Subros

BUY

INDUSTRY	AUTOS
CMP *(as on 20 Apr 2018)*	Rs 328
TP	Rs 384
Nifty	10,564
Sensex	34,465

KEY STOCK DATA	
Bloomberg	SUBR IN
No. of Shares (mn)	60
MCap (Rsbn) / ($ mn)	20/300
6m avg traded value (Rsmn)	50

STOCK PERFORMANCE (%)			
52 Week high / low			Rs 444/212
	3M	6M	12M
Absolute (%)	(11.6)	31.0	42.6
Relative (%)	(8.6)	24.6	25.5

SHAREHOLDING PATTERN (%)	
Promoters	40.01
FIs & Local MFs	6.63
FPIs	0.43
Public & Others	52.93

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Growth + cash flows = BUY

SUBROS has corrected by nearly 30% over the last three months on concerns of Truck AC business. This was post the government's policy change allowing blowers in trucks above 3.5T, instead of complete ACs. Since blowers are cheaper (by ~80% vs ACs) the boost to topline will be much lesser. However, we still believe this business will help add Rs 1.2-1.5bn from FY19 and grow faster than the rest of the business, given its nascent stage.

Meanwhile, Subros' core PV AC business will continue to deliver strong growth (14% CAGR over FY18-20E) helped by faster growth in Maruti, Tata Motors and M&M PV sales and wallet-market share gains. More importantly, growth potential of new businesses like Truck/Bus Aircon, radiators and Condensers is very high (~30% CAGR over the next 3-5 years) and provides scale and diversification.

In 9MFY18, Subros saw 21/49% growth in Revenue/PAT. Key positives include (1) Steady volume growth ~8% in PVs over FY18E, plus rising wallet share at key OEMs (+400bps YoY increase in PV marketshare in FY18) driven by refreshes and new models like Swift, Dzire, Baleno, Brezza, Renault Kwid, Tata Tiago, (2) Strong traction in Truck Aircons and Radiators, and (3) ROE expansion with improvement in margin (4) Improving cash flows, leading to debt reduction.

We expect EPS growth of 45% CAGR over FY18-20E led by 17% CAGR in top line, 70 bps margin expansion and 35% cut in interest cost. Upgrade from Neutral to BUY with TP of Rs 384 (20x FY20E EPS).

Key highlights

- **Gaining market share in PVs:** In one year, Subros has gained 400 bps to 39% market share in PV ACs. We believe recently launched Maruti's refreshed model Swift and capacity expansion (1.5mn to 2.5mn units) will aid strong growth ahead.
- **Traction in Truck/Bus Aircon and Radiator business:** After building significant market share in domestic PVs AC segment, the company embarked on diversifying its revenue base through entry into new business verticals like bus/truck ACs, radiators and Railways. Recent government steps to make mandatory ACs or blower in CVs opens up another revenue stream. The company claims a 70% market share in this segment and expects the CV business to contribute 25% (currently ~6%) of the business in long term. Moreover sustainable revenue from radiator business will support the earnings growth of the company.
- **Strong FCV generation:** We expect Subros to generate FCF of Rs 4.8bn over FY18-21E (19% of current EV). This will help to deleverage its balance sheet.

Financial Summary

Y/E Mar (Rs. mn)	FY16	FY17	FY18E	FY19E	FY20E
Net Sales	13,069	15,495	18,605	21,958	25,516
EBITDA	1,521	1,671	2,000	2,438	2,933
APAT	240	341	546	802	1,151
Diluted EPS (Rs)	4.0	5.7	9.1	13.4	19.2
P/E (x)	82.5	58.1	36.2	24.7	17.2
EV / EBITDA (x)	15.6	14.4	11.8	9.5	7.7
RoE (%)	7.4	10.0	14.8	19.1	23.3

Source: Company, HDFC sec Inst Research

Maruti Suzuki is the largest client for Subros constituting about 75% of the overall revenues but dependence expected to reduce to 65% in medium term owing to new client acquisition and revenue from other verticals

The current capacity utilisation has reached ~90% in ACs for the PV segment

The company is aiming for Greenfield expansion for Suzuki Motors in Gujarat. Subros to increment capacity from 1.5mn from2.5mn- with capex Rs 1.30bn that will be spread into 3 years.

