Q3FY19 – Result Update

NALANDA RESEARCH

Institutional Research

February 12, 2019

Suprajit Engineering

Consistency Persists Even in an Imperfect Conditions

Strong Buy*

Downside Scenario	Current Price	Price Target	Upside Scenario
	190	247	
		29.9% ▲	

Sturdy Growth Performance!

The company posted a decent set of numbers in this tough environment, where depressed sentiments, took a toll on the OEMs financial performance. The top line of Suprajit grew by ~11% YoY in Q3FY19 to Rs. 406 crores, while margins decelerated by 150bps YoY to 15.0% for the same period, however, on the expected line it improved by 140bps QoQ. The major reason for the decline in the margins was on account of increase in its core raw material costs and rise in the minimum wages. The minimum wages has gone up in most of the Indian states and in the US, the company is investing in people for growth in the coming years. The company's bottom line jumped by 39% YoY to Rs. 39 crores, despite flattish EBITDA performance. This was on account of a sharp increase in its other income by 367% YoY to Rs. 18.4 crores for the quarter and lower finance costs, which declined by 19.5% YoY to Rs. 5.8 crores. The other income rose, led by appreciation in MF investments and forward contract gains. On the other side, the effective tax rate was higher by 490bps YoY to 37.7% in Q3FY19.

Healthy Growth Continues in Automotive Cable Division

Suprajit's automotive cable reported ~18% YoY growth to Rs. 682 crores in 9MFY19, this is despite of tough demand environment in the automotive industry. The company has reported robust growth in its aftermarket and steady growth in OEM segment. It also won business in the PV segment for Parking Brake Cable and Gear Shifter Cable. We expect Maruti Suzuki to come on board anytime soon as they have already done its first audit of Suprajit's plant. This will substantially improve the market share of Suprajit in the PV segment *(existing market share is 35%)*. The PV realization is higher and the number of cables are more as compared to 2Ws.

Exploring Newer Areas in Non-Auto Cable Division

The non-automotive cable division posted a sharp double digit growth in its revenues, higher by 15% YoY to Rs. 241 crores in 9MFY19. The management guided for a better Q4 and we expect a healthy set of numbers in the coming years, as it is taking several steps to explore newer segments viz. medical equipment devices, material handling, power sports vehicles, Agri machineries, construction equipment, marine, etc. We feel the strategy & the opportunity size is huge in these newer segments and can expect it to execute in 2-3 years of time frame.

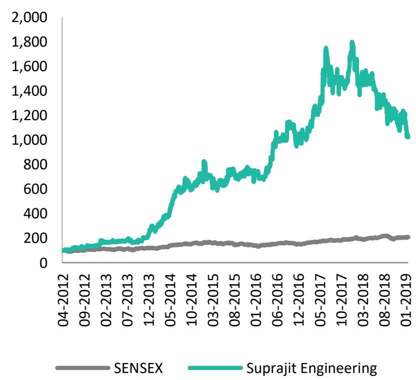
Changing Regulation to Aid Growth

There won't be any impact of electric vehicles as some new applications would come and few of the existing will go. Post BS6, the number of cables in a vehicle will increase by 1-2, this will further aid in volume growth. The demand in Q4FY19 is expected to be similar as Q3FY19 in the domestic market, however, ABS/CBS regulatory change would increase in the number of cable by one. Hence, minor slowdown in OEM growth would get offset by an increase in the number of cables and customers. Overall, there won't be any impact on the performance.

Market Data	
Industry	Auto Ancillaries
Sensex	36,395
Nifty	10,889
Eq. Cap. (INR Crores)	14
Face Value (INR)	1
52-w H/L	298/186
Market Cap (INR Crores)	2,660

Valuation Data	FY19E	FY20E	FY21E
OPM	15.1%	15.5%	16.1%
NPM	9.0%	8.4%	8.9%
P/E (x)	18.3	16.9	14.1
EV/EBITDA (x)	10.5	9.1	8.3

Suprajit Engineering vs. SENSEX



Shareholding Pattern (%)	Dec-17	Mar-18	Dec-18
Promoters	44%	44%	45%
FII	5%	4%	5%
DII	10%	12%	11%
Retail	41%	40%	39%
Total	**100%**	**100%**	**100%**

