Munjal Showa (MUNSHO)

CMP: ₹ 100 | Target:₹ 130 (30%) | Target Period: 12 months | BUY

July 13, 2020

Proxy to HMCL recovery, base case valuations to prevail

Munjal Showa (MSL) is a leading shock absorber (including front forks, struts) manufacturer domestically with a significant market share in the oligopolistic industry. It can be seen as a proxy play on volume & demand recovery at Hero MotoCorp (HMCL), with HMCL accounting for ~80% of its total sales (FY20). Part of the Hero Group (Munjal family), MSL was established in 1985 in technical collaboration with Showa Corporation (Japan), which also holds a 26% stake in the company.

Triggers

Anchor client HMCL leading recovery post Covid-19

MSL, being part of Hero Group, derives majority of its revenue from 2-W market leader HMCL (client mix - HMCL ~78%, HMSI ~7-8%, MSIL ~8%, Honda Cars ~5%). MSL commands ~95% wallet share at HMCL, ~25% of wallet share at MSIL, 100% of wallet share at Honda Cars. Our analysis of Vahan database shows 2-W segment clocked ~60% of pre-Covid retail sales in June - with HMCL sales back to ~60%+ of pre Covid levels (market share at ~40% vs. its wholesale market share at ~36%). This is driven by HMCL's rural stronghold (~50% of sales) & preference for motorcycles for social distancing needs. MSL by virtue of this trend should benefit in the near term.

Large cash balance, high dividend yield give margin of safety

Munjal Showa has a debt-free, cash rich balance sheet (cash & equivalents ~₹ 300 crore i.e. ~50% of net worth, ~70% of present market cap) with consistent cash flow generation track record (present CFO & FCF yield at ~15% & ~10%, respectively) and healthy dividend payout (dividend yield ~4%). It is currently trading at inexpensive valuations (~10x P/E, ~2x EV/EBITDA, ~0.65x P/B) despite double digit RoIC.

Valuation & Outlook

We expect base case valuations to prevail at MSL and assign **BUY** rating, valuing the stock at ₹ 130 i.e. 4x EV/EBITDA with implied P/B at 0.8x FY20 numbers. However, we do not view MSL as a long term portfolio play, given the slow pace of client additions, muted margin profile vs. peers and parallel existence of Showa Corporation in Indian as well as exports markets.

Key Financial Summary

P&L Account (₹ crore)	FY17	FY18	FY19	FY20P
Sales	1,459.7	1,581.4	1,669.3	1,288.0
EBITDA	99.7	113.3	88.4	55.0
EBITDA margin (%)	6.8	7.2	5.3	4.3
PAT	60.7	77.5	62.6	43.0
EPS (₹)	15.2	19.4	15.7	10.6
Balance Sheet (₹ crore)				
Equity	8.0	8.0	8.0	8.0
Net Worth	512.7	569.6	610.6	632.6
Debt	-	-	-	-
Return Ratios (%)				
RoE	11.8	13.6	10.3	6.8
RoCE	18.1	19.4	11.6	5.5
RoIC	26.5	34.7	26.7	10.4
Valuations (x)				
P/E	6.6	5.2	6.4	9.4
EV/EBITDA	1.0	0.9	1.1	1.8
P/B	0.8	0.7	0.7	0.6

Source: Capitaline, ICICI Direct Research

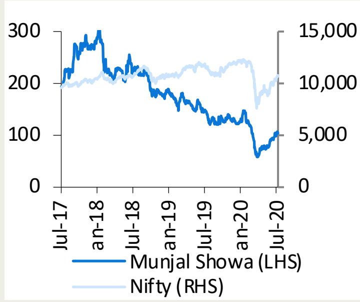
Particulars

Particulars	Amount
Market capitalisation (₹ crore)	400.0
Debt (FY20P, ₹ crore)	-
Cash & Inv. (FY20P, ₹ crore)	300.0
EV (₹ crore)	100.0
52 Week High/Low (₹)	149/55
Equity capital (₹ crore)	8.0
Face value (₹)	2.0
Promoter holding (%)	65.0
DII holding (%)	0.1
FII holding (%)	0.2

Key highlights

- Part of oligopolistic shock absorber space with ~80% revenues from anchor client HMCL
- Proxy play on HMCL recovery post Covid, with healthy balance sheet strength (cash at ~70% of market cap) providing margin of safety
- Assign BUY with target price of ₹ 130 i.e. 4x FY20 EV/EBITDA with implied P/B at 0.8x