Recently, the company tied up with Ashok Leyland, SML Isuzu, M&M and Tata Motors for supplying blower assemblies for CVs

Subros is keen to secure business from State Transport Undertakings (STUs). Most of them are expanding their AC bus fleet.

Betting on strong growth in PV segments

- Subros commands a dominant market share (39% market share) in domestic PV AC business with higher wallet share across all OEMs. Subros is supplying close to 60/50/30% of the total AC requirement of MSIL/Tata Motors/M&M. The company is supplying AC in all high selling models, Swift, Dzire, Baleno, Brezza and enjoys most from Maruti's gain. The company has gained 400bps YoY market share in PV AC business and expected to grab further market share on the back of strong demand of Maruti's refreshed model Swift. Subros targets to increase the capacity from 1.5mn to 2.5mn units by 2021. This additional capacity of 1mn will require investment of Rs 1-1.3 bn.

- We expect Subros revenue from the PV segment to grow at a CAGR of 14% over FY18-20E, on account of market share gain by Maruti and industry leading growth.

Truck Aircon opens up new revenue stream

- The demand for fully-built CVs with an AC is rising, triggering a shift from economy CVs to value CVs. With the government mandating the fitting of a blower or AC unit in category N2 and N3, (trucks above 3.5T), AC market for CVs is opening up in India. In addition, AC bus and reefer truck market experiencing strong demand – the market for AC bus is estimated to be between 15-20k per annum. Although, government amendment that blower can be used in category N2 and N3, (trucks above 3.5T) instead of ACs constraints its growth visibility, we still believe that this business will help aid more than Rs 1.2-1.5bn per annum in its top line(assuming 75:25 blower: AC mix and 50% market share)

Radiator business to grow with faster pace

- Subros had entered into a MoU with Denso Corporation for supply of cooling modules and radiators in FY17. The company is supplying radiators to Hyundai, Maruti, and Toyota through Denso, and expects revenue of Rs 2bn in FY18E (Rs 1.60bn in 9MFY18). We expect radiator business to grow at 15-20% CAGR over next three years.

Strong order book in railway segment

- Currently Subros is present in railway driver's cabin ac's only; going ahead focus would be more towards railway coaches. For railway ac's company will compete with players like Air International, Bombardier etc. Subros is also evaluating opportunities in Metro ac's coach segment where majority of metro ac's are imported from China, Korea and Australia. Railways revenue for 9MFY18 was Rs170mn, expect FY18 revenue could be ~Rs200mn. Annual run rate from Railway business expected to be ~Rs200-250mn.

Levers for margin expansion and strong FCF generation

- Currently, the import content is 40% of raw material cost. The management expects to gradually reduce the import content to 25% over the next 2-3 years. This will result in improved gross margins going forward. We expect Subros to generate FCF of Rs 4.8bn over FY18-21E (19% of current Enterprise value). This will help to deleverage its balance sheet.

The passenger vehicle segment contributes ~90% to Subros' revenues. An expected up cycle in the segment would boost Subros' revenues

The company expects the CV business to contribute 25% of the business in long term

The demand for AC buses is at a nascent stage today, we expect it to rise significantly.

FCF(Rs mn)

Rs mn	FY15	FY16	FY17	FY18E	FY19E	FY20E
Operating Cash Flow	1,345	1,456	1,194	1,616	2,015	2,126
Capex	-1081	-751	-1153	-538	-980	-980
Free cash flow (FCF)	264	706	41	1,078	1,035	1,146

Key Assumptions

Segment Rs mn	FY16	FY17	FY18E	FY19E	FY20E
Revenue from AC Supply (Cars, UVs)	**12,899**	**14,465**	**15,712**	**17,873**	**20,452**
Revenue from Other business	**130**	**985**	**2,842**	**4,033**	**5,012**
CV & Bus ACs		*480*	*580*	*1,331*	*1,735*
Radiators		*370*	*1,920*	*2,280*	*2,720*
Home ACs		*25*	*82*	*102*	*157*
Transportation refrigeration	*20*	*10*	*50*	*70*	*100*
Railways	*110*	*100*	*210*	*250*	*300*
Other Operating income	*40*	*45*	*50*	*52*	*52*
Total	**13,069**	**15,495**	**18,605**	**21,958**	**25,516**

