

# Swaraj Engines Ltd.

## A decent performance, Fundamentals remain intact

Swaraj Engines (SWE) reported a lower single-digit volume decline in Q4FY20, far better than ~12% de-growth in the tractor industry. Based on our recent survey, we believe Swaraj tractors continue to enjoy strong brand equity. Swaraj Engines reported a top-line of Rs 1,751mn (down 8.5% YoY & up 3.0% QoQ), in-line with our estimate. This was on account of engine volume degrowth of 4.3% YoY. Blended realization declined by about 4.4% YoY. The company witnessed an EBITDA margin contraction of 97bps YoY to 11.6%, however there was a jump of 177bps QoQ in margin. PAT witnessed a small fall of 4.9% YoY to Rs 158mn. Considering COVID impact and rising competition, we have lower down our target price to Rs 1,313 with Buy rating as we believe tractor sector would outperform in auto industry with government focus on agriculture and construction activities.

### Sequential improvement in margin

- Results came in better than estimates as margins surprised on positive side.
- The benefits majorly accrued from lower commodity prices, which has yielded in lower RM cost/Sales (%) by ~120bps QoQ to 75.8%. Stringent cost rationalisation measures resulted in lower employee costs by ~60bps QoQ to 5.7%, while other expense remains at a similar level of 5.2% as a % of sales. Hence, margin expanded 177bps QoQ but still was down 97 bps YoY.
- EBITDA declined by 15% YoY to Rs 234mn, while PAT decreased by 4.9% YoY to Rs 158.4mn. This is due to lower effective tax rate (lower by 930bps YoY to 26.1%). The bottom line was clearly higher than our estimates, due to superior operational performance supported by a lower tax.

### COVID to hit tractor industry the least

- Tractor industry had started recovering during 4QFY20 but COVID hit the recovery.
- The government has full focus on agriculture considering the difficult situation. They are set to start construction activities to generate employment under various schemes.
- SWE to report more-or-less in-line growth with the industry. We estimate tractor industry to decline 8% YoY in FY21E, followed by a 14% growth in FY22E.

### Valuation and risks:

- The Board has recommended Rs 25 per share of dividend for the year FY20. In addition, recommended a special dividend payment of Rs 15 per share, taking the total dividend of Rs 40 per share for FY20. Swaraj has been giving higher dividend payouts and offering buyback schemes. We expect this trend should be continued as there is no major capex requirement and hence, return ratios to improve going forward.
- At the current price of Rs 978, the stock is trading at 13.4x FY22E EPS, way below the last six year's average of 1-year forward P/E of 21.7x. By looking at the present uncertain situation and intensifying competition in tractor industry, we have lower down our multiple to 18x FY22E (~17% discount to its six-year average) to arrive at a **target price of Rs 1,313 per share**, which indicates **34% upside from the current levels**. Hence, we have **Buy** rating.
- Key risks are 1) Dependent on a single client and 2) lower than expected growth in industry.

Y/E Mar (Rs mn)	Q4 FY20	Q4 FY19	YoY (%)	Q3 FY20	QoQ (%)	Q4 FY20E	Var. (%)
Engine Sales (No)	20,827	21,767	(4.3)	19,797	5.2	20,485	1.7
Realisation (Rs)	84,088	87,963	(4.4)	85,907	(2.1)	86,000	(2.2)
<b>Net sales</b>	<b>1,751</b>	<b>1,915</b>	<b>(8.5)</b>	<b>1,701</b>	<b>3.0</b>	<b>1,762</b>	<b>(0.6)</b>
Operating costs	1,518	1,641	(7.5)	1,504	0.9	1,561	(2.8)
<b>EBITDA</b>	<b>234</b>	<b>274</b>	<b>(14.7)</b>	<b>197</b>	<b>18.7</b>	<b>201</b>	<b>16.5</b>
<b>EBITDA Margin (%)</b>	<b>13.4</b>	<b>14.3</b>	<b>(97) bps</b>	<b>11.6</b>	<b>177 bps</b>	<b>11.4</b>	<b>196 bps</b>
Depreciation and amortisation	49	53	(7.0)	51	(4.1)	51	(3.7)
Interest	0	0	NA	0	NA	0	NA
Other income	30	36	(18.7)	28	7.2	34	(14.0)
<b>PBT</b>	<b>214</b>	<b>258</b>	<b>(16.8)</b>	<b>173</b>	<b>23.7</b>	<b>184</b>	<b>16.4</b>
Provision for tax	56	91	(38.6)	44	25.9	47	19.5
Effective tax rate (%)	26.1	35.4	(928) bps	25.6	46 bps	25.4	68 bps
<b>PAT (Reported)</b>	<b>158</b>	<b>167</b>	<b>(4.9)</b>	<b>129</b>	<b>22.9</b>	<b>137</b>	<b>15.3</b>
<b>NPM (%)</b>	<b>9.0</b>	<b>8.7</b>	<b>35 bps</b>	<b>7.6</b>	<b>147 bps</b>	<b>7.8</b>	<b>125 bps</b>

