Sharekhan by BNP PARIBAS

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Suprajit Engineering Ltd

Strong Q2; Positive outlook

Automobiles	Sharekhan code: SUPRAJIT
Reco/View: Buy ↔	CMP: **Rs. 456**
	Price Target: **Rs. 537** ↑

↑ Upgrade ↔ Maintain ↓ Downgrade

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

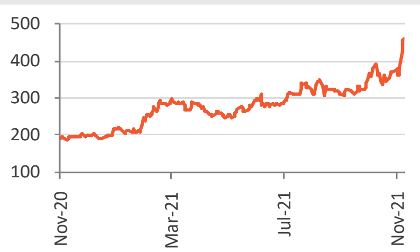
Company details

Market cap:	Rs. 6,378 cr
52-week high/low:	Rs. 475/179
NSE volume: (No of shares)	5.37 lakh
BSE code:	532509
NSE code:	SUPRAJIT
Free float: (No of shares)	7.7 cr

Shareholding (%)

Promoters	44.6
FII	4.7
DII	13.3
Others	37.4

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	21.2	36.7	80.2	138.5
Relative to Sensex	23.3	28.5	58.1	99.9

Sharekhan Research, Bloomberg

Summary

- We reiterate our Buy rating on Suprajit Engineering Limited (Suprajit) with a revised PT of Rs. 537, factoring its robust value proposition to its domestic and global clients and better multiples.
- Q2FY2022 numbers were better than expectations, with revenue, EBIDTA, and PAT improving by 36.5%, 62.6%, and 99.8%, respectively, on a q-o-q basis, helped by strong recovery in sales.
- We expect Suprajit's earnings to report a 33.7% CAGR during FY2021E-FY2023E, driven by a 22.9% revenue CAGR and 130 bps improvement in EBITDA margin, with its ROCE improving back to 22.1% in FY2023E.
- The stock trades at P/E multiple of 24.8x and EV/EBITDA multiple of 16.7x its FY2023E estimates.

Suprajit Engineering Limited's (Suprajit's) Q2FY2022 numbers were better than expectations, with revenue, EBIDTA, and PAT improving by 36.5%, 62.6%, and 99.8%, respectively, on a q-o-q basis. Net revenue improved by 11.4% y-o-y to Rs. 494 crore in Q2FY2022 because of strong sales recovery across its business verticals. On a y-o-y basis, revenue increased by 103% on a low base. EBITDA margin expanded by 260 bps q-o-q to 16.2% in Q2FY2022, led by product mix, cost reductions, and operating leverage benefits despite rise in raw-material costs. Gross margin declined by 210 bps q-o-q to 42.6%. The company reported EBITDA and PAT growth of 8.9% y-o-y and 12.4% y-o-y to Rs. 80 crore and Rs. 54 crore, respectively. Management was optimistic about sales recovery but highlighted the chips shortage issue to impact sales in the near term. We continue to remain positive on Suprajit, as the company continues to strengthen its value proposition to its domestic and global clients, aided by a leadership position in the domestic cable business and locational advantage to its global peers. We remain positive on Suprajit's growth prospects and, thus, retain our Buy rating on the stock.

Key positives

- EBITDA margin expanded by 260 bps q-o-q to 16.2% in Q2FY2022, led by product mix, cost reductions, and operating leverage benefits, despite rise in raw-material costs.
- Management outlook remains positive for the coming quarters, aided by pent-up demand and expansion of the company's product and client portfolio.

Key negatives

- Gross margin declined by 210 bps q-o-q to 42.6% in Q2, led by commodity inflation and product mix.
- Chips supply shortage remains a key concern for the management, as production of its clients might get impacted. Port congestion, container costs, and shipment delays continue to be challenging during Q2FY2022.

Management Commentary

- Management was optimistic about sales recovery but highlighted the chips shortage issue to impact sales in the near term.
- The company is planning an additional capex of about Rs. 125 crore for various new projects in hand for the next 18 months.
- Chips supply shortage remains a key concern for management, as production of its clients might get impacted.