(INR Crores)	FY17	FY18	FY19E	FY20E	FY21E
Revenue	1,203	1,431	1,613	1,886	2,125
Growth (%)	*26.3%*	*19.0%*	*12.7%*	*16.9%*	*12.7%*
EBITDA	202	237	243	293	341
Growth (%)	*30.9%*	*17.1%*	*2.9%*	*20.3%*	*16.5%*
EBITDA Margin (%)	16.8%	16.5%	15.1%	15.5%	16.1%
PAT	114	138	146	158	188
Growth (%)	*41.6%*	*21.8%*	*5.1%*	*8.3%*	*19.5%*
EPS (INR)	8.1	9.9	10.4	11.3	13.5
P/E (x)	23.2	28.4	18.3	16.9	14.1
EV/EBITDA (x)	11.4	15.9	10.5	9.1	8.3

Source: Company, NSPL Research

** Read last page for disclaimer & rating rationale*

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Phoenix Lamps Performance remains Subdued; Outlook Positive

Suprajit has reported a flattish growth in 9MFY19 to Rs. 236 crores in Phoenix Lamps and margins too declined by 160bps YoY to 12.1% for the same period. The calculated Q3FY19 numbers too looks depressed as net revenues fell by 130bps YoY to 82 crores, while margins decelerated from 17.3% in Q3FY18 to 10.5% in Q3FY19. The major reason for poor performance was that Honda has switched over to LED in its mass market models and hence, Suprajit lost business. We expect faster adoption of LEDs by other OEM players too.

The management is taking serious steps in turning around this business segment viz. Brand building exercise, working on stringent cost rationalization efforts, customer engagement, etc. We believe these steps are in the right direction, however, will take a year to stabilize and then will see a decent set of growth in it. The company's aftermarket division has been doing good and is commanding a leadership position in it *(Market share of 75% in 2W; 65% each in PV & CV in domestic)*. The focus remains on 1) aftermarket & exports for halogen bulbs and 2) challenging each & every part of the costs to bring it down. The company is present only in aftermarket in international countries and there is a good opportunity for them to take some market share in OEMs too.

Post introducing the new H7 bulb, the company sees the customers coming back. However, we believe it will take some time to gain the confidence back in the lamps business. The opportunity size in the US & EU is huge and post tariffs on Chinese goods, there has been an increase in the sales in Suprajit's lamps. The company has been rigorous in the cost rationalization front and doing lot many projects to curtail the overall expenses. Positively, big players globally were earlier sourcing from Chinese players and now they have turned up to India as well. Moreover, we expect a strategic inorganic acquisition in the LEDs and believe it is a matter of time, this division should do well.

Multiple Products in the Pipeline

Recently, the company indigenously developed 1) Gear Shifter Cable and 2) Parking Brake Cable in its technology centre. The company already won a few orders and expect more in it. There are more products under R&D *(not disclosed due to competitive reasons)* and believe these new products are required in each and every car and hence, the opportunity size is enormous in it.

Trading at an Eye-Catching Valuations

Based on the investment rationales discussed, we strongly believe in the company's business model and its potential growth in the medium to long term on account of its competitive positioning.
We trust that the company is very ethical, well-diversified, a consistent performer and all this along with the stability in terms of performance should continue. Currently, the company is trading attractively at a P/E of 14.1x and EV/EBITDA of 8.3x FY21E.

We recommend a Strong Buy on Suprajit Engineering with an average fair value of Rs. 247 per share, valuing the company with P/E and EV/EBITDA Methodology. In the past three years, it use to trade at a forward P/E of ~19x and EV/EBITDA of ~11.5x. We have lower down the earning multiple and assigned ~18x and 10.0x to its FY21E EPS & EBITDA respectively on account of on-going uncertainty in the domestic and global automotive demand. However, we believe the medium to long term potential & opportunity size is enormous.

