India Midcaps

RESULT UPDATE

SUPRAJIT ENGINEERING

In line show; outlook robust

India Equity Research| Automobiles

Edelweiss
Ideas create, values protect

Suprajit Engineering's Q3FY17 consolidated EBITDA (including Phoenix Lamps - PHLL), at INR421mn, came in line with our estimate. Key highlights: 1) SEL to continue to outperform industry growth by 5-10% at consolidated level; Indian market growth to be in line with industry; 2) it became tier I supplier to Maruti Suzuki with a small order for speedo cable. Aims to gain significant market share over long term; 3) PHLL expects to regain lost market share post commissioning of new H7 line; margins to converge in line with SEL as production from new line ramps up; and 4) strong traction in Suprajit Europe and Suprajit Automotive led by orders from BMW, Audi and VW; exports share can scale up to 15-20% (10% currently). We upgrade to 'BUY' with TP of INR246 (INR218 earlier).

In line operating performance; PHLL surprises positively

SEL's consolidated revenue (ex PHLL and Wescon) stood at INR1.9bn (down 3% YoY), led by revenue decline in domestic business. PHLL revenues surprised positively at INR846mn, up 8% YoY (our estimate of 5% decline). Consolidated revenue (ex Wescon) was 4% below our estimate, but EBITDA margins surprised positively at 16.2% (our estimate 15.6%), leading to in line EBITDA.

Strong revenue outlook across businesses

Management remained confident of cables business outperforming industry growth by 5-10%, driven by increasing share of business among key clients and higher content per vehicle. For PHLL, enhanced product quality post the new H7 line should translate into new client order wins and enable it to recoup lost market share. Strong traction seen in export markets (Suprajit Europe and Suprajit Automotive) is an added growth driver.

Outlook and valuations: On strong footing; upgrade to 'BUY'

We believe SEL remains well placed to capitalise on its domestic and exports recovery. PHLL is expected to regain market share as restructuring phase in now behind. Over FY16-19, we estimate consolidated EPS to log CAGR of ~18% and RoE (including PHLL) to remain stable at ~21.5%. We introduce FY19E EPS of INR10.6 and upgrade to **'BUY'** with TP of INR246 (20x SEL's FY19E core EPS, INR18 cash/share, INR34 for PHLL and INR24 for Wescon).

Financials **(INR mn)**

Year to March	Q3FY17	Q3FY16	*% Chg*	Q2FY17	*% Chg*	FY16	FY17E	FY18E
Net revenues	3,132	2,605	20.2	2,816	11.2	9,525	11,059	12,597
EBITDA	478	429	11.4	468	2.1	1,543	1,911	2,210
Adjusted Profit	221	225	(1.7)	292	(24.2)	841	1,031	1,204
Adjusted Diluted EPS	1.7	1.7	(1.7)	2.2	(24.2)	6.4	7.9	9.2
Diluted P/E (x)						31.7	25.9	22.1
EV/EBITDA (x)						18.2	13.7	11.5
ROACE (%)						26.4	24.9	25.8

EDELWEISS RATINGS

Absolute Rating	**BUY**
Investment Characteristics	Growth

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

CMP	: INR 206
Target Price	: INR 246
52-week range (INR)	: 238 / 126
Share in issue (mn)	: 131.3
M cap (INR bn/USD mn)	: 27 / 405
Avg. Daily Vol. BSE/NSE ('000)	: 79.3

SHARE HOLDING PATTERN (%)

	Current	Q2FY17	Q1FY17
Promoters *	51.8	47.4	47.4
MF's, FI's & BKs	2.5	8.5	8.0
FII's	4.6	7.7	7.5
Others	41.0	36.5	37.1

** Promoters pledged shares (% of share in issue) : NIL*

PRICE PERFORMANCE (%)

	BSE Midcap Index	Stock	Stock over Index
1 month	5.6	2.4	(3.2)
3 months	7.0	4.1	(2.9)
12 months	38.8	47.4	8.7

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Q3FY17 conference call: Key highlights