Source: Company, EISEC Research

Y/E Mar (Rs mn)	Revenue	YoY (%)	EBITDA	EBITDA (%)	Adj PAT	YoY (%)	EPS (Rs)	RoE (%)	RoCE (%)	P/E (x)	EV/EBITDA (x)
FY18	7,712	15.8	1,216	15.8	801	16.4	66.1	31.3	30.8	30.8	18.8
FY19	8,717	13.0	1,317	15.1	824	2.9	68.0	35.3	34.4	24.4	14.1
FY20	7,733	(11.3)	1,004	13.0	710	(13.8)	58.6	30.0	29.3	15.4	9.1
FY21E	7,207	(6.8)	985	13.7	692	(2.6)	57.1	28.7	28.2	17.1	10.2
FY22E	8,374	16.2	1,251	14.9	884	27.7	72.9	34.7	34.1	13.4	7.9

Source: Company, EISEC Research Estimates

**Rating: Buy** **Upside/(Downside): 34%**  
**Current Price: 978** **Target Price: 1,313**

### | Market data

Bloomberg:	SWE IN
52-week H/L (Rs):	1,455/807
Mcap (Rs bn/USD mn):	11.9/157
Shares outstanding (mn):	12.1
Free float:	49.0%
Avg. daily vol. 3mth (3M Avg – in '000):	5.8
Face Value (Rs):	10
Group:	BSE Smallcap
Source: Bloomberg, EISEC Research	

### | Shareholding pattern

	Mar-20	Dec-19	Sep-19	Jun-19
Promoter	52.2	52.2	52.2	52.2
FIIIs	1.2	1.2	1.2	1.2
DIIIs	10.3	10.0	11.0	11.1
Public/others	36.4	36.7	35.6	35.5

Source: BSE

### | Price performance (%)\*

YE Mar (R)	1M	3M	12M	36M
BSE Smallcap	9.1	-28.0	-25.3	-30.9
Swaraj Engines	9.9	-17.5	-27.7	-45.8

\*as on 8<sup>th</sup> May 2020; Source: AceEquity, EISEC Research

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## Valuation and Recommendations

- The Board has recommended Rs 25 per share of dividend for the year FY20. In addition, recommended a special dividend payment of Rs 15 per share, taking the total dividend of Rs 40 per share for FY20.
- Swaraj has been giving higher dividend payouts and offering buyback schemes. We expect this trend should be continued as there is no major capex requirement and hence, return ratios to improve going forward.
- At the current price of Rs 978, the stock is trading at 13.4x FY22E EPS, much lower than the last six year's average of 1-year forward P/E of 21.7x. By looking at the present uncertain situation and intensifying competition in tractor industry, we have lower down our multiple to 18x FY22E (~17% discount to its six-year average) to arrive at a target price of Rs 1,313 per share, which indicates 34% upside from the current levels. Hence, we maintain our **Buy** rating.
- Key risks are company's dependence on a single client and lower than expected growth in the tractor industry.

