

Swaraj Engines

BUY

INDUSTRY AGRI EQUIPMENT

CMP (as on 25 Jan 2019) Rs 1,502

Target Price Rs 1,828

Nifty 10,781

Sensex 36,026

KEY STOCK DATA

Bloomberg SWE IN

No. of Shares (mn) 12

MCap (Rs bn) / (\$ mn) 18/256

6m avg traded value (Rs mn) 8

STOCK PERFORMANCE (%)

52 Week high / low Rs 2,112/1,306

3M 6M 12M

Absolute (%) 8.0 (14.1) (23.4)

Relative (%) 1.1 (11.8) (23.4)

SHAREHOLDING PATTERN (%)

Promoters 50.73

FIs & Local MFs 11.78

FPIs 2.57

Public & Others 34.92

Source : BSE

Abhishek Jain

abhishekkumar.jain@hdfcsec.com

+91-22-6171-7314

Aditya Makharia

aditya.makharia@hdfcsec.com

+91-22-3021-2077

Growth drivers intact

Swaraj Engines Ltd (SEL)'s 3QFY19 revenue was in line with estimate (Rs 1.99bn, +8% YoY) while operating margin saw a dip of 17bps YoY/-241bps QoQ to 13.8% owing to 104bps contraction in gross margin. APAT stood at Rs 173mn (flat YoY). Engine volumes grew by 2.7% YoY to 22.569k units while tractor sales at the parent level (M&M) were at 90.72k units (+11% YoY). During 9MFY19, M&M's tractor production grew by 9% YoY and sales grew 8.5%, inventory is at normal level.

Although, tractor industry (Domestic + Export) grew 15% YoY in YTD FY19, we expect growth rate to moderate in coming months owing to drought situation in few states and 3% fall in Rabi showing on account of depleting water resources in certain regions. We expect tractor volume to rise in the range of 4-6% in 4Q on the back of positive momentum post farm loan waivers, festive demand (Pongal), increase in MSPs and increase in rural spending along with subsidies support ahead of upcoming Lok Sabha election.

We believe that long term structural story remains intact with acceleration in the pace of mechanization of Indian agriculture. SEL would be one of the key beneficiaries of the continued growth in tractor

Financial Summary

(Rs mn)	3QFY19	3QFY18	YoY (%)	2QFY19	QoQ (%)	FY17	FY18	FY19E	FY20E	FY21E
Net Sales	1,987	1,833	8.4	2,470	(19.6)	6,662	7,712	8,837	10,027	11,278
EBITDA	275	257	7.1	401	(31.5)	1,046	1,216	1,344	1,569	1,792
APAT	173	172	0.6	254	(31.7)	688	801	863	1,011	1,141
Diluted EPS (Rs)	14.3	14.2	0.6	20.9	(31.7)	56.8	66.1	71.1	83.3	94.1
P/E (x)						26.3	22.6	21.0	17.9	15.9
EV / EBITDA (x)						15.1	13.4	12.0	10.0	8.4
RoE (%)						25.2	31.3	35.6	36.4	35.0

Source: Company, HDFC sec Inst Research

volumes. Moreover, capacity addition (from 105k to 120k units, completed in March-18) would enable the company to meet the rising demand over the next 2 years without incurring any major Capex. SEL has been rewarding its shareholders with a high pay-out ratio (~40%), negative working capital (-25 days, FY18), healthy ROCE (~35%) with strong FCF of Rs ~3bn over FY18-21E are other key positives. We cut our EPS estimate in the range of 4-7% over FY19-21E. Maintain BUY with a reduced TP of Rs 1828 (20x Dec-20E EPS).

Key highlights

- **Focus on higher HP engines:** With M&M's renewed focus on Swaraj brand tractors and the company's efforts towards new launches with increasing focus on higher HP engines, we expect SEL's volume off- take and realization to remain healthy. M&M total volume above 51HP grew by 11% YoY in FY19.
- **Strong balance sheet:** SEL operates with a negative cash conversion cycle, debt-free balance sheet with cash equivalents of Rs 1.82bn in FY18. SEL has the ability to withstand unfavorable business cycles, as was witnessed in FY15 and FY16

Revenue growth supported by volume growth of 3% YoY (22.56k units) and 6% YoY growth in realization