Our Call

Valuation - Maintain Buy with a revised PT of Rs. 537: Suprajit would continue to gain wallet share from customers in the cable segment (domestic PV segment and higher sourcing by global OEM) and Phoenix Lamps (increased sourcing by Osram). Further, the company would continue to enter new segments in the non-automotive cable division. We expect FY2022E and FY2023E to be a strong year, driven by normalisation of economic activity and improving demand. Operating leverage coupled with cost-control measures would help in margin improvement. We have fine-tuned our earnings estimates, driven by the company's leadership position in the cable business. Propelled by a robust business outlook and prudent capital allocation, we expect Suprajit's earnings to report a 33.7% CAGR during FY2021E-FY2023E, driven by a 22.9% revenue CAGR and 130 bps improvement in EBITDA margin, with its ROCE improving back to 22.1% in FY2023E. The stock trades at P/E multiple of 24.8x and EV/EBITDA multiple of 16.7x its FY2023E estimates, which is trading close to the higher end of its long-term average multiples. Premium valuation is justified given the company's leadership position in the cable business. We retain our Buy rating on the stock with a revised price target (PT) of Rs. 537. .

Key Risks

Chips supply shortage, rising commodity prices, and transportation constraints remain key concerns. Moreover, delayed approval from OEMs for the incremental business may impact performance.

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22E	FY23E	FY24E
Revenue	1,641	2,001	2,478	2,872
Growth (%)	5.0	22.0	23.8	15.9
EBIDTA	237	302	389	462
OPM (%)	14.4	15.1	15.7	16.1
Net Profit	143	189	255	310
Growth (%)	37.3	32.7	34.6	21.6
EPS (Rs.)	10.3	13.7	18.4	22.4
P/E	44.2	33.3	24.8	20.4
P/BV	6.6	5.7	4.9	4.1
EV/EBIDTA	27.8	21.6	16.7	13.7
ROE (%)	14.9	17.2	19.7	20.3
ROCE (%)	16.0	18.9	22.1	23.4

Source: Company; Sharekhan estimates

Key Highlights of Q2FY2022 results and conference call

Strong performance in Q2FY2022: Suprajit's Q2FY2022 numbers were better than expectations, with revenue, EBIDTA, and PAT improving by 36.5%, 62.6%, and 99.8%, respectively, on a q-o-q basis. Net revenue improved by 11.4% y-o-y to Rs. 494 crore in Q2FY2022 because of strong sales recovery across its business verticals. On a y-o-y basis, revenues increased by 103% on a low base. EBITDA margin expanded by 260 bps q-o-q to 16.2% in Q2FY2022, led by product mix, cost reductions, and operating leverage benefits despite rise in raw-material costs. Gross margin declined by 210 bps q-o-q to 42.6%. The company reported EBITDA and PAT growth of 8.9% y-o-y and 12.4% y-o-y to Rs. 80 crore and Rs. 54 crore, respectively. The company's automotive cable business saw a significant improvement in operational performance. EBITDA margin of the automotive cable business improved by 190 bps y-o-y to 19.9% in Q2.

Positive management commentary: Management was cautiously optimistic about recovery in the medium term, though chips supply shortage globally is a concern for management. The company expects domestic demand to continue to recover going forward. The company expects to grow at a faster pace than the industry, given its leadership and dominant positions in its businesses. Management expects robust business traction in the medium term, aided by introducing new products to existing clients and selling old products to new clients. The company expects to operate at more than 90% capacity in all its plans, aided by expected strong pick-up in both OEM as well as replacement markets.

Beneficiary of value proposition to its established and potential clients: Suprajit continues to strengthen its value proposition to its domestic and global clients. The company has a strong foothold in the cable business in the automotive segment, where it holds 30-35% market share. The company has a dominant 60-65% market share in the two-wheeler cable business. As per estimates shared by the company, Suprajit has a 40-45% market share in the cable business in Indian markets, including the non-automotive business. Key drivers for Suprajit's success are its ability to produce low-cost cables among domestic players, aided by its operational efficiency and dedicated plants for respective clients. Among global peers, the company benefits from its locational cost advantage. Corresponding to the cable business, Suprajit has similar cost advantages in its lamps division, where its key global competitors include Philips India Limited. The lean and low-cost employee structure and scale of operations help Suprajit maintain its competitive benefits across its product lines – automotive cable, non-automotive cables, and lamp business division.

