

Play on rural revival, superior B/S justify valuation premium

Swaraj Engines (SEL) reported a subdued set of Q1FY21 numbers. Net revenues for the quarter were down 43% YoY ₹ 117 crore, tracking a 40% decline in engine volumes to 13,756 units. ASPs for the period were to the tune of ₹ 85,047/unit, down 1.1% QoQ, 4.6% YoY. Margins fell 240 bps QoQ to 11% despite a 60 bps gross margin expansion as negative operating leverage played out. Consequent PAT for the quarter came in at ₹ 7.8 crore, down 54% YoY. Dividend for the year was at ₹ 40/share.

Tractor recovery on track, demand picture encouraging

SEL offers a play on the rural economy courtesy its anchor client M&M, which is the domestic tractor industry market leader with 41.2% market share. We expect the tractor segment to stay largely unaffected by demand side issues being faced by the rest of the automotive industry, courtesy stability in the outlook of rural incomes (on the back of good Rabi crop harvest, remunerative crop prices, healthy water table levels, normal monsoon 2020) and absence of regulatory disruption like BS-VI norms. Longer term demand drivers like the government's continued focus on doubling farm incomes and improving rural infrastructure as well as underpenetrated nature of farm mechanisation in India stay intact. Vahan data indicates that demand on the ground is encouraging, with June prints up ~10% YoY vs. ~40% decline for total auto industry. The management commentary said SEL reached near 100% capacity utilisation in June, which further supports our stance on domestic tractor industry outlook over FY20-22E. We build 3.2% engine volume CAGR for the company.

Superior financial health augments investibility

SEL is a debt-free, cash rich company with cash & liquid investments worth ~₹ 182 crore on books as of FY20 (~10% of current market cap), accompanied by a negative net working capital cycle of ~30 days. With healthy ~13-15% margin profile, asset turnover of ~3-4x, the company boasts of industry-leading return ratios (30% RoE, 34% RoCE, 163% RoIC as of FY20). Amid modest incremental capex requirements, strong cash generation (FY20 CFO ~₹ 100 crore, FCF at >₹ 80 crore), SEL is also a generous dividend payer (~70% payout, present dividend yield at ~3%). Its superior financial health stand out, particularly in present uncertain times.

Valuation & Outlook

We expect sales, EBITDA, PAT to grow at a CAGR of 3.5%, 10.4%, 9%, respectively, in FY20-22E. SEL, through its large business share of M&M's tractor division, is an auxiliary play on the post Covid revival of the domestic rural economy. Demand visibility in times of sluggishness elsewhere, in our opinion, is set to lead to continuation of premium valuations commanded by the company. Its robust financials offer additional comfort. We value SEL at ₹ 1,740 i.e. 25x FY22E EPS and retain **BUY** on the stock.

Key Financial Summary

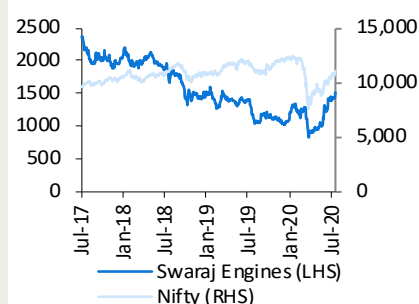
Key Financials	FY18	FY19	FY20	FY21E	FY22E	CAGR (FY20P-22E)
Net Sales	771	872	773	767	829	3.5%
EBITDA	122	132	100	106	122	10.4%
EBITDA Margins (%)	15.8	15.1	13.0	13.8	14.8	
Net Profit	80	82	71	73	84	9.0%
EPS (₹)	66.1	67.9	58.6	60.1	69.5	
P/E	22.9	22.3	25.8	25.2	21.8	
RoNW (%)	35.1	34.6	30.1	29.1	29.4	
RoCE (%)	45.9	47.1	34.0	33.9	34.7	