During this quarter M&M tractor production grew by 3% YoY while sales (domestic+ export) was up 11%

Tractor sales at the parent level (M&M) in 3QFY19 were at 90.7k units (+11% YoY), vs industry growth of 20% YoY

EBITDA margin contracted to 13.8%, hit by 104bps drop in gross margin, partially offset by operating leverage

Other income was lower owing to outflow of cash (Rs 710mn) and buy back of Share

Quarterly Financials Snapshot

(Rs mn)	3QFY19	3QFY18	YoY (%)	2QFY19	QoQ (%)
Net Sales	1,987	1,833	8.4	2,470	(19.6)
Material Expenses	1,509	1,373	9.9	1,854	(18.6)
Employee Expenses	99	89	11.8	100	(1.1)
Other Expenses	104	115	(9.3)	114	(9.2)
EBITDA	275	257	7.1	401	-31.5
Depreciation	47.2	42	12.4	48	(1.7)
EBIT	228	215	6.1	353	-35.6
Other Income & EO Items	40.3	49	(17.8)	39	4.4
Interest	0	0	na	0	
PBT	268	264	1.6	392	(31.6)
Tax	95	91	3.5	138	-31.5
RPAT	173	172	0.6	254	(31.7)
EO Items (Adj For Tax)	0	0	na	0	na
APAT	173	172	0.6	254	-31.7
AEPS (Rs/sh)	14.3	14.2	0.6	20.9	(31.7)

Source: Company, HDFC sec Inst Research

Margin Analysis

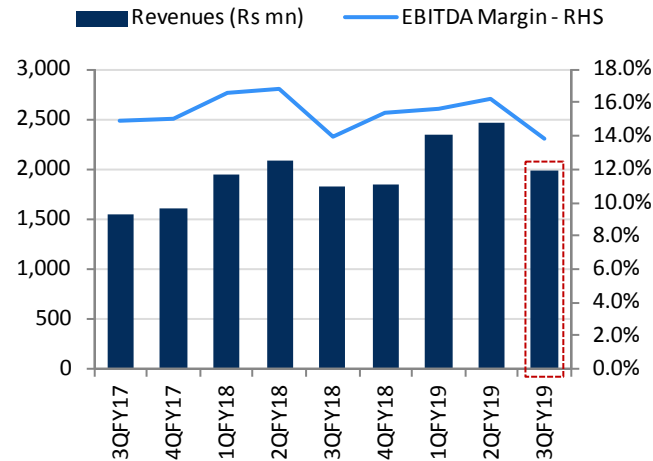
Margin Analysis (% of Net Sales)	3QFY19	3QFY18	YoY (%)	2QFY19	QoQ (%)
Material Expenses as % of Net Sales	75.9	74.9	104	75.1	88
Employee Expenses as % of Net Sales	5.0	4.8	15	4.1	93
Other Expenses as % of Net Sales	5.2	6.2	-102	4.6	60
EBITDA Margin (%)	13.8	14.0	-17	16.2	-241
Net Profit Margin (%)	8.7	9.4	-68	10.3	-154
Tax Rate (%)	35.3	34.7	64	35.3	3

Source: Company, HDFC sec Inst Research

Increase in MSP and higher government's rural spending will continue to support volume growth

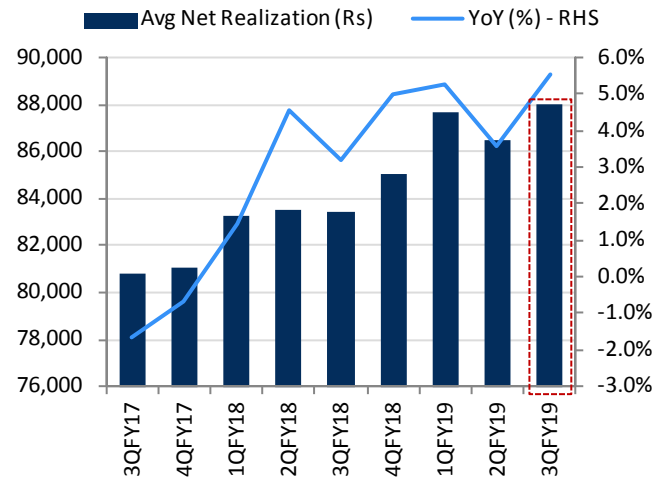
Avg. Net Realization per engine stood at Rs 88k (+5.6% YoY, +1.8% QoQ) and EBITDA per engine stood at Rs 12.8k (+4.3%YoY & -13.3% QoQ)