Source: Company, HDFC sec Inst Research

Peer Valuations

	Mcap (Rsbn)	CMP (Rs/sh)	Rating	TP	Adj EPS (Rs/sh)			P/E (x)			EV/EBITDA (x)			RoE (%)		
					FY18E	FY19E	FY20E	FY18E	FY19E	FY20E	FY18E	FY19E	FY20E	FY18E	FY19E	FY20E
Exide Industries	207	243	BUY	262	8.5	11.0	12.6	28.5	22.0	19.3	17.3	16.2	12.5	21.4	20.3	23.8
Jamna Auto	38	96	NEU	90	3.0	3.8	4.8	31.8	25.0	20.1	18.6	14.7	11.9	32.5	33.3	33.5
Suprajit Engineering	36	275	NEU	296	10.3	14.0	16.6	26.7	19.6	16.6	16.0	12.3	10.6	24.6	26.5	25.0
Ramkrishna Forgings	24	828	BUY	913	19.6	34.9	51.3	42.3	23.7	16.1	13.2	10.0	7.5	10.5	14.7	18.7
Subros	**20**	**328**	**BUY**	**384**	**9.1**	**13.4**	**19.2**	**36.2**	**24.7**	**17.2**	**11.8**	**9.5**	**7.7**	**14.8**	**19.1**	**23.3**
JBM Auto	18	440	BUY	560	18.3	24.8	31.2	24.0	17.7	14.1	9.5	8.0	6.7	17.3	18.4	19.5
NRB Bearing	16	170	BUY	204	7.4	8.7	10.2	22.9	19.5	16.7	13.1	11.3	9.9	21.0	21.3	21.4
Lumax Autotech	12	905	BUY	987	36.3	43.8	54.9	24.9	20.6	16.5	10.3	8.4	6.5	14.7	15.8	17.4

Source: Company, HDFC sec Inst Research

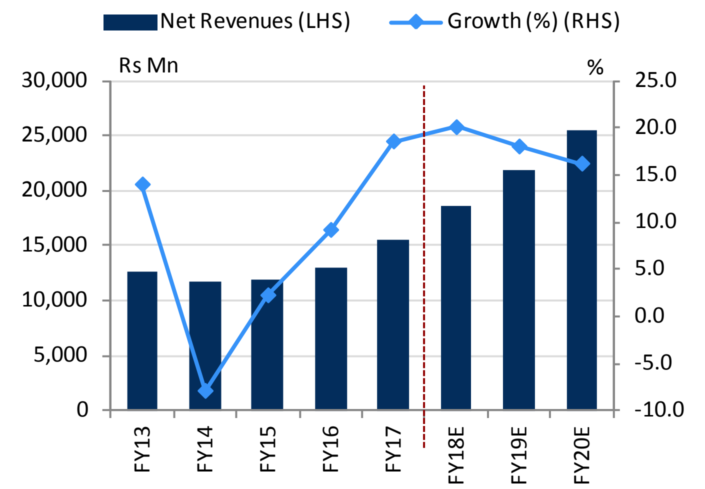
We expect 17% CAGR growth in revenue over FY18-20E on the back of 14% growth in AC from PV segment and 32% growth from new verticals

Subros is targeting to reduce the import of components from 40% to 25% and improve the EBITDA margin by 250-300bps over the next two to three years. This can be an upside risk for our valuation

In-house manufacturing and higher capacity utilization to aid in margin improvements

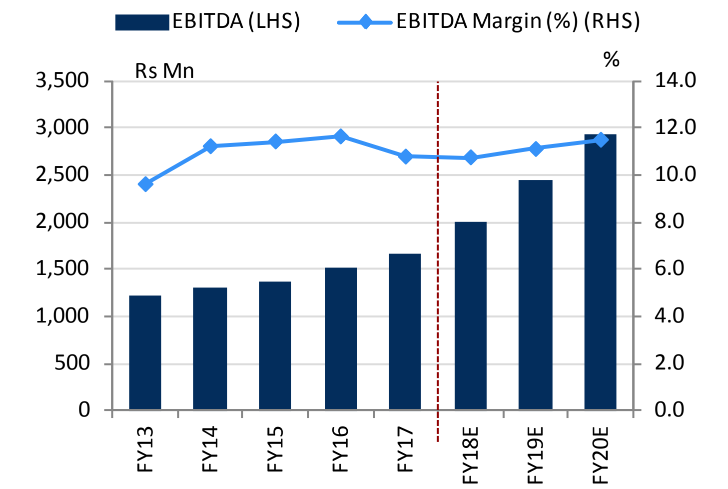
On the back of strong cash flow generation and lower capex (average Rs.750mn over FY18-20E vs past five year average capex of Rs. 1.2 bn), Subros continues to reduce debt