Suprajit

- Post demonetisation, demand recovered in February and expects normalcy from March across both OEM and aftermarket segments.
- To continue to outperform industry growth by 5-10% at consolidated level; Indian market growth to be in line with industry growth given strong market share. However, there are pockets where the company has scope to gain market share.
- Good progress in new orders and client additions:
  - Share of business with HMSI to increase to 60%.
  - Has become a direct supplier to Maruti from being a tier II supplier. To supply Speedo cables for one of Maruti's older models. Earlier, it was supplying doors and latch components to Maruti as a tier II supplier. Aims to gain higher market share in Maruti over long term as it has done in the past with various other OEMs.
  - Has also become tier I supplier to Honda and Toyota.
  - Secured new business from Audi and BMW in export markets.
- 9mFY17 revenue mix by segment and region
  - Cable entity : 2W (52%), Auto (33%, Aftermarket (10%) and non-Auto (5%) and domestic (82%) and global (18%).
  - Consolidated (including PHLL): 2W (42%), Auto (27%), Aftermarket (28%) and non Auto (4%) and domestic (69%) and global (31%).
  - Consolidated (Including PHLL and Wescon) : 2W (39%), Auto (24%), Aftermarket (25%) and non-Auto (12%) and domestic (63%) and global (37%).
- Strong traction seen in Suprajit Europe and Suprajit Automotive
  - Securing new orders from clients like BMW, Audi and VW. Jan was the best month ever in terms of revenues.
  - Seeing good traction over next 2 years for cable exports business. Export business share can up from ~10% to 15%-20% range.
- To benefit from implementation of ABS and CBS norms as new cables will be needed.
- SEL produced 150mn cables out of 225mn capacity, implying capacity utilisation of 65-70%.
- For PHLL 56mn out of 87mn cable capacity.

Phoenix lamps

- New H7 line has been installed and being commissioned. Retired the old line and replaced with a new H7 line with better quality. There is no change in overall capacity (11mn capacity for new line versus 2 old lines of 5.2mn each).
- Multiple products like H8 and H16 can be rolled out from the same line. Expects improvement in market share, margins and realisations from Q1FY18 as production ramps up since H7 and H8 are higher priced products.

- Expects to regain business that was lost in the past couple of years; few clients might give orders once the new line is operational.
- PHLL's margins should converge in line with SEL's business going forward.
- Other income has become negative due to forex loss impact. Exceptional gain in the quarter was due to insurance claim relating to Trifa.
- RM costs were higher due to impact of absorption costs, which were bunched up in the quarter; RM costs should normalise going forward.

Wescon

- Integration remains on track.
- SEL working on 3 brand strategy:
  - SEL – Automotive brand
  - Wescon – Non-automotive segment
  - PHLL (halogen lamp brand) with 2 sub brands, Luxlite and Trifa
- Wescon operates in outdoor power equipment (OPE) segment where demand is seasonal in nature (green and white seasons)
  - Green (Apr- June) is seasonally strong for demand and suppliers starting delivering in Jan
  - Q4 and Q1 are the seasonally strongest quarters for Wescon; Q3 is the worst quarter
- Company expects a strong Q4FY17 for Wescon
- Reiterated FY18 growth guidance of USD 40mn and EBITDA margin of 16-18%
- Debt and gross block are USD25mn and USD10mn, respectively
- Wescon has flexibility to supply to its clients from any of the 3 facilities (USA, Mexico and India), each of which has a different cost structure
- Wescon has ~60% market share in North America in outdoor segment; going forward focus will on gaining market share in other segments

Margins

- Expects margins to remain stable going forward and towards upper end of the 14-16% range.
- Working on internal cost cutting measures to maintain margins

Others

- Consolidated tax rate to be in normal range
- No major capex plans across businesses over next 2 years, maintenance capex to remain ~1-2% of revenues.
- PHLL volume growth was 5% higher than value growth. Outlook remains strong from Q1FY18, once the new line commences production

Table 1: SOTP

SEL FY19 Core EPS	8.5
Target Multiple	20
SEL value per share	**170**
Surplus cash per share	18
PHLL value per share	34
Wescon value per share	24
Target price	**246**

Source: Edelweiss research

Table 2: Financial snapshot (Standalone)

Year to March	Q3FY17	Q3FY16	*% change*	Q2FY17	*% change*
Total income	1,537	1,591	***(3.4)***	1,695	***(9.4)***
Raw Material	948	981	*(3.4)*	1,066	*(11.1)*
Staff costs	195	192	*1.4*	207	*(5.6)*
Other expenses	125	133	*(6.0)*	128	*(2.0)*
Adj EBIDTA	**269**	**284**	***(5.4)***	**295**	***(8.9)***
Other income	10	30	*(65.2)*	148	*(93.0)*
Interest	58	47	*23.5*	51	*12.5*
Depreciation	27	21	*27.4*	26	*1.8*
Total tax	61	83	*(26.5)*	98	*(38.4)*
Adjusted PAT	**134**	**153**	***(12.7)***	**224**	***(40.3)***