Net Revenue On The Rise



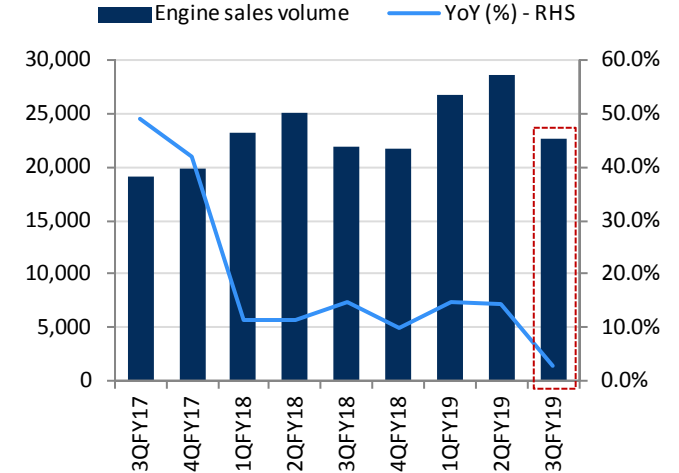
Source: Company, HDFC sec Inst Research

Increasing ASP Owing To Better Mix



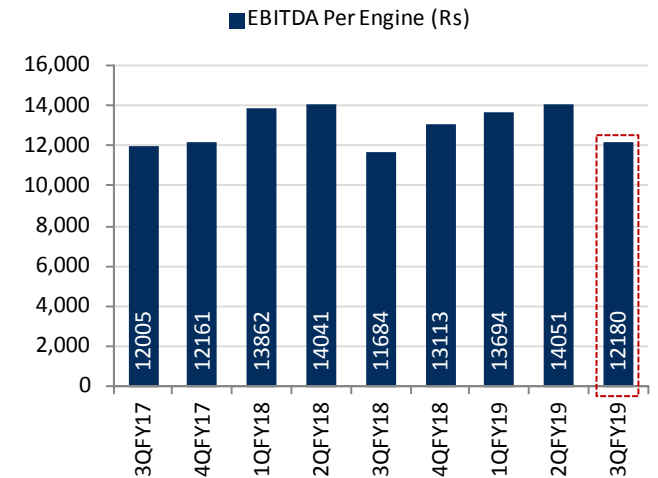
Source: Company, HDFC sec Inst Research

Engine Sales Volume Inched Up



Source: Company, HDFC sec Inst Research

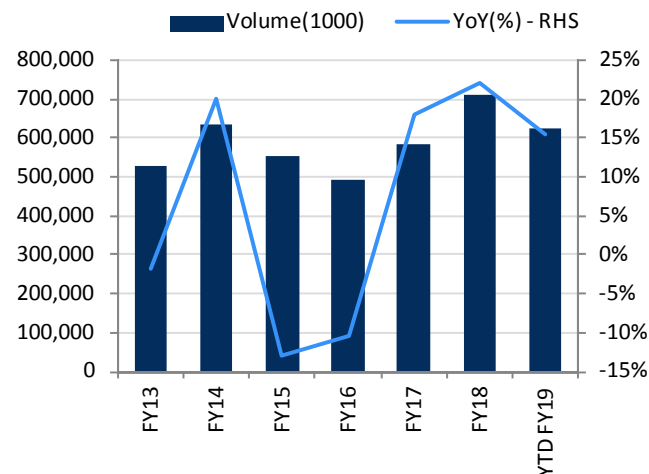
EBITDA Per Engine Dipped YoY/QoQ



Source: Company, HDFC sec Inst Research

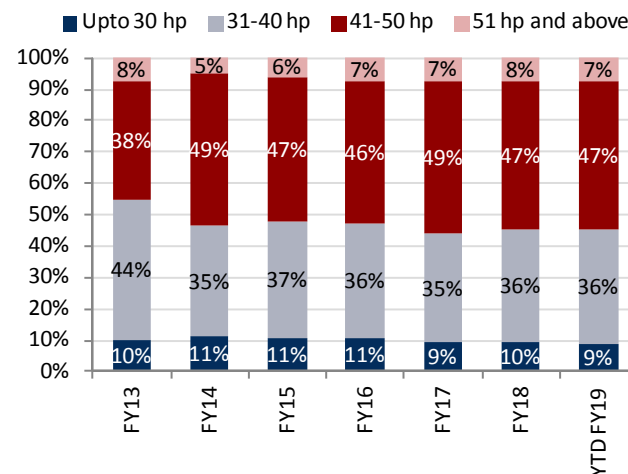
In past three years, tractor industry witnessed strong growth led by increased demand from commercial sector and increase in rural spending along with subsidies support.

Domestic Tractor Volume Trend



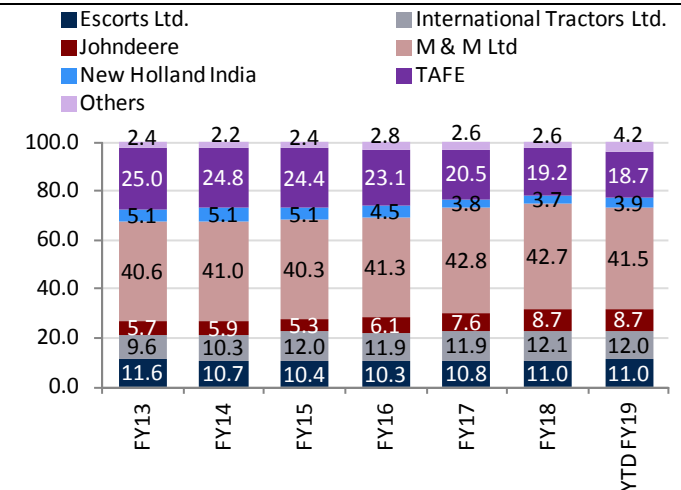
Source: Company, HDFC sec Inst Research

Domestic HP segmental



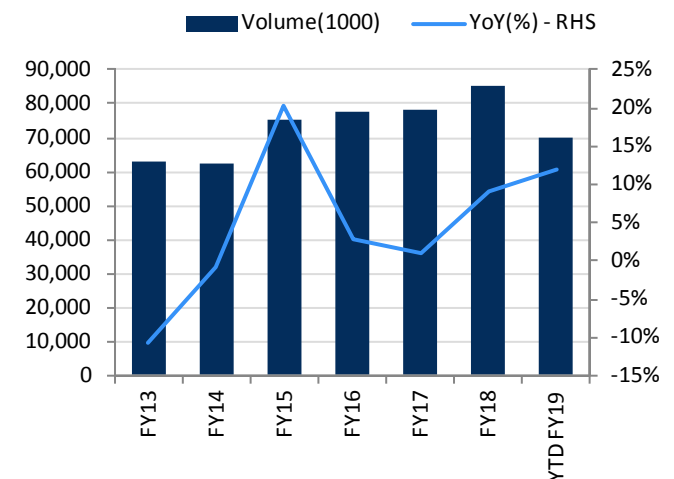
Source: Company, HDFC sec Inst Research

Domestic Market share



Source: Company, HDFC sec Inst Research