17% Revenue CAGR Over FY18-20E



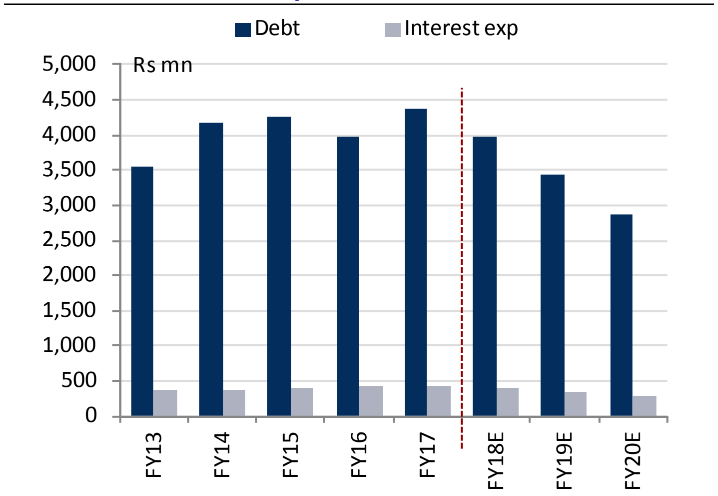
Source: Company, HDFC sec Inst Research

EBITDA Margin Inching Upward



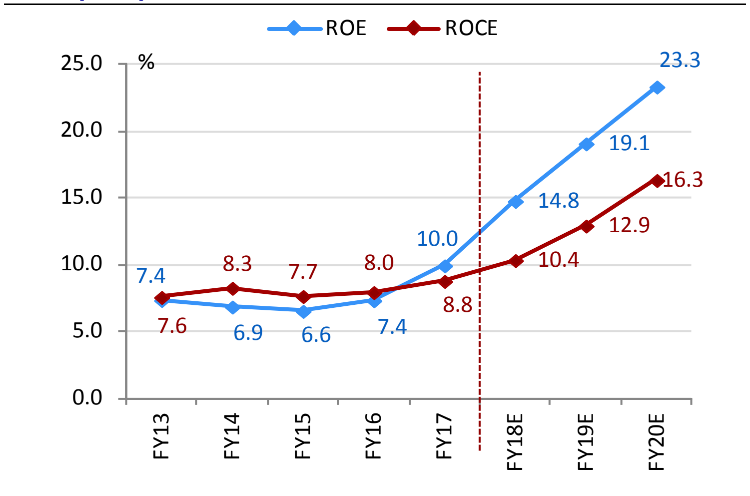
Source: Company, HDFC sec Inst Research

Debt And Interest Expenses To Go Down



Source: Company, HDFC sec Inst Research

Sharp Improvement In Return Ratios



Source: Company, HDFC sec Inst Research

Income Statement (Standalone)

(Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
Net Revenues	**13,069**	**15,495**	**18,605**	**21,958**	**25,516**
Growth (%)	***9.2***	***18.6***	***20.1***	***18.0***	***16.2***
Material Expenses	8,840	10,709	12,837	14,975	17,325
Power & Fuel expenses	237	252	316	373	459
Employee Expenses	1,262	1,539	1,730	2,130	2,398
Other Operating Expenses	1,208	1,325	1,721	2,041	2,399
EBITDA	**1,521**	**1,671**	**2,000**	**2,438**	**2,933**
EBITDA Margin (%)	***11.6***	***10.8***	***10.7***	***11.1***	***11.5***
EBITDA Growth (%)	***11.2***	***9.8***	***19.7***	***21.9***	***20.3***
Depreciation	864	879	918	1,016	1,088
EBIT	**657**	**791**	**1,082**	**1,422**	**1,846**
Other Income (Incl. EO Items)	24	(277)	45	48	52
Interest	417	422	399	357	298
PBT	**264**	**92**	**728**	**1,114**	**1,599**
Tax (Incl Deferred)	24	(49)	182	312	448
RPAT	**240**	**141**	**546**	**802**	**1,151**
EO (Loss)/Profit (Net of Tax)	-	(200)	-	-	
APAT	**240**	**341**	**546**	**802**	**1,151**
APAT Growth (%)	***18.1***	***42.1***	***60.2***	***46.8***	***43.6***
Adjusted EPS (Rs)	**4.0**	**5.7**	**9.1**	**13.4**	**19.2**
EPS Growth (%)	***18.1***	***42.1***	***60.2***	***46.8***	***43.6***