Acquisition of LDC business: The company has signed a Definitive Share and Asset Purchase Agreement to acquire Light Duty Cable (LDC) business unit with Kongsberg Automotive ASA, listed on the Oslo Stock Exchange, Norway. The enterprise value of the transaction is pegged at US$ 42 million. Key details of the transaction are as follows:

- The LDC business unit of Kongsberg Automotive Group consists of cable business, supplying to automotive, non-automotive, and two-wheeler segments along with Electro-Mechanical Actuators (EMA). EMA will become a new product segment to Suprajit with significant new opportunities.
- This transaction also involves the transfer of global sales and engineering expertise related to this business to Suprajit. The transaction is expected to close by the end of January 2022.
- Total employee strength of LDC is approximately 1,300 employees at the end of Q2. The current year's sale is expected to be in the range of US$90 million. LDC is expected to have close to US$100 million in revenue with double-digit EBITDA next year.
- **LDC consists of three manufacturing plants located in Matamoros – Mexico, Siofok - Hungary, and Shanghai** – China, and a warehouse in Brownsville – USA. The new acquisition would provide Suprajit's automotive footprint in America and China and expand the footprint in Europe.
- The current installed capacity of LDC division is 106 million cables per annum. With this acquisition, the group's cable installed capacity will increase to 400+ million cables per year.
- **Impact:** The new acquisition would significantly increase and strengthen Suprajit's presence in the cables business globally, with deeper penetration in the automotive market. The company will get access to new customers in the global market, which will help it increase its revenue.

Strong broad-based growth; Expect robust double-digit growth in the medium term: The company has a strong long-term revenue visibility, given its strong position in the cable and lamps business. We expect Suprajit's earnings to report a 33.7% CAGR during FY2021E-FY2023E, driven by a 22.9% revenue CAGR and 130 bps improvement in EBITDA margin, with its ROCE improving to 22.1% in FY2023E. The company is open to grow inorganically in the auto ancillary space and diversify its portfolio. The company has a history of acquiring companies for its expansion of customer base, new geographies, and increasing dominancy in its core business.

Results (Consolidated) Rs cr

Particulars	Q2FY22	Q2FY21	YoY (%)	Q1FY22	QoQ (%)
Revenue	494	443	11.4	362	36.5
Total operating expenses	414	370	11.9	312	32.4
EBITDA	80	73	8.9	49	62.6
Depreciation	15	14	1.8	14	2.0
Interest	4	6	(35.9)	5	-25.2
Other income	15	9	76.6	7	129.7
PBT	77	62	23.9	37	109.7
Tax	23	14	63.3	10	137.2
Adjusted PAT	54	48	12.4	27	99.8
Reported PAT	50	48	3.1	43	14.8
Adjusted EPS (Rs.)	3.9	3.4	13.6	2.0	99.8

Source: Company, Sharekhan Research

Key Ratios (Consolidated)

Particulars	Q2FY22	Q2FY21	YoY (bps)	Q1FY22	QoQ (bps)
Gross margin (%)	42.6	41.2	140	44.7	-210
EBIDTA margin (%)	16.2	16.6	-40	13.6	260
EBIT margin (%)	13.3	13.3	-10	9.6	360
Net profit margin (%)	10.9	10.8	10	7.5	350
Effective tax rate (%)	29.9	22.7	720	26.4	350

Source: Company, Sharekhan Research

Divisional Performance Rs cr

Particulars	Q2FY22	Q2FY21	YoY (%)	Q1FY22	QoQ (%)
Phoenix Lamps Division (Including Trifa & Luxlite)					
Operating revenue	92.5	92.2	0.4	61.0	51.7
EBITDA (Operational)	8.9	13.6	(34.6)	3.9	130.5
EBITDA margin (%)	9.6	14.8	(520 bps)	6.3	330 bps
SENA Division (including India and Wescon US)					
Operating revenue	101.1	78.6	28.6	103.8	(2.6)
EBITDA (Operational)	11.5	10.9	5.9	16.2	(28.8)
EBITDA margin (%)	11.4	13.8	(240 bps)	15.6	(420 bps)
Automotive Cable division					
Operating revenue	300.1	272.4	10.2	196.9	52.4
EBITDA (Operational)	59.6	49.0	21.7	29.2	104.2
EBITDA margin (%)	19.9	18.0	190 bps	14.8	510 bps

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Demand remains strong in both domestic and export markets, while near-term supply disruption remains a challenge

Business outlook for the automotive segment is expected to improve with the normalisation of economic activities. Automotive demand is expected to witness recovery in the two-wheeler and four-wheeler segments, aided by pent-up demand and increased personal mobility transport. Rural and semi-urban demand remains buoyant on robust farm income from the previous year, with a large reservoir and early arrival of monsoon. Recovery in export destinations is auguring well for the sector. Moreover, exports provide a huge growth potential, given India's cost-effective manufacturing, being geographically closer to key markets of Middle East and Europe and being the second largest producer of key raw material, steel. Rollout of COVID-19 vaccination programmes in many countries is keeping the overall outlook positive for the coming months, following the respective approval of various vaccines. Auto component exports are expected to grow from $15 billion to $80 billion by FY2027.