Export Tractor Volume Trend



Source: Company, HDFC sec Inst Research

We expect PAT to grow at a CAGR of 13% over FY18-21E.

Assumptions

Assumptions (Rs mn)	FY16	FY17	FY18	FY19	FY20E	FY21E
Engine - Sales Volumes	64,088	82,297	92,022	99,384	109,322	119,161
YoY Growth (%)	(0.8)	28.4	11.8	8.0	10.0	9.0
Avg Net Realisation per Engine (Rs)	79,164	78,621	81,235	86,109	88,692	91,353
YoY Growth (%)	(2.4)	(0.7)	3.3	6.0	3.0	3.0
Engine - Revenues	5,073	6,470	7,475	8,558	9,696	10,886
YoY Growth (%)	(3.2)	27.5	15.5	14.5	13.3	12.3
Engine Components - Revenues	19	161	199	239	287	345
YoY Growth (%)	(6.3)	761.3	24.0	20.0	20.0	20.0
Spares - Revenues	140	-	-	-	-	-
YoY Growth (%)	41.0	-	-	8.0	10.0	10.0
Scrap - Revenues	27.4	30.3	36.8	39.7	43.7	48.1
YoY Growth (%)	(25.9)	10.8	21.5	8.0	10.0	10.0
Consolidated Net Revenue Growth	(2.6)	26.7	15.8	14.6	13.5	12.5
Gross Margin (%)	24.8	25.6	25.5	24.8	25.1	25.3