As % of total income

Year to March	Q3FY17	Q3FY16	*bps change*	Q2FY17	*bps change*
Raw material	61.7	61.7	*(1)*	62.9	*(120)*
Staff costs	12.7	12.1	*61*	12.2	*51*
Other expenses	8.1	8.4	*(23)*	7.5	*61*
EBIDTA	**17.5**	**17.8**	***(38)***	**17.4**	***8***
Adjusted PAT	8.7	9.6	*(93)*	13.2	*(452)*
Tax rate	31.2	33.6	*(236)*	27.0	*425*

Source: Company, Edelweiss research

Financial snapshot **(INR mn)**

Year to March	Q3FY17	Q3FY16	% change	Q2FY17	% change	YTD17	FY17E	FY18E
Net revenues	3,132	2,605	*20.2*	2,816	*11.2*	8,492	11,059	12,597
Raw material costs	1,726	1,468	*17.5*	1,628	*6.0*	4,842	6,398	7,265
Staff costs	587	360	*63.2*	415	*41.4*	1,363	1,522	1,717
Other expenses	341	348	*(2.1)*	305	*11.9*	931	1,227	1,404
EBITDA	478	429	*11.4*	468	*2.1*	1,356	1,911	2,210
Depreciation	72	41	*75.6*	53	*37.6*	165	182	190
EBIT	406	388	*4.5*	415	*(2.3)*	1,191	1,730	2,020
Other income	10	78	*(87.2)*	185	*(94.6)*	210	226	211
Interest	91	61	*48.5*	69	*31.7*	220	252	243
Add: Exceptional items	(40)	10	*NA*	60	*NA*	-	-	-
Profit before tax	325	405	*(19.8)*	531	*(38.8)*	1,181	1,703	1,988
Provision for taxes	112	142	*(20.7)*	154	*(27.3)*	369	505	579
Minority interest	31	28	*9.6*	24	*27.5*	-	-	-
Reported net profit	182	235	*(22.8)*	352	*(48.5)*	731	1,199	1,408
Adjusted Profit	221	225	*(1.7)*	292	*(24.2)*	724	1,031	1,204
Diluted shares (mn)	131	131		131		120	131	131
Adjusted Diluted EPS	1.7	1.7	*(1.7)*	2.2	*(24.2)*	5.4	7.9	9.2
Diluted P/E (x)	-	-		-		-	25.9	22.1
EV/EBITDA (x)	-	-		-		-	13.7	11.5
ROACE (%)	-	-		-		-	24.9	25.8
As % of net revenues								
Raw material	55.1	56.3		57.8		57.0	57.9	57.7
Employee cost	18.7	13.8		14.7		16.0	13.8	13.6
Other expenses	10.9	13.4		10.8		11.0	11.1	11.1
EBITDA	15.3	16.5		16.6		16.0	17.3	17.5
Adjusted net profit	7.1	8.6		10.4		8.5	9.3	9.6
Reported net profit	5.8	9.0		12.5		8.6	10.8	11.2
Tax rate	34.6	34.9		29.1		31.3	29.6	29.2

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

Enviable 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	FY17E	FY18E	FY19E
Macro				
GDP(Y-o-Y %)	7.2	6.5	7.1	7.7
Inflation (Avg)	4.9	4.8	5.0	5.2
Repo rate (exit rate)	6.8	6.3	6.3	6.3
USD/INR (Avg)	65.0	67.5	69.0	69.0
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	20.0	12.0	15.0	17.0
2W	8.0	5.0	12.0	12.0
Aftermarket - Revenue assumptions	18	12	20	18
Non-Auto	(5.0)	10.0	10.0	10.0
Export - Revenue assumptions	15	24	20	15
Avg. Interest rate (%)	9.7	12.2	11.8	11.0
Depreciation rate (%)	3.6	3.8	3.8	3.8
Tax rate (%)	33.4	29.6	29.2	28.3
Dividend payout (%)	16.4	16.7	16.6	17.5
Net borrowings (INR mn)	(1,182)	(1,182)	(2,052)	(3,079)
Capex (INR mn)	1,789	300	300	300
Debtor days	64	60	47	47
Inventory days	67	62	42	43
Payable days	49	52	48	48
Cash conversion cycle	82	70	42	43

Income statement (INR mn)