Source: ICICI Direct Research, Company

SWARAJ

Particulars	Amount
Market capitalisation (₹ crore)	1,833.3
Total Debt (FY 20, ₹ crore)	-
Cash & Inv. (FY 20, ₹ crore)	182.5
EV	1,650.8
52 week H/L (₹)	1545 / 807
Equity capital (₹ crore)	12.1
Face value (₹)	10.0

Price chart



Key Highlights

- Revenues decline 43% YoY in Q1FY21 amid 40% drop in engine volumes. Margins decline 240 bps QoQ to 11% courtesy negative operating leverage
- Offers a play on rural revival post Covid through anchor client M&M's tractor division
- Capital efficient, debt free business with excellent cash generation and dividend payout record
- Maintain BUY with revised target price of ₹ 1,740

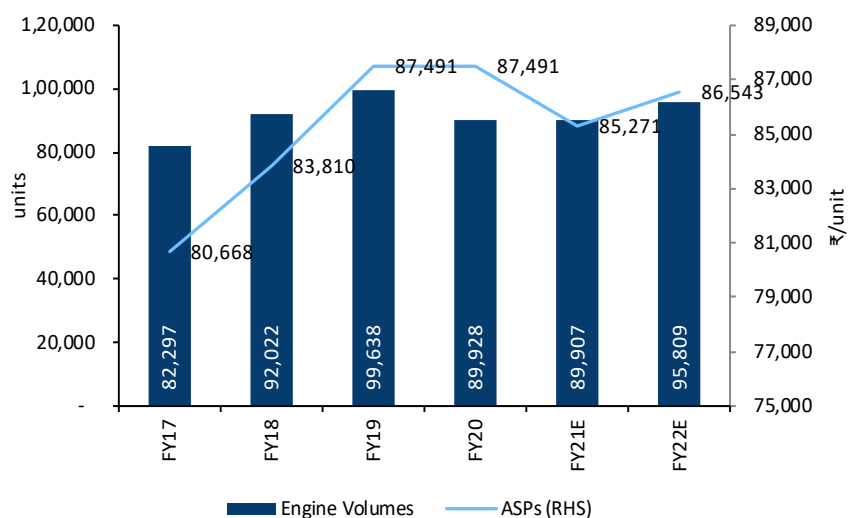
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Financial story in charts

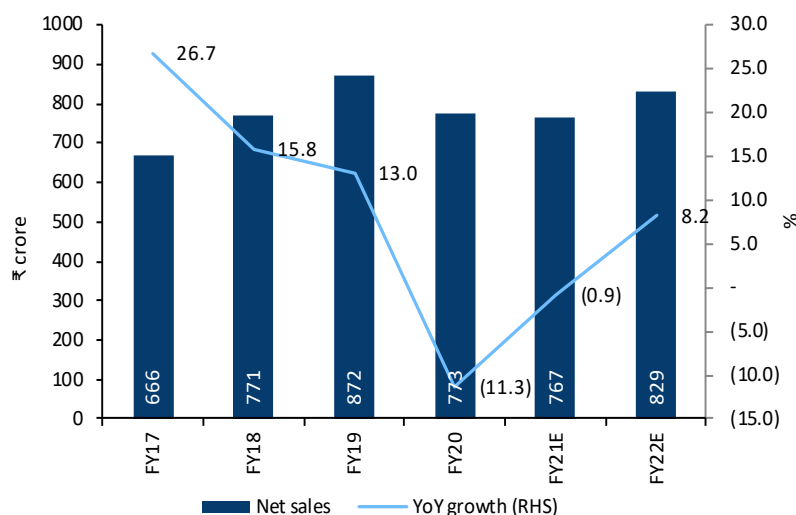
Exhibit 1: Trend in volumes and realisations