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Q3FY19 Result Analysis

(INR Crores)	Q3FY19	Q3FY18	YoY (%)	Q2FY19	QoQ (%)	9MFY19	9MFY18	YoY (%)
Net sales	**406**	**366**	**10.7%**	**391**	**3.6%**	**1,159**	**1,025**	**13.1%**
COGS	235	212	11.0%	226	3.6%	662	571	16.0%
Employee Expenses	76	65	17.4%	76	-0.3%	224	191	17.5%
Other Expenses	34	30	14.6%	35	-3.6%	103	101	2.1%
EBITDA	**61**	**60**	**0.9%**	**53**	**14.2%**	**169**	**162**	**4.5%**
D&A	10	10	8.6%	10	2.0%	30	28	9.3%
Other income	18	4	366.9%	3	522.5%	25	16	63.3%
EBIT	**69**	**55**	26.1%	**46**	49.6%	**164**	**150**	9.7%
Interest Expense	6	7	-19.5%	6	-8.8%	19	21	-12.8%
PBT	**63**	**47**	**33.0%**	**40**	**59.0%**	**146**	**129**	**13.4%**
Tax	24	19	24.4%	16	52.9%	54	46	15.8%
PAT	**39**	**28**	**38.8%**	**24**	**62.9%**	**92**	**82**	**12.1%**
EPS in INR	**2.8**	**2.0**	**38.6%**	**1.7**	**62.8%**	**6.6**	**5.9**	**12.1%**

Margin Analysis	Q3FY19	Q3FY18	YoY (%)	Q2FY19	QoQ (%)	9MFY19	9MFY18	YoY (%)
Material Expenses % Net Sales	57.9%	57.7%	0.1%	57.9%	0.0%	57.2%	55.7%	1.4%
Gross Margin	42.1%	42.3%	-0.1%	42.1%	0.0%	42.8%	44.3%	-1.4%
Employee Expenses % Net Sales	18.8%	17.7%	1.1%	19.5%	-0.7%	19.3%	18.6%	0.7%
Other Expenses % Net Sales	8.4%	8.1%	0.3%	9.0%	-0.6%	8.9%	9.9%	-1.0%
EBITDA Margin (%)	15.0%	16.4%	-1.5%	13.6%	1.4%	14.6%	15.8%	-1.2%
Tax Rate (%)	37.7%	40.4%	-2.6%	39.2%	-1.5%	36.9%	36.1%	0.8%
PAT Margin (%)	9.7%	7.7%	2.0%	6.1%	3.5%	7.9%	8.0%	-0.1%

Source: Company, NSPL Research

- **The net sales growth is driven by automotive and non-automotive divisions, as growth remains subdued for its phoenix lamps division.** The automotive cable segment reported a robust growth of 13.3% YoY to Rs. 238 crores in Q3FY19, this is despite of subdued performance of OEMs in the domestic as well as global automotive demand. The non-automotive cable segment also reported 17% YoY growth to Rs. 86 crores. But, the phoenix lamps division reported a de-growth of 1.3% in Q3FY19 to Rs. 82 crores. The performance of the phoenix lamps division was impacted as the Honda Motors switched over to LED in its mass market models and hence, volumes lost over there.

- The EBITDA Margins of all its segments were lower on a YoY basis. This was largely on account of increase in the core raw material prices, rise in the minimum wages and lower operating leverage benefits. **The management expects a sustainable margin band of 14-16% in the coming years.**

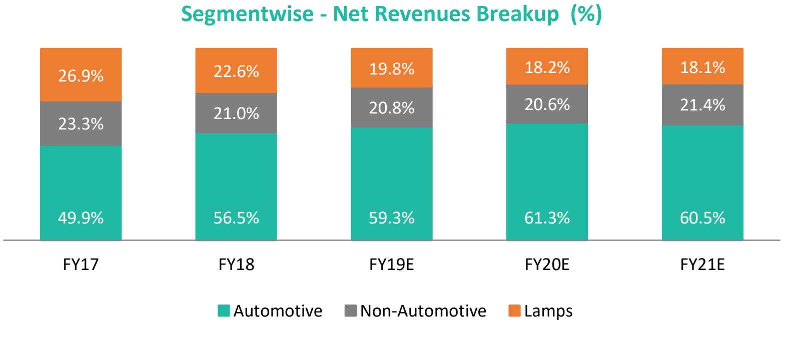
- Suprajit continues to seeks organic as well as inorganic opportunities and expects M&A at the right time & with right valuations.