**Fig 1: 1-year forward P/E chart**



Source: AceEquity, EISEC Research

**Fig 2: 1-year forward EV/EBITDA chart**



Source: AceEquity, EISEC Research

## Quarterly financials, operating metrics and key performance indicators

**Fig 3: Quarterly Financials**

Y/E March (Rs mn)	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20
<b>Net Sales</b>	<b>2,345</b>	<b>2,470</b>	<b>1,987</b>	<b>1,915</b>	<b>2,054</b>	<b>2,227</b>	<b>1,701</b>	<b>1,751</b>
Raw Materials	1,766	1,854	1,509	1,436	1,576	1,713	1,309	1,327
Employee Costs	96	100	99	97	103	109	107	99
Other Expenditure	117	114	104	107	101	105	88	91
<b>EBITDA</b>	<b>366</b>	<b>401</b>	<b>275</b>	<b>274</b>	<b>274</b>	<b>300</b>	<b>197</b>	<b>234</b>
Depreciation	47	48	47	53	48	53	51	49
Interest	1	-	-	0	-	0	-	-
Other Income	39	39	40	36	36	34	28	30
<b>PBT</b>	<b>357</b>	<b>392</b>	<b>268</b>	<b>258</b>	<b>262</b>	<b>281</b>	<b>173</b>	<b>214</b>
Tax	126	138	95	91	93	27	44	56
Tax rate (%)	35.3	35.3	35.3	35.4	35.5	9.6	25.6	26.1
<b>Reported PAT</b>	<b>231</b>	<b>254</b>	<b>173</b>	<b>167</b>	<b>169</b>	<b>254</b>	<b>129</b>	<b>158</b>
<b>YoY Growth (%)</b>								
Revenue	20.9	18.4	8.4	3.4	(12.4)	(9.8)	(14.4)	(8.5)
EBITDA	13.4	14.4	7.1	(4.0)	(25.3)	(25.2)	(28.4)	(14.7)
Adj. PAT	7.3	8.0	0.6	(6.8)	(26.6)	0.1	(25.7)	(4.9)
<b>QoQ Growth (%)</b>								
Revenue	26.6	5.3	(19.6)	(3.6)	7.3	8.4	(23.6)	3.0
EBITDA	28.2	9.6	(31.5)	(0.3)	(0.2)	9.6	(34.4)	18.7
Adj. PAT	29.0	10.0	(31.7)	(4.0)	1.6	50.1	(49.2)	22.9
<b>Margin (%)</b>								
EBITDA	15.6	16.2	13.8	14.3	13.3	13.5	11.6	13.4
PAT	9.8	10.3	8.7	8.7	8.2	11.4	7.6	9.0
<b>Key Drivers</b>								
Engine Sales (in Units)	26,742	28,560	22,569	21,767	23,033	26,271	19,797	20,827

Source: Company, EISEC Research

**Fig 4: Key Assumptions**

(No of units)	FY17	FY18	FY19	FY20	FY21E	FY22E
<b>Capacity (in units)</b>	1,05,000	1,05,000	1,20,000	1,20,000	1,20,000	1,35,000
Engine Sales (in units)	82,297	92,022	99,638	89,928	83,467	95,134
Capacity Utilization (%)	78.4	87.6	83.0	74.9	69.6	70.5
Engine Realization (Rs)	78,662	81,221	84,852	83,068	83,068	84,729
Engine Revenues (Rs mn)	6,474	7,474	8,454	7,470	6,933	8,061
Component Revenues (Rs mn)	34	34	40	40	40	43
<b>Total (Rs mn)</b>	<b>6,508</b>	<b>7,509</b>	<b>8,494</b>	<b>7,510</b>	<b>6,973</b>	<b>8,104</b>
Other operating Income* (Rs mn)	154	203	223	223	235	270
<b>Total Operating income (Rs mn)</b>	<b>6,661</b>	<b>7,712</b>	<b>8,717</b>	<b>7,733</b>	<b>7,207</b>	<b>8,374</b>