Price Chart



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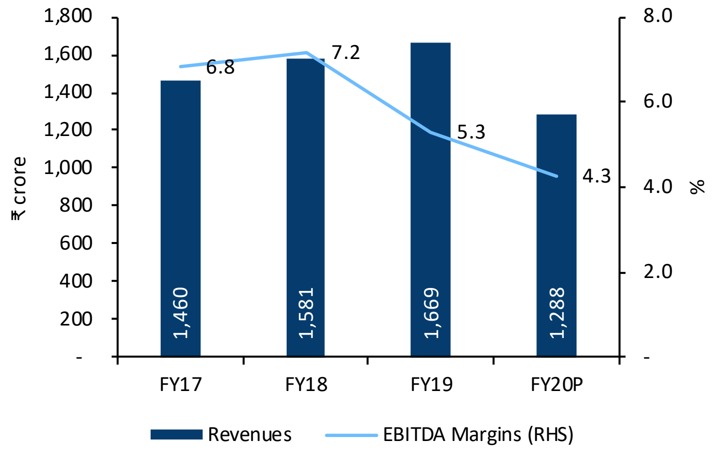
Story in charts

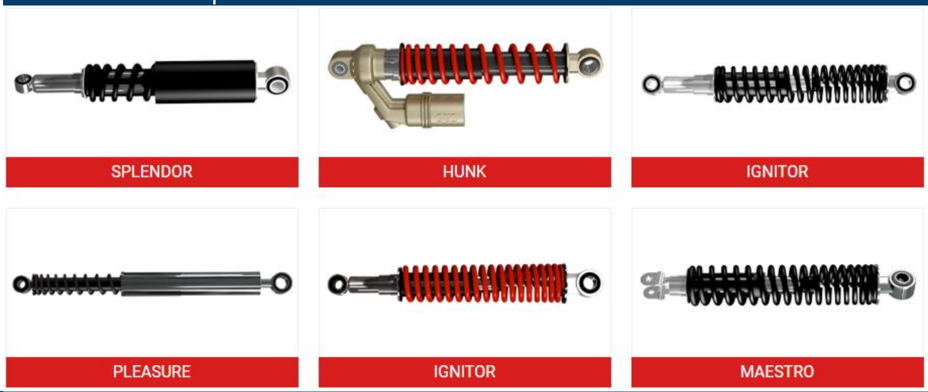
Exhibit 1: Trend in revenues, margins



Source: Company, ICICI Direct Research

MSL derives 85% revenues from 2-W and the rest from 4-W. Also, 23% YoY revenue decline during the past year has reduced FY17-20P CAGR to -4.1%. EBITDA margins have also dipped over the past two years courtesy negative operating leverage. Going forward, however, with anchor client HMCL expected to benefit from quicker post Covid recovery on account of ~52% market share in rural facing motorcycle segment, MSL is also expected to outperform peers in the coming months