- **The capex would be Rs. 120 crores *(including maintenance capex)* for the FY19E & FY20E.** This would get spent on increasing the cable capacities from 250mn to 300mn p.a.

- The company has total debt of Rs. 343 crores including WC debt and it is almost similar to the last year's level.

- **The BoD has separated the position of Chairman and MD.** We believe this is a right step as the size and opportunities of the business is expanding and require separate senior executives at top level.

- The UK is in the middle of Brexit and the company is getting ready for it. The company has geared up the productions and build up its inventories in a warehouse.



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Investment Rationales

Strong Visibility of Next Leg of Growth – *to be driven by all the segments*

1. **In the automotive segment, the company has improved its market share from ~20% five years ago to ~35% in FY18** and this increase was majorly contributed by adding new clients in its kitty. The management is very enthusiastic about it and believe the leader in the domestic PVs to come on board in the near future, which would improve its market share substantially. Moreover, post acquisition of the Wescon Control LLC, Suprajit has got an access to the global customers, where it has enormous potential. More importantly, the number of cables required in a car is ~25 vis-à-vis ~5 in 2Ws. Hence, the opportunity is large in 4Ws. Also, the margins in 4W cable is higher by 2-4% as compared to 2W cable.

2. **In the non-automotive space, the potential opportunity is enormous.** At present the company serves majorly to tractors, construction machineries manufacturer and entered into the manufacturing of cables for washing machines. We believe the options are open for the company to enter into newer segments and think this will not only provide a stable set of growth in the medium term, but, will also aid in reducing the volatility from the automotive industry. The non-automotive division contributed nil in FY02, which increased to 16% in FY17 and 21% in FY18 to the top line.

3. **Suprajit is the strong market leader in the manufacturing of 2W cables in the world.** The company is a preferred supplier to almost all the OEMs in domestic as well as overseas. The company with its diversification strategy has reduced the dependence on 2Ws from 96.5% in FY02 to 36% in FY18. Post BS6, the number of cable requirement will increase and in addition to it, the global players continue to enter into India. All this along with higher than the industry growth will eventually aid Suprajit in improving its market share further.

4. **King-sized Aftermarket:** The aftermarket division supplies spare parts through trade & mechanic repair shops and alone in India has ~20,000 touch points. The management sees huge opportunity in aftermarket. Post GST, Suprajit is getting benefits as there is a gradual shift observed from unorganised to organised players. The company is getting benefitted as it has huge touch base across India. Also, the margins too are higher as compared to direct sales to OEMs. The management looks serious in expanding the reach and growing this division.

5. **Enormous Opportunities in Exports:** The company is also growing and expanding outside India, where the opportunity size is enormous. Post Wescon's acquisition, it has access to the global customers along with plants in a few countries. The company's aim is to double the size of automotive exports by FY21E vs. FY18.

6. **Strategic Opportunities Under Lamps Division:** Suprajit is one of the top five manufacturer of halogen lamps globally and we believe this will be a trigger point if the company strategically enters into manufacturing of LEDs. Although the LED penetration is in the low double digit, but the market is gradually moving towards it. The global competition in Halogen is from Chinese players, which makes cheaper products and from South Korean players, which makes quality products with premium pricing. Suprajit strategy is to make a good quality product with a reasonable price, hence, the company should benefit.

Risks:

- **Increase in the Raw Material Prices:** Suprajit Engineering is heavily dependent on the key raw materials viz. Steel, PVC, Rubber, Plastic and Brass. The increase in the volatility of these key materials can have an impact on its financials. The sudden and continuous increase in the commodities and major raw material prices can bring down its overall margins. Although, the company has some pass through clause with its major customers.

- **The On-going Trade War** between the major economies can disrupt the global automotive demand and in-turn impact the financials of Suprajit Engineering. The export contributes about ~40% in the top line. This will be offset by the pickup in the aftermarket division.

- **Quality Compromise**: To reduce quality risk, skilled workforce has provided job skill enhancement training, but, still quality or delivery related issues can weaken the rapport with the customers.

- **Competition:** There is no major listed competitor, hence the company will continue to get the scarcity premium. To deal with the unlisted & foreign competition, the company undertakes continuous R&D activities and develops low priced products with the quality of global standards.