Source: Company, HDFC sec Inst Research

Balance Sheet (Standalone)

(Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
SOURCES OF FUNDS					
Share Capital - Equity	120	120	120	120	120
Reserves	3,234	3,370	3,780	4,382	5,245
Total Shareholders' Funds	**3,354**	**3,490**	**3,900**	**4,502**	**5,365**
Minority Interest					
Long Term Debt	2,898	2,669	2,269	1,769	1,269
Short Term Debt	1,083	1,707	1,720	1,660	1,600
Total Debt	**3,980**	**4,376**	**3,989**	**3,429**	**2,869**
Net Deferred Taxes	295	246	211	215	220
Long Term Provisions & Others	102	56	56	56	56
TOTAL SOURCES OF FUNDS	**7,731**	**8,169**	**8,157**	**8,202**	**8,510**
APPLICATION OF FUNDS					
Net Block	5,740	5,222	5,863	5,847	5,760
CWIP	449	1,241	220	200	180
Investments	25	25	25	25	25
LT Loans & Advances	466	587	504	504	504
Total Non-current Assets	**6,680**	**7,075**	**6,612**	**6,576**	**6,469**
Inventories	1,766	2,052	2,141	2,527	3,006
Debtors	986	1,302	1,172	1,384	1,748
Other Current Assets	507	980	1,081	1,233	1,368
Cash & Equivalents	70	83	240	157	157
Total Current Assets	**3,328**	**4,418**	**4,633**	**5,300**	**6,278**
Creditors	1,293	1,786	1,786	2,137	2,450
Other Current Liabilities &Provns	985	1,539	1,302	1,537	1,786
Total Current Liabilities	**2,278**	**3,324**	**3,088**	**3,674**	**4,237**
Net Current Assets	**1,050**	**1,093**	**1,545**	**1,626**	**2,042**
TOTAL APPLICATION OF FUNDS	**7,731**	**8,169**	**8,157**	**8,202**	**8,510**

Source: Company, HDFC sec Inst Research

Cash Flow Statement(Standalone)

(Rsmn)	FY16	FY17	FY18E	FY19E	FY20E
Reported PBT	264	92	728	1,114	1,599
Non-operating & EO items			-	-	-
Interest expenses	417	422	399	357	298
Depreciation	864	879	918	1,016	1,088
Working Capital Change	(32)	(176)	(212)	(164)	(416)
Tax Paid	(57)	(23)	(217)	(308)	(443)
Other operating Items	-	-			
OPERATING CASH FLOW (a)	**1,456**	**1,194**	**1,616**	**2,015**	**2,126**
Capex	(751)	(1,153)	(538)	(980)	(980)
Free cash flow (FCF)	*706*	*41*	*1,078*	*1,035*	*1,146*
Investments		-		-	-
Non-operating Income	-		-	-	-
INVESTING CASH FLOW (b)	**(751)**	**(1,153)**	**(538)**	**(980)**	**(980)**
Debt Issuance/(Repaid)	(288)	395	(387)	(560)	(560)
Interest Expenses	(417)	(422)	(399)	(357)	(298)
FCFE	*0*	*14*	*292*	*118*	*287*
Share Capital Issuance	(48)	(78)	(137)	(200)	(288)
Dividend					
FINANCING CASH FLOW (c)	**(670)**	**(28)**	**(922)**	**(1,117)**	**(1,146)**
NET CASH FLOW (a+b+c)	**35**	**13**	**156**	**(82)**	**(1)**
EO Items, Others	35	70	84	240	157
Closing Cash & Equivalents	70	84	240	157	157