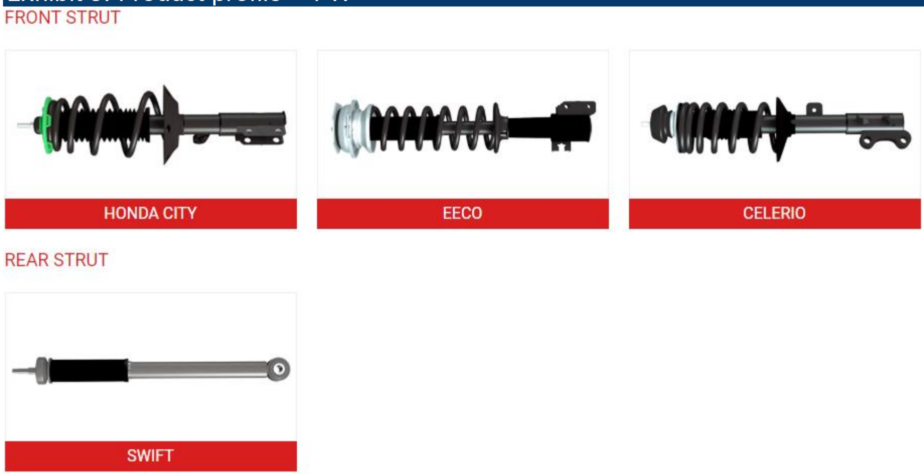
Exhibit 2: Product profile – 2-W



Source: Company, ICICI Direct Research

The 2-W ASPs at ~₹ 1,700/vehicle i.e. ₹ 433/unit

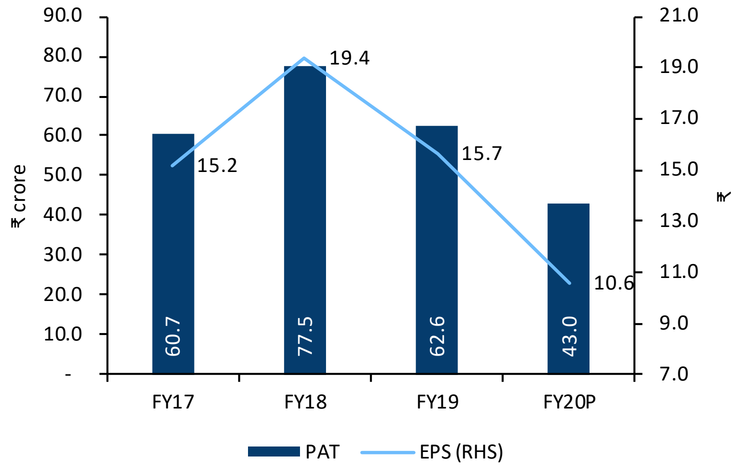
Exhibit 3: Product profile – 4-W



Source: Company, ICICI Direct Research

The 4-W ASPs are at ~₹ 4,400/vehicle i.e. ₹ 1,100/unit

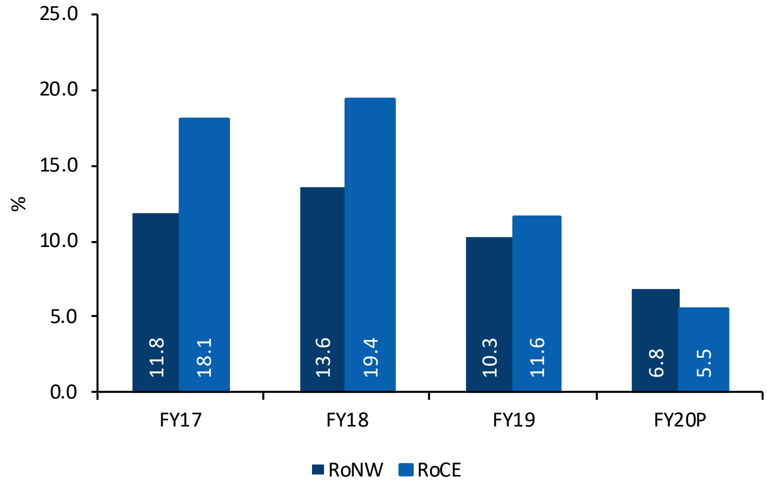
Exhibit 4: PAT, EPS trend



Source: Company, ICICI Direct Research

Revenue decline accompanied by margin dip have led to fall in profitability

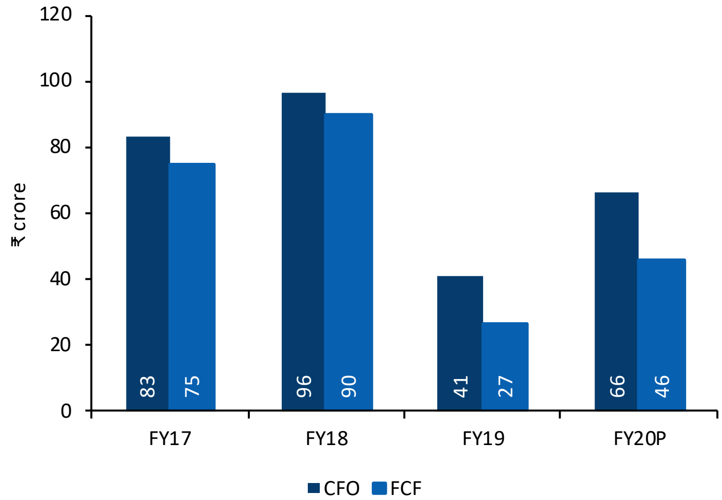
Exhibit 5: Trend in return ratios



Source: Company, ICICI Direct Research

Return ratios have fallen sharply after FY18 on account of deterioration in margin trajectory

Exhibit 6: CFO, FCF levels at MSL



Source: Company, ICICI Direct Research

MSL has a strong cash generation track record, with present CFO and FCF yield at ~15% and ~10%, respectively. It has remained debt free over the past four years

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