We expect SEL to clock 3.2% volume CAGR over FY20-22 to 95,809 units

Source: Company, ICICI Direct Research

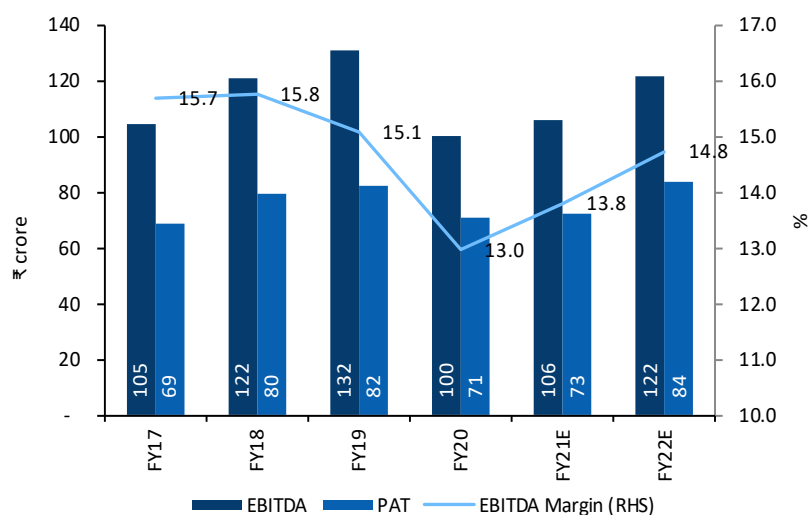
Exhibit 2: Topline trend



SEL's revenues are expected to grow at CAGR of 3.5% over FY2022E

Source: Company, ICICI Direct Research

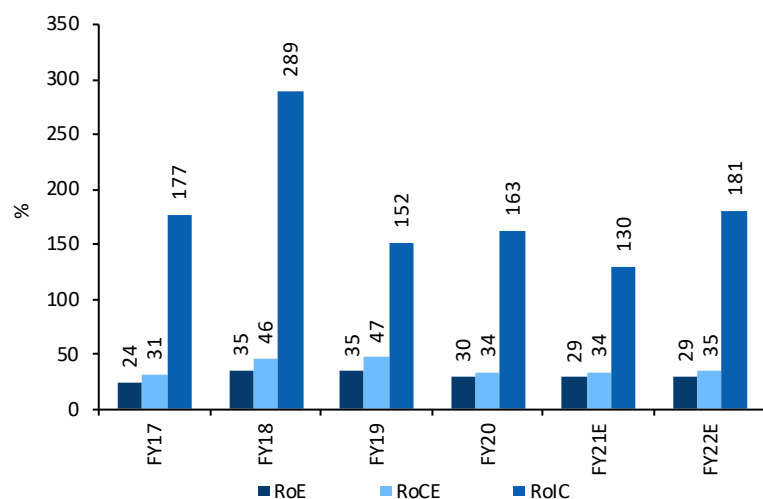
Exhibit 3: Trend in EBITDA, EBITDA margins and PAT



Margins seen rebounding from lows touched in FY20, supported by a rise in volumes. Erstwhile margin trajectory of ~15% is seen being reclaimed by FY22E. We expect PAT to grow at 9% CAGR over FY20-22E