- **Technology Obsolescence:** Any technological disruption in the control cables can be seen as a threat. However, we believe that the cables are cost effective in a car and don't see any replacement of it.

- **The Company's growth is dependent on the Automotive Industry**, which in turn depends upon the macro-economic stability. Any decline in the growth of the automotive industry can impact the performance of Suprajit Engineering. However, we believe, the long term outlook for the automotive industry remains robust with rising income levels, strong macro-economic fundamentals and easy availability of finance.

- **Unsuccessful Acquisition:** The company keeps looking for inorganic acquisitions, hence, any failed target can imbalance the financial equations.

Source: Company, NSPL Research

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STRENGTHS

In the past, the company was heavily dependent on 2W cables (96.5% in FY02), however, now it is well distributed among 2Ws (36%), 4Ws (22%), Aftermarket (21%) and Non-Automotive Cables (21%). In addition, in FY02, the revenues from domestic was 99% and in FY18, the Domestic:Exports were evenly distributed in the ratio of ~60:40.

Suprajit is among the leaders in manufacturing of automotive cables and halogen bulbs. The company is a dominant supplier in the domestic automotive industry and is a preferred supplier to both domestic as well as overseas customers. It exports to 50+ countries and has a strong presence in non-automotive cables.

Over 30 years of expertise in cables and has a Strong relationship with OEMs.

Suprajit Engineering is strategically placed its manufacturing locations near to the automotive hubs in India, which resulted in efficient supply chain distribution and lower logistics cost.

The company manufactures in a very large scale and hence, it gives this mass manufacturer a competitive cost advantage. The company has the ability to setup modular capacities at low capex for dynamic growth.

No customer contributes more than 10% in the topline and company has excellent rapport.

Suprajit has good distribution reach with 20,000 touch points.

OPPORTUNITIES

The Government has mandated to shift to BS6 norms by April 2020, which will likely to improve the number of cables in a vehicle.

The OEMs product life cycle is getting shorter, which could provide cable manufacturers an added advantage as there will always be a requirement for a newer cables. This will provide a continued growth for opportunities for the leader like Suprajit.

Due to regulatory requirements, technology changes, high costs, etc. the global OEMs prefer to outsource the component manufacturing to low cost countries like India. Most major automobile manufacturers have set up production bases in India.

The company is expanding its reach to secure good business in the huge aftermarket division. Moreover, there is a good potential to grow its export business.

There is a huge opportunity in the non-automotive space, where mechanical cables are required.

The market is gradually evolving into LED bulbs and we expect Suprajit to crack a deal (organic/inorganic) sooner or later in this strategic space.

Suprajit Engineering – *SWOT Analysis*

WEAKNESSES

The Exports contribute about 41% of the revenues. Any slowdown in the major economies can impact its financials.

Any quality or delivery related issues can weaken the rapport with the customers.

Suprajit Engineering is heavily dependent on the key raw materials viz. Steel, PVC, Rubber, Plastic and Brass. The increase in the volatility of these key materials can have an impact on its financials.

THREATS

The company's growth is dependent on the Automotive Industry, which in turn depends upon the macro-economic stability. Any decline in the growth of the automotive industry can impact the performance of Suprajit Engineering. However, we believe, the long term outlook for the automotive industry remains robust with rising income levels, strong macro-economic fundamentals and easy availability of finance.

Any technological disruption in the cable industry can slow down the financials of Suprajit.

The company keeps looking for inorganic opportunities, hence, any failed acquisition can imbalance the financial equations.