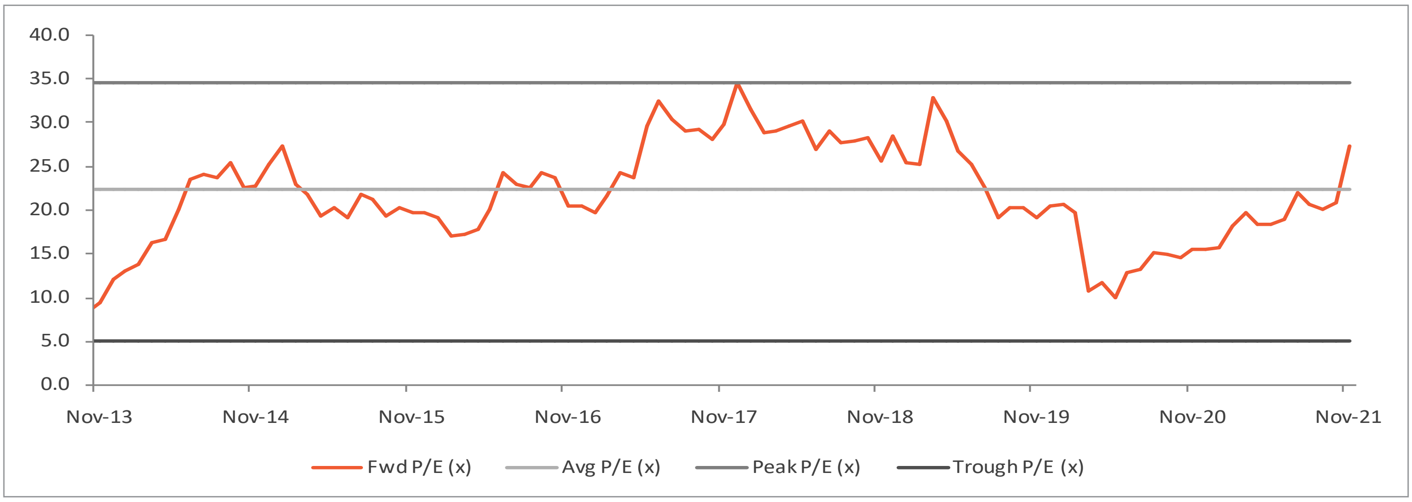
■ Company outlook - Beneficiary of two-wheeler and PV demand

Suprajit is one of the largest manufacturers of mechanical control cables with a presence in both automotive and non-automotive segments. Revenue growth has been healthy in the pre-COVID regime, driven by a steady offtake and diversification into the aftermarket and exports segments. The company has entered segments such as lamps and has started catering to non-automotive segments through acquisitions and has augmented capacities in the cables business. The company has been gaining market share in the domestic cable division with increased share of business with automotive clients. The company's market share in two-wheelers is 60-65%, while that for the automotive business is at 30-35%. Market share for the Indian market is at 40-45%. The aftersales market, both at Suprajit and Phoenix Lamps division, has been strong along with encouraging offtake from OEMs. The company is in talks with leading PV players such as Maruti Suzuki to further increase sourcing. In non-automotive cables, the company is planning to enter into new segments such as medical device equipment, consumer durables, and agriculture and construction equipment, which would drive growth. Under the lighting segment, Suprajit has recently acquired Osram manufacturing facility for halogen lamps to become the world's third largest player and is expanding its presence in the aftermarket segment by entering into new geographies. We expect Suprajit to continue outpacing the domestic automotive OEM industry.