Year to March	FY16	FY17E	FY18E	FY19E
Income from operations	9,525	11,059	12,597	14,421
Materials costs	5,635	6,398	7,265	8,355
Manufacturing expenses	1,093	1,227	1,404	1,603
Employee costs	1,253	1,522	1,717	1,954
Total operating expenses	7,982	9,148	10,386	11,913
EBITDA	1,543	1,911	2,210	2,508
Depreciation	158	182	190	200
EBIT	1,386	1,730	2,020	2,308
Add: Other income	155.26	225.55	210.8	221.6
Less: Interest Expense	250	252	243	225
Add: Exceptional items	(57)	-	-	-
Profit Before Tax	1,234	1,703	1,988	2,304
Less: Provision for Tax	431	505	579	652
Reported Profit	803	1,199	1,408	1,651
Exceptional Items	(38)	-	-	-
Adjusted Profit	841	1,031	1,204	1,396
Shares o /s (mn)	131	131	131	131
Adjusted Basic EPS	6.4	7.9	9.2	10.6
Diluted shares o/s (mn)	131	131	131	131
Adjusted Diluted EPS	6.4	7.9	9.2	10.6
Adjusted Cash EPS	7.6	9.2	10.6	12.2
Dividend per share (DPS)	1.1	1.3	1.5	1.9
Dividend Payout Ratio(%)	19.2	19.5	19.4	20.4

Common size metrics

Year to March	FY16	FY17E	FY18E	FY19E
Operating expenses	83.8	82.7	82.5	82.6
Materials costs	59.2	57.9	57.7	57.9
Staff costs	13.2	13.8	13.6	13.6
S G & A expenses	11.5	11.1	11.1	11.1
Depreciation	1.7	1.6	1.5	1.4
Interest Expense	2.6	2.3	1.9	1.6
EBITDA margins	16.2	17.3	17.5	17.4
Net Profit margins	8.8	9.3	9.6	9.7

Growth ratios (%)

Year to March	FY16	FY17E	FY18E	FY19E
Revenues	55.7	16.1	13.9	14.5
EBITDA	60.7	23.8	15.7	13.5
PBT	65.1	38.0	16.7	15.9
Adjusted Profit	67.3	22.6	16.8	15.9
EPS	52.9	22.6	16.8	15.9

Balance sheet (INR mn)

As on 31st March	FY16	FY17E	FY18E	FY19E
Share capital	131	131	131	131
Reserves & Surplus	4,344	5,174	6,145	7,255
Shareholders' funds	4,476	5,305	6,276	7,386
Minority Interest	542	710	914	1,170
Short term borrowings	1,829	1,376	1,376	1,376
Long term borrowings	757	679	679	679
Total Borrowings	2,586	2,056	2,056	2,056
Def. Tax Liability (net)	86	86	86	86
Sources of funds	**7,690**	**8,157**	**9,332**	**10,698**
Gross Block	4,441	4,741	5,041	5,341
Net Block	3,474	3,592	3,702	3,802
Capital work in progress	7	7	7	7
Total Fixed Assets	3,481	3,599	3,709	3,809
Cash and Equivalents	1,676	3,238	4,107	5,135
Inventories	1,669	938	1,080	1,254
Sundry Debtors	2,096	1,522	1,743	2,009
Loans & Advances	628	328	376	434
Other Current Assets	10	13	13	13
Current Assets (ex cash)	4,404	2,800	3,211	3,711
Trade payable	944	882	1,010	1,165
Other Current Liab	926	598	685	791
Total Current Liab	1,870	1,480	1,695	1,956
Net Curr Assets-ex cash	2,534	1,320	1,516	1,754
Uses of funds	**7,690**	**8,157**	**9,332**	**10,698**
BVPS (INR)	34.1	40.4	47.8	56.2

Free cash flow (INR mn)

Year to March	FY16	FY17E	FY18E	FY19E
Reported Profit	803	1,199	1,408	1,651
Add: Depreciation	158	182	190	200
Interest (Net of Tax)	166	177	172	162
Others	(15)	(151)	(140)	(158)
Less: Changes in WC	1,398	(1,213)	195	239
Operating cash flow	(286)	2,620	1,436	1,617
Less: Capex	1,789	300	300	300
Free Cash Flow	**(2,075)**	**2,320**	**1,136**	**1,317**

Cash flow metrics

Year to March	FY16	FY17E	FY18E	FY19E
Operating cash flow	(286)	2,620	1,436	1,617
Investing cash flow	(2,003)	(224)	(239)	(228)
Financing cash flow	2,016	(984)	(477)	(510)
Net cash Flow	(273)	1,412	720	878
Capex	(1,789)	(300)	(300)	(300)
Dividend paid	161	201	233	285