Source: Company, HDFC sec Inst Research

Change in estimates

In Rs mn	New			Old			% chg		
	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
Volume	99384	109322	119161	101224	116408	126885	(1.8)	(6.1)	(6.1)
Net Sales	8,837	10,027	11,278	8,913	10,558	11,875	(0.9)	(5.0)	(5.0)
EBITDA	1,344	1,569	1,792	1,395	1,676	1,913	(3.6)	(6.4)	(6.3)
Adj PAT	863	1,011	1,141	896	1,082	1,227	(3.7)	(6.6)	(6.9)
Adj EPS (in Rs)	71	83	94	74	89	101	(3.7)	(6.6)	(6.9)

Source: HDFC sec Inst Research

Peer Set Comparison

	MCap (Rs bn)	CMP (Rs/sh)	Rating	TP	Adj EPS (Rs/sh)			P/E (x)			EV/EBITDA (x)			RoE (%)		
					FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
Exide Industries	191	225	BUY	304	10.4	12.2	14.4	21.6	18.4	15.6	12.1	10.1	8.2	15.8	16.6	17.5
Suprajit Engineering	27	206	BUY	282	10.5	13.2	15.0	19.6	15.6	13.7	11.6	9.5	7.9	20.4	21.4	20.3
Jamna Auto	22	54	BUY	100	3.8	4.7	5.4	14.1	11.6	10.0	7.9	6.4	5.6	32.3	32.2	30.5
Swaraj Engines	18	1,502	BUY	1,828	71.1	83.3	94.1	21.0	17.9	15.9	12.0	10.0	8.4	35.6	36.4	35.0
Subros	15	225	BUY	435	14.7	19.8	23.7	15.3	11.4	9.5	14.6	12.2	10.7	18.0	19.1	19.5
Ramkrishna Forging	15	507	BUY	904	37.1	44.3	56.6	13.7	11.4	9.0	6.5	5.9	4.9	14.9	15.4	16.9
NRB Bearings	17	175	NEU	217	10.5	12.1	13.1	16.6	14.5	13.4	9.7	8.6	7.7	24.7	23.8	21.8
JBM Auto	11	270	BUY	560	24.6	31.1	34.8	11.0	8.7	7.7	6.0	4.8	4.0	21.6	21.9	20.6
Lumax Autotech	11	155	BUY	245	9.7	12.0	13.4	16.0	12.9	11.6	8.3	6.7	6.1	14.9	16.4	16.5

Source: Bloomberg, HDFC sec Inst Research

Income Statement

(Rs mn)	FY17	FY18	FY19E	FY20E	FY21E
Net Revenues	6,662	7,712	8,837	10,027	11,278
Growth (%)	26.7	15.8	14.6	13.5	12.5
Raw Material Expenses	4,955	5,743	6,645	7,510	8,425
Power & Fuel Expenses	52	59	71	80	90
Employee Expenses	310	348	396	440	488
Other Operating Expenses	299	346	380	427	483
Operating Profits	1,046	1,216	1,344	1,569	1,792
Operating Profit Margin (%)	15.7	15.8	15.2	15.7	15.9
Other Operating Income	-	-	-	-	-
EBITDA	1,046	1,216	1,344	1,569	1,792
EBITDA Margin (%)	15.7	15.8	15.2	15.7	15.9
EBITDA Growth (%)	41.7	16.3	10.6	16.7	14.2
Depreciation	163	168	179	193	219
EBIT	883	1,048	1,166	1,376	1,574
Other Income	172	190	155	172	175
Interest & Financial Charges	0	10	-	-	-
PBT	1,055	1,227	1,321	1,548	1,749
Tax	366	426	459	538	607
RPAT	688	801	863	1,011	1,141
EO (Loss) / Profit (Net Of Tax)	-	-	-	-	-
APAT	688	801	863	1,011	1,141
APAT Growth (%)	34.3	16.4	7.7	17.2	12.9
AEPS	56.8	66.1	71.1	83.3	94.1
EPS Growth (%)	34.3	16.4	7.7	17.2	12.9