■ Valuation - Maintain Buy with a revised PT of Rs. 537

Suprajit would continue to gain wallet share from customers in the cable segment (domestic PV segment and higher sourcing by global OEM) and Phoenix Lamps (increased sourcing by Osram). Further, the company would continue to enter new segments in the non-automotive cable division. We expect FY2022E and FY2023E to be a strong year, driven by normalisation of economic activity and improving demand. Operating leverage coupled with cost-control measures would help in margin improvement. We have fine-tuned our earnings estimates, driven by the company's leadership position in the cable business. Propelled by a robust business outlook and prudent capital allocation, we expect Suprajit's earnings to report a 33.7% CAGR during FY2021E-FY2023E, driven by a 22.9% revenue CAGR and 130 bps improvement in EBITDA margin, with its ROCE improving to 22.1% in FY2023E. The stock trades at P/E multiple of 24.8x and EV/EBITDA multiple of 16.7x its FY2023E estimates, which is trading close to the higher end of its long-term average multiples. Premium valuation is justified given the company's leadership position in the cable business. We retain our Buy rating on the stock with a revised PT of Rs. 537.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Company	CMP (Rs)	P/E (x)			EV/EBITDA (x)			ROCE (%)		
		FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
Suprajit Engineering	456	33.9	25.6	20.1	21.6	16.7	13.4	16.0	18.9	21.1
Schaeffler India*	7757	83.3	43.9	32.4	42.9	25.7	19.2	12.4	20.6	23.0
Sundram Fasteners	819	47.6	37.0	24.6	26.6	21.2	15.1	16.0	18.8	24.5

*Source: Company Data; Sharekhan Research; * Financials are for CY2020, CY2021E and CY2022E*

About company

Suprajit is a global leader in the automotive cable and halogen bulb industry. With a competitive manufacturing base in India, UK, US, and Mexico, along with technical and logistical supports worldwide, the company provides optimal product development and manufacturing solutions to its domestic and international customers. With a CAGR of over 25%, Suprajit has one of the largest manufacturing capacities in the world with 300+ million cables per year and 110+ million bulbs per year. Suprajit is a well-diversified company deriving 60% of its revenue from global operations, while 40% of its revenue is derived domestically. 2W is the largest segment contributing 37% to revenue, while 20% revenue is derived from the automotive (4W) segment. Aftermarket constitutes 23% of revenue, while the non-automotive segment constitutes 20% of revenue.

Investment theme

Suprajit is one of the largest manufacturers of mechanical control cables with a presence in both automotive and non-automotive segments. Revenue growth has been healthy in the pre-COVID regime, driven by steady offtake and diversification into aftermarket and exports segments. The company continues to strengthen its value proposition to its domestic and global clients, aided by its leadership position in the domestic cable business and locational advantage to its global peers. Key drivers for Suprajit's success are its ability to produce low-cost cables among domestic players, aided by its operational efficiency and dedicated plants for respective clients. The company has entered segments such as lamps and has started catering to non-automotive segments through acquisitions and has augmented capacities in the cables business. The company has been gaining market share in the domestic cable division with increased share of business with automotive clients. The company's market share in 2W is 60-65%, while that for automotive business at 30-35%. Market share in the Indian market is 40-45%. The aftersales market both at Suprajit and Phoenix Lamps division has been strong along with encouraging offtake from OEMS. We expect Suprajit to benefit from strong demand witnessed in domestic as well as export markets, aided by recovery in economic activities. The company will also benefit from its capex plan strategy, which will help it capitalise further in the next peak season.

Key Risks

- Chips supply shortage, rising commodity prices, and transportation constraints remain key concerns.
- Delayed approval from OEMs for incremental business could impact performance.

Additional Data

Key management personnel

Ajith Rai	Executive Chairman
Mohan N.S.	Managing Director and Group CEO
Peter Greensmith	CEO-Suprajit Europe
Steve Fricker	CEO-Wescon Controls
Medappa Gowda J	CFO and Company Secretary

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Supriyajith Family Trust	38.0
2	Dsp Small Cap Fund	5.3
3	Hdfc Small Cap Fund	5.2
4	Sundaram-Clayton Ltd.	4.1
5	Kula Ajith Kumar Rai	2.7
6	Tvs Motor Co. Ltd.	2.1
7	Shobita Punja	1.4
8	Emerging Securities Pvt. Ltd.	1.4
9	India Capital Fund Limited	1.4
10	Kula Ramprasad Rai	1.3

Source: Bloomberg