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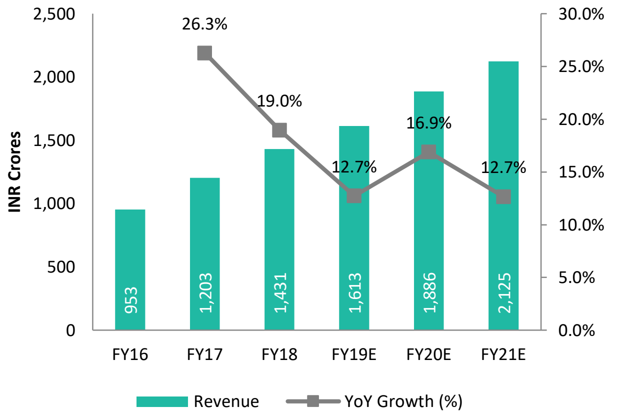
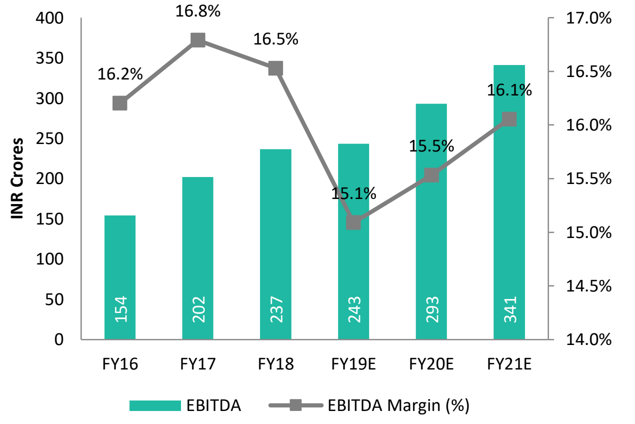
Story in Charts

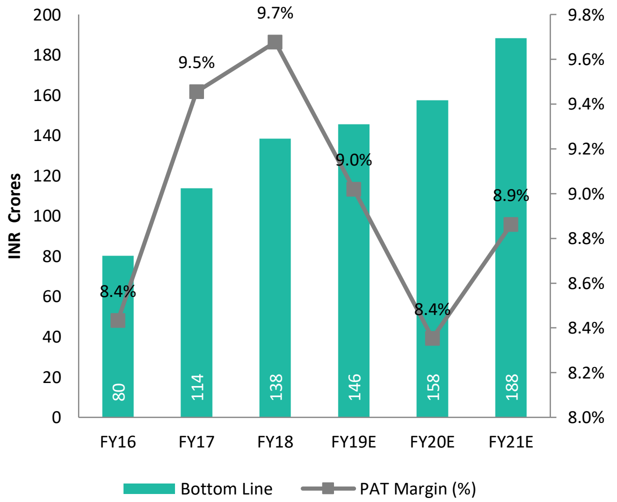
Continues Double Digit Journey..!



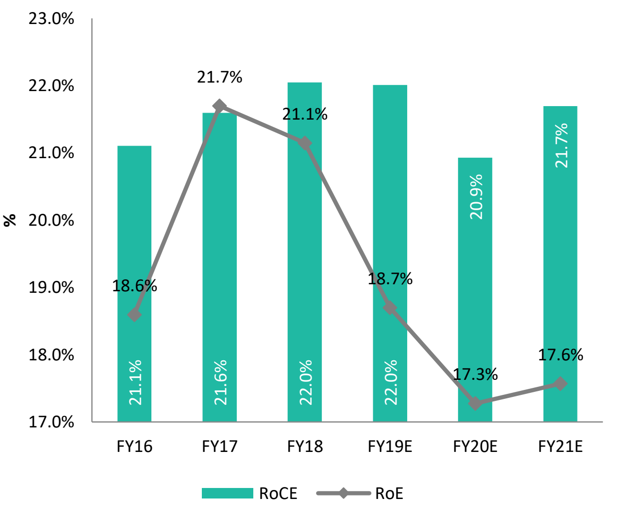
With Premium Margin..!



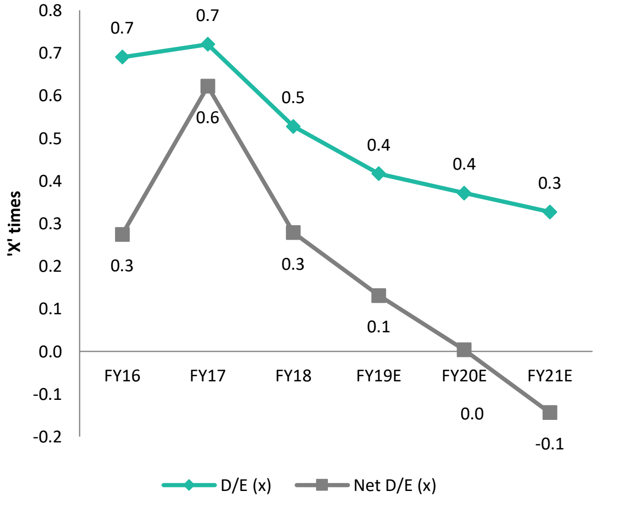
Bottom Line Performance to Remain Robust