Source: Company, EISEC Research Estimates

Note: \* includes scrap sales

## Financial Statements

Income Statement	FY18	FY19	FY20	FY21E	FY22E
<b>YE March (Rs mn)</b>					
<b>Net Sales</b>	<b>7,712</b>	<b>8,717</b>	<b>7,733</b>	<b>7,207</b>	<b>8,374</b>
Raw Materials	5,743	6,566	5,925	5,377	6,197
% of sales	74.5	75.3	76.6	74.6	74.0
Personnel	348	393	418	435	469
% of sales	4.5	4.5	5.4	6.0	5.6
Manufact. & Other Exp.	405	442	386	411	457
% of sales	5.2	5.1	5.0	5.7	5.5
<b>EBITDA</b>	<b>1,216</b>	<b>1,317</b>	<b>1,004</b>	<b>985</b>	<b>1,251</b>
<b>EBITDA Margin (%)</b>	<b>15.8</b>	<b>15.1</b>	<b>13.0</b>	<b>13.7</b>	<b>14.9</b>
Depreciation & Amortisation	168	195	201	206	220
<b>EBIT</b>	<b>1,048</b>	<b>1,121</b>	<b>803</b>	<b>779</b>	<b>1,031</b>
Interest Expenses	10	1	0	-	-
<b>EBT</b>	<b>1,038</b>	<b>1,120</b>	<b>803</b>	<b>779</b>	<b>1,031</b>
Other Income	190	154	128	146	151
<b>PBT</b>	<b>1,227</b>	<b>1,274</b>	<b>931</b>	<b>925</b>	<b>1,182</b>
Tax-Total	426	450	220	233	297
Effective tax rate (%)	34.7	35.3	23.7	25.2	25.2
Extraord. items -Adj.	-	-	-	-	-
<b>Reported PAT</b>	<b>801</b>	<b>824</b>	<b>710</b>	<b>692</b>	<b>884</b>

Source: Company, EISEC Research Estimates

Key Ratios	FY18	FY19	FY20	FY21E	FY22E
<b>YE March</b>					
<b>Growth ratios (%)</b>					
Net sales & operating income	15.8	13.0	(11.3)	(6.8)	16.2
EBITDA	16.3	8.3	(23.7)	(1.9)	27.0
Reported PAT	16.4	2.9	(13.8)	(2.6)	27.7
<b>Margin Ratio (%)</b>					
EBITDA Margin	15.8	15.1	13.0	13.7	14.9
EBIT Margin	13.6	12.9	10.4	10.8	12.3
PBT Margin	15.9	14.6	12.0	12.8	14.1
PAT Margin	10.4	9.5	9.2	9.6	10.6
<b>Return Ratio (%)</b>					
ROE	31.3	35.3	30.0	28.7	34.7
ROCE	30.8	34.4	29.3	28.2	34.1
ROIC	129.2	107.6	86.7	91.6	109.3
<b>Turnover Ratio days (days)</b>					
Gross Block Turnover (x)	3.83	3.86	3.08	2.73	2.96
Inventory Period	15	20	17	15	15
Debtors Period	7	8	2	8	8
Creditors	47	44	47	35	35
Cash Conversion Cycle	(24.3)	(15.9)	(27.4)	(12.0)	(12.0)
<b>Solvency Ratio (%)</b>					
Debt-equity (x)	-	-	-	-	-
Net Debt-equity (x)	(0.5)	(0.4)	(0.3)	(0.3)	(0.3)
Liquidity ratio (x)	1.4	1.3	1.2	1.4	1.4
Interest coverage ratio (%)	104	1,246	8,030	NA	NA
<b>Per share (Rs)</b>					
Adjusted EPS	66.1	68.0	58.6	57.1	72.9
CEPS	79.9	84.1	75.2	74.1	91.1
Book value	181.3	180.9	178.7	188.7	199.0
Dividend per share	44.0	50.0	50.0	40.0	50.0
Dividend Payout (%)	66.7	73.6	85.4	70.1	68.6
Dividend Yield (%)	4.5	5.1	5.1	4.1	5.1
<b>Valuation</b>					
P/E	30.8	24.4	15.4	17.1	13.4
P/BV	10.8	8.5	4.6	4.8	4.5
EV/EBITDA	18.8	14.1	9.1	10.2	7.9
EV/Sales	3.0	2.1	1.2	1.4	1.2