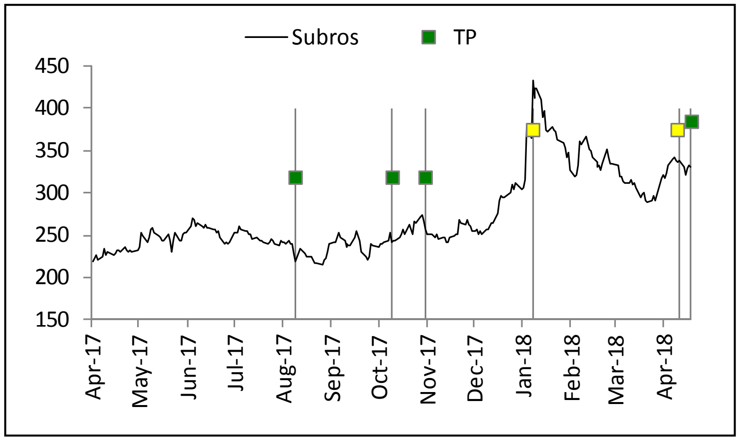
Source: Company, HDFC sec Inst Research

Key Ratios (Standalone)

	FY16	FY17	FY18E	FY19E	FY20E
PROFITABILITY (%)					
GPM	32.4	30.9	31.0	31.8	32.1
EBITDA Margin	11.6	10.8	10.7	11.1	11.5
APAT Margin	1.8	2.2	2.9	3.7	4.5
RoE	7.4	10.0	14.8	19.1	23.3
RoIC (or Core RoCE)	7.8	8.6	10.2	12.8	16.2
RoCE	8.0	8.8	10.4	12.9	16.3
EFFICIENCY					
Tax Rate (%)	9.2	(52.6)	25.0	28.0	28.0
Fixed Asset Turnover (x)	1.14	1.41	1.68	1.88	2.20
Inventory (days)	*49.3*	*48.3*	*42.0*	*42.0*	*43.0*
Debtors (days)	*27.5*	*30.7*	*23.0*	*23.0*	*25.0*
Other Current Assets (days)	*14.1*	*23.1*	*21.2*	*20.5*	*19.6*
Payables (days)	*36.1*	*42.1*	*35.0*	*35.5*	*35.1*
Other Current Liab&Provns (days)	*27.5*	*36.2*	*25.6*	*25.6*	*25.6*
Cash Conversion Cycle (days)	27.4	23.8	25.6	24.4	27.0
Debt/EBITDA (x)	2.6	2.6	2.0	1.4	1.0
Net D/E (x)	1.2	1.2	1.0	0.7	0.5
Interest Coverage (x)	1.6	1.9	2.7	4.0	6.2
PER SHARE DATA (Rs)					
EPS	4.0	5.7	9.1	13.4	19.2
CEPS	18.4	17.0	24.4	30.3	37.3
Dividend	1.6	1.3	2.3	3.3	4.8
Book Value	55.9	58.2	65.0	75.0	89.4
VALUATION					
P/E (x)	82.5	58.1	36.2	24.7	17.2
P/BV (x)	5.9	5.7	5.1	4.4	3.7
EV/EBITDA (x)	15.6	14.4	11.8	9.5	7.7
EV/Revenues (x)	1.8	1.6	1.3	1.1	0.9
OCF/EV (%)	6.1	5.0	6.9	8.7	9.4
FCF/EV (%)	3.0	0.2	4.6	4.5	5.1
FCFE/Mkt Cap (%)	0.0	0.1	1.5	0.6	1.5
Dividend Yield (%)	0.5	0.4	0.7	1.0	1.5

Source: Company, HDFC sec Inst Research

RECOMMENDATION HISTORY



Date	CMP	Reco	Target
11-Aug-17	227	BUY	318
11-Oct-17	252	BUY	318
2-Nov-17	267	BUY	318
9-Jan-18	377	NEU	375
12-Apr-18	340	NEU	375
23-Apr-18	328	BUY	384

Rating Definitions

BUY : Where the stock is expected to deliver more than 10% returns over the next 12 month period

NEUTRAL : Where the stock is expected to deliver (-)10% to 10% returns over the next 12 month period

SELL : Where the stock is expected to deliver less than (-)10% returns over the next 12 month period

Disclosure:

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