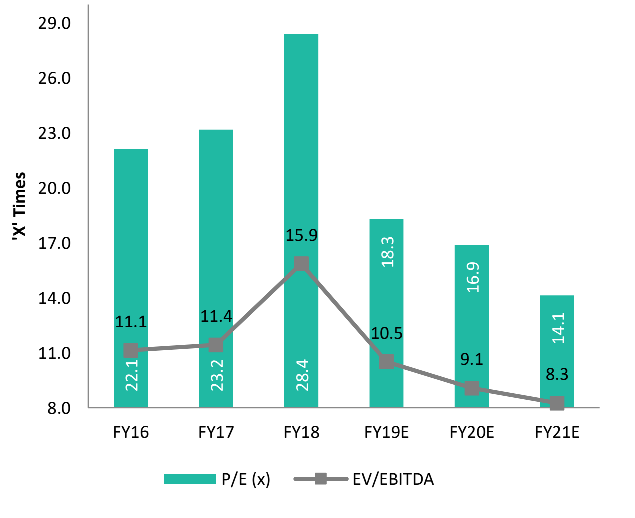
& Return Ratios to Remain Healthy..!



On the Way to Become Net Cash..!



Eye Catching Valuations..!



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Profit & Loss (INR Crores)	FY17	FY18	FY19E	FY20E	FY21E
Net sales	**1,203**	**1,431**	**1,613**	**1,886**	**2,125**
COGS	690	801	922	1,082	1,218
Employee Expenses	198	257	300	344	385
Other Expenses	113	137	148	168	180
EBITDA	**202**	**237**	**243**	**293**	**341**
D&A	27	37	45	50	53
Other income	20	21	44	19	21
EBIT	**195**	**221**	**243**	**262**	**309**
Interest Expense	29	27	25	27	28
PBT	**166**	**193**	**217**	**235**	**281**
Exceptional Items	1	0	0	0	0
PBT (Including exceptional items)	**164**	**193**	**217**	**235**	**281**
Tax	50	55	72	78	93
PAT	**114**	**138**	**146**	**158**	**188**
EPS in INR	**8.1**	**9.9**	**10.4**	**11.3**	**13.5**

Balance Sheet (INR Crores)	FY17	FY18	FY19E	FY20E	FY21E
Share Capital	14	14	14	14	14
Net Worth	**524**	**655**	**778**	**912**	**1,072**
Long Term Borrowings	193	108	99	94	89
Other Financial Liabilities	1	3	3	4	4
Long Term Provisions	8	6	6	7	8
Deferred tax liabilities (net)	66	52	59	69	77
Other non current liabilities	3	3	4	4	5
Total Non Current Liabilities	**271**	**172**	**171**	**178**	**184**
Short Term Borrowings	137	174	165	182	197
Trade Payables	105	182	212	252	287
Other Financial Liabilities	70	82	93	109	122
Other Current Liabilities	14	11	13	15	17
Short Term Provisions	10	9	11	12	14
Current tax liabilities (net)	5	16	18	20	23
Total Current Liabilities	**340**	**475**	**511**	**590**	**660**
Total Equity and Liabilities	**1,135**	**1,302**	**1,461**	**1,681**	**1,916**
Fixed and Intangible Assets	559	547	574	576	553
Loans	4	4	5	6	6
Income tax assets (net)	1	1	2	2	2
Deferred tax asset (net)	1	0	0	0	0
Other non-current assets	19	21	24	28	32
Total Non-Current Assets	**584**	**575**	**605**	**611**	**594**
Inventories	202	236	268	311	347
Investment	23	130	147	172	194
Trade receivables	244	289	323	372	413
Cash and cash equivalents	21	30	73	161	308
Other bank balances	2	2	2	2	2
Other Current Assets	61	39	44	52	58
Total Current Assets	**551**	**727**	**856**	**1,069**	**1,322**
Total Assets	**1,135**	**1,302**	**1,461**	**1,681**	**1,916**

