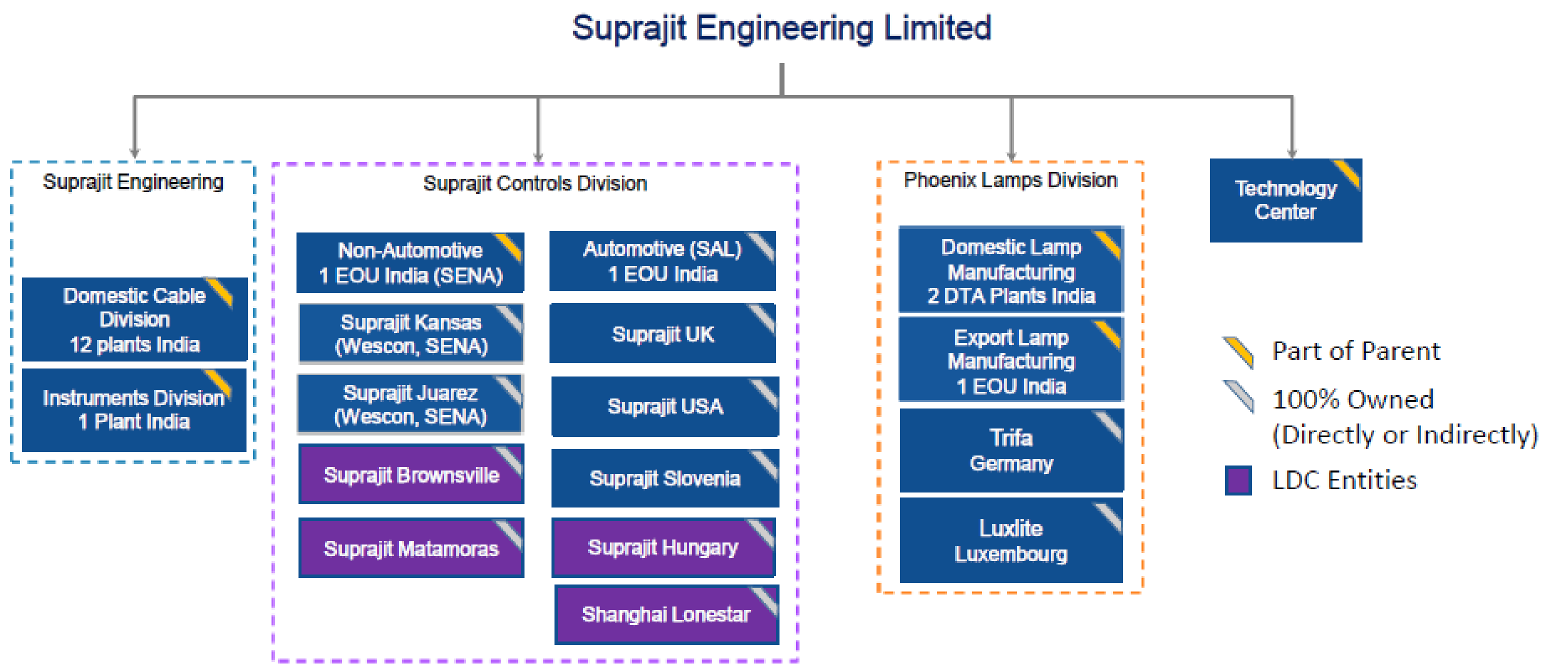
1985		2022
Single Segment	Two-Wheeler → Three-Wheeler & India Aftermarket → Passenger & Commercial Vehicles, Agriculture → Power Sports, Garden Equipment, Global After market, Electric Vehicles	Multiple Segments
Single Customer	TVS Motor Company → Bajaj Hero Honda Yamaha → Tata Motors, Swaraj Mazda, Eicher Motors Mahindra → BMW, VW, GM Ford, Suzuki → John Deere, Kubota, MTD → Hero Electric, Ather	Multiple Customers
Single Product	Mechanical Control Cables → Speedometers → Cable based levers & assemblies → Automotive Halogen Lamps Electronics → Electro-Mechanical Actuation	Multiple Products
Single Location	Karnataka → - Multiple States - Maharashtra Gujarat, Haryana Uttarakhand, Rajasthan Tamil Nadu, Uttar Pradesh → - Multiple Countries - UK, US, Germany, Luxembourg, Mexico, Slovenia	Multiple Locations
Single Brand	Suprajit → PHOENIX, TRIFA → WESCON CONTROLS	Multiple Brands

Through Strong Organic Growth, Capacity Expansion, and Strategic Acquisitions



(Source: Company, HDFCsec)

Corporate Structure



(Source: Company, HDFCsec)

Financials

Income Statement

(Rs cr)	FY20	FY21	FY22	FY23E	FY24E
Net Revenues	**1563**	**1641**	**1840**	**2894**	**3184**
Growth (%)	***-1.7***	***5.0***	***12.2***	***57.2***	***10.0***
Operating Expenses	1344	1404	1581	2500	2745
EBITDA	**219**	**237**	**260**	**394**	**439**
Growth (%)	***-6.0***	***8.2***	***9.8***	***51.4***	***11.6***
EBITDA Margin (%)	***14.0***	***14.4***	***14.1***	***13.6***	***13.8***
Depreciation	58	57	59	69	79
Other Income	22	34	37	32	32
EBIT	**183**	**214**	**238**	**356**	**392**
Interest expenses	23	19	15	25	28
Exceptional item	-27	0	12	0	0
PBT	**133**	**194**	**235**	**332**	**365**
Tax	29	52	62	84	92
PAT	**104**	**143**	**173**	**248**	**273**
Adj. PAT	**110**	**143**	**173**	**248**	**273**
Growth (%)	***-17.8***	***29.8***	***21.3***	***43.3***	***10.0***
EPS	7.9	10.2	12.5	17.9	19.7