Source: Company, HDFC sec Inst Research

Balance Sheet

(Rs mn)	FY17	FY18	FY19E	FY20E	FY21E
SOURCES OF FUNDS					
Share Capital	124	121	121	121	121
Reserves	2,709	2,164	2,442	2,869	3,412
Total Shareholders Funds	2,834	2,285	2,564	2,990	3,534
Long-term Debt	-	-	-	-	-
Short-term Debt	-	-	-	-	-
Total Debt	-	-	-	-	-
Other Liabilities	29	36	36	36	36
Net Deferred Tax Liability	63	58	58	58	58
TOTAL SOURCES OF FUNDS	2,925	2,379	2,657	3,084	3,627
APPLICATION OF FUNDS					
Net Block	917	937	801	907	989
CWIP	4	42	300	300	300
Other Non Current Assets	38	109	109	109	109
Total Non-current Assets	959	1,088	1,209	1,316	1,398
Inventories	261	319	366	415	467
Debtors	131	153	175	199	223
Cash & Equivalents	2,351	1,829	2,022	2,416	2,955
Other Current Assets	20	86	86	86	86
Total Current Assets	2,762	2,387	2,649	3,116	3,732
Creditors	701	985	1,089	1,236	1,390
Other Current Liabilities	95	112	112	112	112
Total Current Liabilities	796	1,096	1,201	1,348	1,502
Net Current Assets	1,966	1,291	1,448	1,768	2,229
TOTAL APPLICATION OF FUNDS	2,925	2,379	2,657	3,084	3,627

Source: Company, HDFC sec Inst Research

Cash Flow

(Rs mn)	FY17	FY18	FY19E	FY20E	FY21E
Reported PBT	1,055	1,227	1,321	1,548	1,749
Non-operating & EO Items	(8)	(67)	-	-	-
Interest Expenses	(162)	(111)	-	-	-
Depreciation	163	168	179	193	219
Working Capital Change	150	110	36	74	78
Tax Paid	(379)	(433)	(459)	(538)	(607)
Others	5	(1)	-	-	-
OPERATING CASH FLOW (a)	823	893	1,077	1,278	1,438
Capex	(62)	(225)	(300)	(300)	(300)
<i>Free Cash Flow (FCF)</i>	<i>761</i>	<i>668</i>	<i>777</i>	<i>978</i>	<i>1,138</i>
Investments	(379)	(206)	-	-	-
Non-operating Income	163	121	-	-	-
Others	(41)	785	-	-	-
INVESTING CASH FLOW (b)	(319)	475	(300)	(300)	(300)
Debt Issuance/(Repaid)	-	-	-	-	-
Interest Expenses	(0)	(10)	-	-	-
<i>FCFE</i>	<i>761</i>	<i>658</i>	<i>777</i>	<i>978</i>	<i>1,138</i>
Share Capital Buy Back	-	(707)	-	-	-
Dividend	(491)	(640)	(584)	(584)	(598)
Others	417	(532)	-	-	-
FINANCING CASH FLOW (c)	(74)	(1,890)	(584)	(584)	(598)
NET CASH FLOW (a+b+c)	430	(522)	193	394	539
Opening Cash & Equivalents	1,921	2,351	1,829	2,022	2,416
Closing Cash & Equivalents	2,351	1,829	2,022	2,416	2,955