Source: NSPL Research

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Cash Flow (INR Crores)	FY17	FY18	FY19E	FY20E	FY21E
PBT	164	193	217	235	281
Operating Profit before Working Capital Changes	215	245	287	311	361
Cash Generated from Operations	179	249	267	281	339
Less: income tax paid	-54	-31	-72	-78	-93
Cash Flow from Operating	**126**	**217**	**195**	**203**	**246**
(Incr)/ Decr in Gross PP&E	-39	-26	-71	-52	-31
Cash Flow from Investing	**-169**	**-125**	**-88**	**-76**	**-52**
(Decr)/Incr in Debt	92	-35	-17	12	10
Finance costs	-29	-28	-25	-27	-28
Cash Flow from Financing	**47**	**-85**	**-65**	**-39**	**-46**
Incr/(Decr) in Balance Sheet Cash	4	8	43	88	147
Cash at the Start of the Year	17	21	30	73	161
Cash at the End of the Year	**21**	**30**	**73**	**161**	**308**

RATIOS	FY17	FY18	FY19E	FY20E	FY21E
Profitability					
Return on Capital (%)	21.6%	22.0%	22.0%	20.9%	21.7%
Return on Equity (%)	21.7%	21.1%	18.7%	17.3%	17.6%
Margin Trend					
EBITDA Margin (%)	16.8%	16.5%	15.1%	15.5%	16.1%
Net profit Margin (%)	9.5%	9.7%	9.0%	8.4%	8.9%
Solvency					
Total Debt / Equity	0.7	0.5	0.4	0.4	0.3
Net Debt / Equity	0.6	0.3	0.1	0.0	-0.1
Valuation Ratios					
P/E	23.2	28.4	18.3	16.9	14.1
EV/EBITDA	11.4	15.9	10.5	9.1	8.3
P/B	5.0	6.0	3.4	2.9	2.5

Source: NSPL Research

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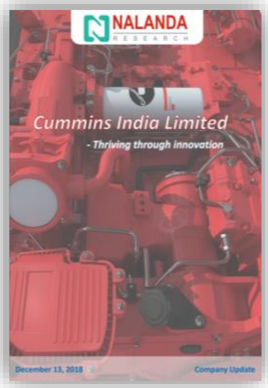

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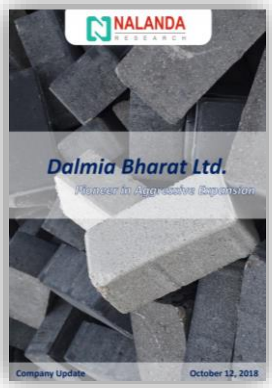

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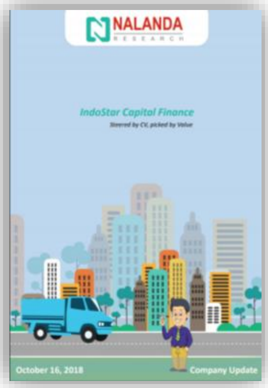

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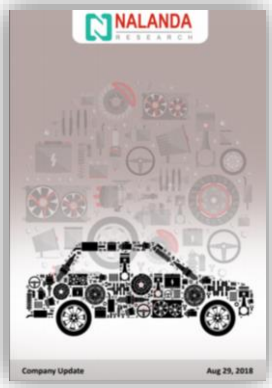

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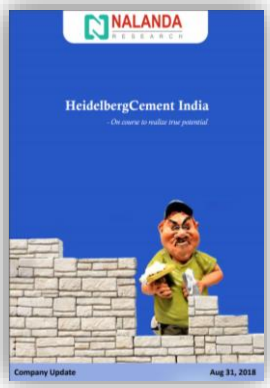

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Suprajit Engineering			
Date	CMP (INR)	Target Price (INR)	Recommendation
February 12, 2019	190	247	Strong Buy
December 20, 2018 (Company Update)	228	280	Strong Buy

Rating Legend	
Strong Buy	**More than 15%**
Buy	**5% - 15%**
Hold	**0 – 5%**
Reduce	**-5% - 0**
Sell	**Less than -5%**

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Disclosure of Interest Statement	
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Other disclosures	NO

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