Profitability and efficiency ratios

Year to March	FY16	FY17E	FY18E	FY19E
ROAE (%)	21.6	21.7	21.3	21.0
ROACE (%)	26.4	24.9	25.8	25.5
Inventory Days	67	62	42	43
Debtors Days	64	60	47	47
Payable Days	49	52	48	48
Cash Conversion Cycle	82	70	42	43
Current Ratio	3.3	4.1	4.3	4.5
Gross Debt/EBITDA	1.7	1.1	0.9	0.8
Gross Debt/Equity	0.5	0.3	0.3	0.2
Adjusted Debt/Equity	0.5	0.3	0.3	0.2
Net Debt/Equity	0.2	(0.2)	(0.3)	(0.4)
Interest Coverage Ratio	5.5	6.9	8.3	10.2

Operating ratios

Year to March	FY16	FY17E	FY18E	FY19E
Total Asset Turnover	1.6	1.4	1.4	1.4
Fixed Asset Turnover	3.6	3.1	3.5	3.8
Equity Turnover	2.6	2.0	1.9	1.8

Valuation parameters

Year to March	FY16	FY17E	FY18E	FY19E
Adj. Diluted EPS (INR)	6.4	7.9	9.2	10.6
Y-o-Y growth (%)	*52.9*	*22.6*	*16.8*	*15.9*
Adjusted Cash EPS (INR)	7.3	10.5	12.2	14.1
Diluted P/E (x)	32.2	26.3	22.5	19.4
P/B (x)	6.1	5.1	4.3	3.7
EV / Sales (x)	3.0	2.4	2.0	1.7
EV / EBITDA (x)	18.5	13.9	11.8	10.1
Dividend Yield (%)	0.5	0.6	0.7	0.9

Wescon is not part of consolidated financials as we await more clarity on its growth outlook

Peer comparison valuation

	Market cap	Diluted P/E (X)		EV / EBITDA (X)		ROAE (%)	
Name	(USD mn)	FY17E	FY18E	FY17E	FY18E	FY17E	FY18E
Suprajit Engineering	405	26.3	22.5	13.9	11.8	21.7	21.3
Amara Raja Batteries	2,196	30.3	25.4	17.2	14.6	21.1	21.1
Exide Industries	2,714	25.6	22.3	15.3	13.2	15.3	16.1
Motherson Sumi Systems	7,406	31.9	24.9	12.3	9.6	27.4	25.8
Median	-	28.3	23.7	14.6	12.5	21.4	21.2
AVERAGE	-	28.5	23.8	14.7	12.3	21.4	21.1

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	33.7	Rai supriya a	10.92
Sundaram clayton ltd	4.39	Prudential icici ass	3.47
Commonwealth bank of	2.4	Dsp blackrock invest	2.32
Tvs motor company lt	2.2	Punja shobita	1.47
Mondrian em mrk sm c	1.45	Malabar india fund l	1.41

**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
13-Feb-17	**Motherson Sumi Systems**	In line quarter; *Result Update*	351	Hold
10-Feb-17	**Mahindra & Mahindra**	Muted quarter; demand outlook remains bullish; *Result Update*	1,278	Buy
09-Feb-17	**Hero MotorCorp**	Robust show; cost pressures ahead; *Result Update*	3,223	Hold

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

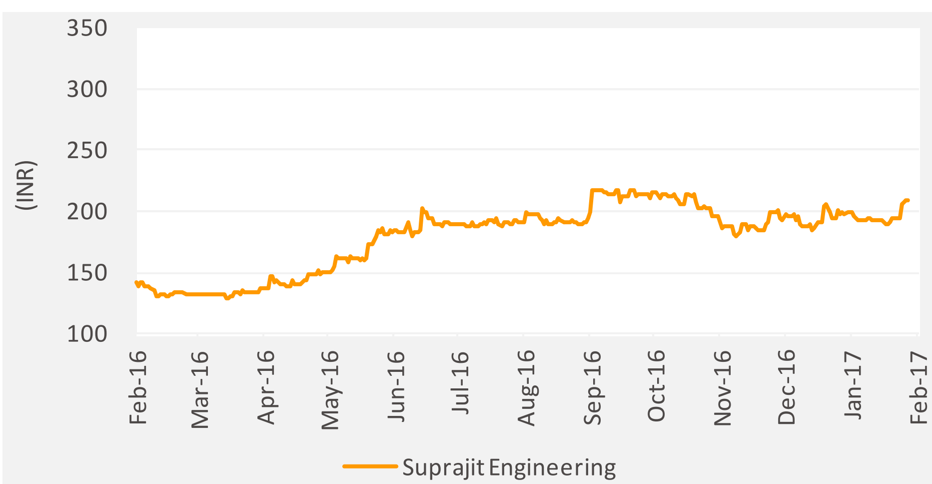
	Buy	Hold	Reduce	Total
Rating Distribution* * 1 stocks under review	161	67	11	240

	> 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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