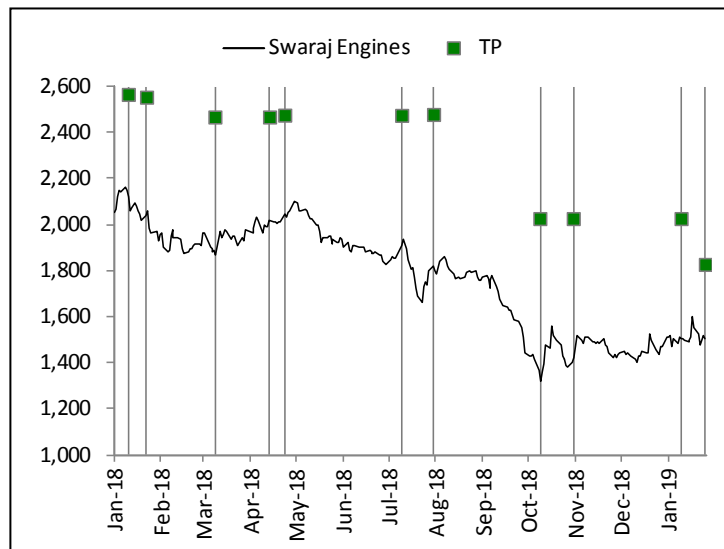
Source: Company, HDFC sec Inst Research

Key Ratios

	FY17	FY18	FY19E	FY20E	FY21E
PROFITABILITY (%)					
GPM	25.6	25.5	24.8	25.1	25.3
EBITDA Margin	15.7	15.8	15.2	15.7	15.9
EBIT Margin	13.3	13.6	13.2	13.7	14.0
APAT Margin	10.3	10.4	9.8	10.1	10.1
RoE	25.2	31.3	35.6	36.4	35.0
Core RoCE	83.0	121.8	128.5	137.9	153.4
RoCE	24.3	30.5	34.3	35.2	34.0
EFFICIENCY					
Tax Rate (%)	34.7	34.7	34.7	34.7	34.7
Asset Turnover (x)	2.4	2.9	3.5	3.5	3.4
<i>Inventory (days)</i>	<i>14</i>	<i>15</i>	<i>15</i>	<i>15</i>	<i>15</i>
<i>Debtors (days)</i>	<i>7</i>	<i>7</i>	<i>7</i>	<i>7</i>	<i>7</i>
<i>Other Current Assets (days)</i>	<i>1</i>	<i>4</i>	<i>4</i>	<i>3</i>	<i>3</i>
<i>Payables (days)</i>	<i>38</i>	<i>47</i>	<i>45</i>	<i>45</i>	<i>45</i>
<i>Other Current Liab & Prov (days)</i>	<i>5</i>	<i>5</i>	<i>5</i>	<i>4</i>	<i>4</i>
Working Capital (days)	-21	-25	-24	-24	-24
Debt/EBITDA (x)	-	-	-	-	-
Net D/E	(0.8)	(0.8)	(0.8)	(0.8)	(0.8)
Interest Coverage	8,827.0	103.7	NA	NA	NA
PER SHARE DATA					
AEPS (Rs/sh)	56.8	66.1	71.1	83.3	94.1
CEPS (Rs/sh)	70.2	79.9	85.8	99.3	112.1
DPS (Rs/sh)	33.0	25.0	40.0	40.0	41.0
BV (Rs/sh)	234	188	211	247	291
VALUATION					
P/E	26.3	22.6	21.0	17.9	15.9
P/BV	6.4	7.9	7.1	6.1	5.1
EV/EBITDA	15.1	13.4	12.0	10.0	8.4
OCF/EV (%)	5.2	5.5	6.7	8.1	9.5
FCF/EV (%)	4.8	4.1	4.8	6.2	7.5
FCFE/MCAP (%)	4.2	3.6	4.3	5.4	6.3
Dividend Yield (%)	2.2	1.7	2.7	2.7	2.7

Source: Company, HDFC sec Inst Research

RECOMMENDATION HISTORY



Date	CMP	Reco	Target
10-Jan-18	2,182	BUY	2,566
23-Jan-18	2,090	BUY	2,554
8-Mar-18	1,914	BUY	2,468
13-Apr-18	2,018	BUY	2,468
24-Apr-18	2,065	BUY	2,476
9-Jul-18	1,890	BUY	2,475
31-Jul-18	1,819	BUY	2,476
8-Oct-18	1,402	BUY	2,027
31-Oct-18	1,401	BUY	2,027
9-Jan-19	1,489	BUY	2,027
28-Jan-19	1,502	BUY	1,828

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

INSTITUTIONAL RESEARCH
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HDFC securities Limited, I Think Techno Campus, Building - B, "Alpha", Office Floor 8, Near Kanjurmarg Station, Opp. Crompton Greaves, Kanjurmarg (East), Mumbai 400 042 Phone: (022) 3075 3400 Fax: (022) 2496 5066

Compliance Officer: Binkle R. Oza Email: complianceofficer@hdfcsec.com Phone: (022) 3045 3600

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