Source: Company, EISEC Research Estimate

Balance Sheet	FY18	FY19	FY20	FY21E	FY22E
<b>YE March (Rs mn)</b>					
<b>Sources of funds</b>					
Capital	121	121	121	121	121
Reserves & Surplus	2,164	2,259	2,238	2,346	2,500
<b>Shareholders' Funds</b>	<b>2,285</b>	<b>2,380</b>	<b>2,359</b>	<b>2,467</b>	<b>2,622</b>
Minority Interest	-	-	-	-	-
Total Debt	-	-	-	-	-
Deferred Tax Liabilities	58	72	45	45	45
<b>Total Liabilities</b>	<b>2,343</b>	<b>2,451</b>	<b>2,404</b>	<b>2,513</b>	<b>2,667</b>
<b>Application of funds</b>					
Gross Block	2,070	2,445	2,582	2,702	2,952
Accumulated Dep.	(1,150)	(1,345)	(1,547)	(1,753)	(1,973)
Capital WIP	60	20	40	0	0
Non-current Asset	109	78	47	44	51
<b>Net Fixed Assets</b>	<b>1,088</b>	<b>1,198</b>	<b>1,122</b>	<b>993</b>	<b>1,029</b>
Investments	761	838	1,111	1,151	1,191
Goodwill	-	-	-	-	-
Inventories	319	474	370	296	344
Sundry Debtors	153	187	41	158	184
Other Current Assets	86	186	192	179	208
Cash & Bank Balances	1,068	779	714	668	759
<b>Total Current Assets</b>	<b>1,626</b>	<b>1,627</b>	<b>1,318</b>	<b>1,301</b>	<b>1,494</b>
Creditors	985	1,042	992	691	803
Other Current Liabilities	70	89	63	155	144
Provisions	77	81	91	86	100
<b>Total Current Liabilities</b>	<b>1,132</b>	<b>1,211</b>	<b>1,146</b>	<b>932</b>	<b>1,048</b>
<b>Net Current Assets</b>	<b>494</b>	<b>415</b>	<b>172</b>	<b>369</b>	<b>447</b>
<b>Total assets</b>	<b>2,343</b>	<b>2,451</b>	<b>2,404</b>	<b>2,513</b>	<b>2,667</b>

Source: Company, EISEC Research Estimates

Cash Flow	FY18	FY19	FY20E	FY21E	FY22E
<b>YE March (Rs mn)</b>					
<b>Operating profit before WC changes</b>					
	<b>783</b>	<b>880</b>	<b>758</b>	<b>753</b>	<b>954</b>
Net change in working capital	110	(180)	209	(240)	6
<b>Cash flow from operating activities (a)</b>	<b>893</b>	<b>700</b>	<b>967</b>	<b>513</b>	<b>960</b>
<b>Adjusted Operating Cash flow</b>					
	<b>883</b>	<b>700</b>	<b>967</b>	<b>513</b>	<b>960</b>
Capital expenditure	(234)	(336)	(156)	(80)	(250)
Adjusted FCF	650	363	811	433	710
<b>Cash flow from investing activities (b)</b>	<b>475</b>	<b>(260)</b>	<b>(301)</b>	<b>26</b>	<b>(139)</b>
<b>Cash flow from financing activities (c)</b>					
	<b>(1,357)</b>	<b>(630)</b>	<b>(732)</b>	<b>(597)</b>	<b>(701)</b>
Net change in cash (a+b+c)	11	(190)	(67)	(58)	120
Opening cash balance	20	30	(159)	(226)	(284)
<b>Ending cash balance</b>	<b>30</b>	<b>(159)</b>	<b>(226)</b>	<b>(284)</b>	<b>(164)</b>
Other bank balances	1,038	938	940	952	923
<b>Cash on balance sheet</b>	<b>1,068</b>	<b>779</b>	<b>714</b>	<b>668</b>	<b>759</b>

Source: Company, EISEC Research Estimates

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Source: ACEEquity, EISEC Research

Analyst holding in stock: **NO**

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