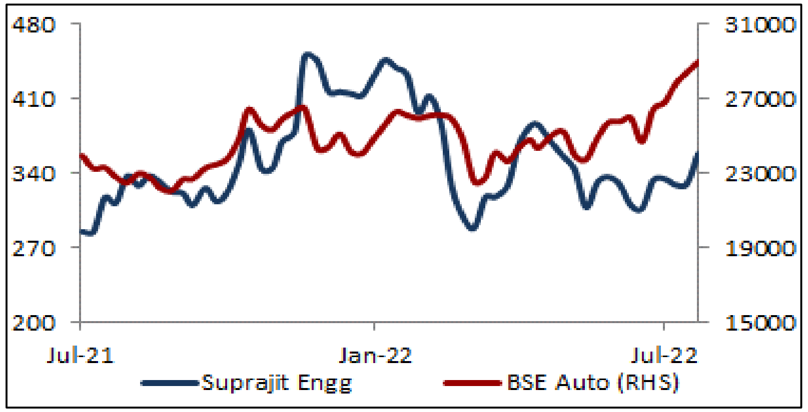
Balance Sheet

As at March (Rs cr)	FY20	FY21	FY22	FY23E	FY24E
SOURCE OF FUNDS					
Share Capital	14	14	14	14	14
Reserves	840	976	1070	1279	1504
Shareholders' Funds	**854**	**990**	**1084**	**1293**	**1518**
Minority Interest	0	0	0	0	0
Total Debt	311	270	312	447	407
Net Deferred Taxes	56	55	55	55	55
Other Non-curr. Liab.	10	17	25	29	36
Total Source of Funds	**1232**	**1332**	**1475**	**1824**	**2015**
APPLICATION OF FUNDS					
Net Block & Goodwill	613	598	588	678	692
CWIP	15	5	10	20	12
Invst. & Other Non-Curr Ass	291	334	282	316	361
Total Non Current Assets	**919**	**937**	**880**	**1015**	**1066**
Inventories	276	315	343	563	628
Trade Receivables	275	332	297	515	584
Cash & Equivalents	64	94	188	131	175
Other Current Assets	46	36	30	79	87
Total Current Assets	**661**	**776**	**859**	**1289**	**1475**
Trade Payables	214	248	194	357	393
Other Current Liab & Provisions	135	133	69	123	133
Total Current Liabilities	**349**	**381**	**263**	**480**	**525**
Net Current Assets	312	395	596	809	950
Total Application of Funds	**1232**	**1332**	**1475**	**1824**	**2015**

Cash Flow Statement

(Rs cr)	FY20	FY21	FY22	FY23E	FY24E
Reported PBT	133	194	235	332	365
Non-operating & EO items	16	-18	-25	-10	2
Interest Expenses	23	19	15	25	28
Depreciation	58	57	59	69	79
Working Capital Change	50	-43	-43	-270	-97
Tax Paid	-47	-48	-58	-84	-92
OPERATING CASH FLOW (a)	**232**	**161**	**182**	**62**	**285**
Capex	-66	-25	-53	-170	-85
Free Cash Flow	166	136	129	-108	200
Investments	-94	-21	74	-20	-40
Non-operating income	4	-14	15	0	0
INVESTING CASH FLOW (b)	**-157**	**-60**	**37**	**-190**	**-125**
Debt Issuance / (Repaid)	11	-51	-4	135	-40
Interest Expenses	-23	-19	-15	-25	-28
FCFE	64	31	199	-18	92
Share Capital Issuance	0	0	-48	0	0
Dividend	-44	-10	-27	-39	-48
FINANCING CASH FLOW (c)	**-55**	**-81**	**-95**	**72**	**-116**
NET CASH FLOW (a+b+c)	**21**	**20**	**123**	**-57**	**44**

Price chart



Key Ratios

	FY20	FY21	FY22	FY23E	FY24E
Profitability Ratios (%)					
EBITDA Margin	14.0	14.4	14.1	13.6	13.8
EBIT Margin	11.7	13.0	12.9	12.3	12.3
APAT Margin	7.0	8.7	9.4	8.6	8.6
RoE	13.5	15.5	16.7	20.9	19.4
RoCE	16.3	17.6	17.9	22.7	21.4
Solvency Ratio (x)					
Net Debt/EBITDA	1.1	0.7	0.5	0.8	0.5
Net D/E	0.3	0.2	0.1	0.2	0.2
PER SHARE DATA (Rs)					
EPS	7.9	10.2	12.5	17.9	19.7
CEPS	12.0	14.3	16.7	22.9	25.4
BV	61.0	70.8	78.3	93.4	109.7
Dividend	1.8	1.5	2.0	2.8	3.5
Turnover Ratios (days)					
Debtor days	67	68	62	51	63
Inventory days	64	66	65	57	69
Creditors days	46	52	44	35	43
VALUATION (x)					
P/E	45.6	35.1	28.7	20.0	18.2
P/BV	5.9	5.1	4.6	3.8	3.3
EV/EBITDA	23.0	20.5	18.6	12.7	11.1
EV / Revenues	3.2	3.0	2.6	1.7	1.5
Dividend Yield (%)	0.5	0.4	0.6	0.8	1.0
Dividend Payout (%)	22.3	14.7	16.0	15.6	17.8

(Source: Company, HDFC sec)

ATUL JAGDISH KARWA

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HDFC Sec Retail Research Rating description

Green Rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. This stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Yellow Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicality of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.

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