Source: Company, ICICI Direct Research

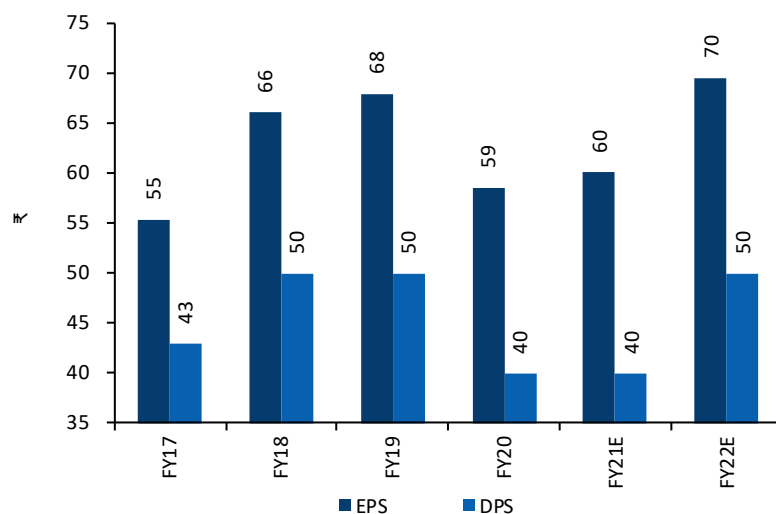
Exhibit 4: Trend in return ratios



Source: Company, ICICI Direct Research

Return ratio profile is among the industry's best, with RoIC > 100% courtesy large cash reserves as a percentage of net worth

Exhibit 5: Trend in EPS and DPS



Source: Company, ICICI Direct Research

SEL has consistently paid out ~70% of earnings as dividends, with present dividend yield at ~3%

Exhibit 6: Valuation summary

	Sales (₹ crore)	Growth (%)	EPS (₹)	Growth (%)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
FY 18	771	15.8	66.1	19.3	22.9	13.6	35.1	45.9
FY 19	872	13.0	67.9	2.8	22.3	12.7	34.6	47.1
FY 20	773	(11.3)	58.6	(13.8)	25.8	16.4	30.1	34.0
FY 21E	767	(0.9)	60.1	2.6	25.2	15.6	29.1	33.9
FY 22E	829	8.2	69.5	15.8	21.8	13.1	29.4	34.7

Source: Company, ICICI Direct Research

Financial Summary

Exhibit 7: Profit and loss statement					₹ crore
(Year-end March)	FY19	FY20	FY21E	FY22E	
Net Sales	871.7	773.3	766.6	829.2	
Other Operating Income	0.0	0.0	0.0	0.0	
Total Operating Income	871.7	773.3	766.6	829.2	
Growth (%)	13.0	-11.3	-0.9	8.2	
Raw Material Expenses	656.6	592.5	578.5	621.9	
Employee Expenses	39.3	41.8	42.0	43.5	
Other Operating Expense	44.2	38.6	40.2	41.5	
Total Operating Expenditure	740.1	672.9	660.6	706.9	
EBITDA	131.7	100.4	106.0	122.3	
Growth (%)	8.2	-23.7	5.6	15.4	
Depreciation	19.5	20.1	21.1	22.8	
Interest	0.1	0.0	0.0	0.0	
Other Income	15.4	12.8	12.7	13.3	
PBT	127.4	93.1	97.7	112.8	
Exceptional Item	0.0	0.0	0.0	0.0	
Total Tax	45.0	22.0	24.8	28.4	
PAT	82.4	71.0	72.9	84.4	
Growth (%)	2.9	-13.8	2.6	15.8	
EPS (₹)	67.9	58.6	60.1	69.5	

Source: Company, ICICI Direct Research

Exhibit 8: Cash flow statement					₹ crore
(Year-end March)	FY19	FY20	FY21E	FY22E	
Profit after Tax	82.4	71.0	72.9	84.4	
Add: Depreciation	19.5	20.1	21.1	22.8	
(Inc)/dec in Current Assets	-29.0	24.5	-21.7	-6.7	
Inc/(dec) in CL and Provisions	8.0	-6.6	-0.4	9.3	
Others	0.1	0.0	0.0	0.0	
CF from operating activities	81.0	109.1	71.8	109.8	
(Inc)/dec in Investments	-7.7	-27.3	11.1	-35.0	
(Inc)/dec in Fixed Assets	-34.2	-16.1	-15.0	-15.0	
Others	5.0	1.0	0.0	0.0	
CF from investing activities	(37.0)	(42.3)	(3.9)	(50.0)	
Issue/(Buy back) of Equity	0.0	0.0	0.0	0.0	
Inc/(dec) in loan funds	0.0	0.0	0.0	0.0	
Dividend paid & dividend tax	-72.8	-58.2	-48.5	-60.7	
Inc/(dec) in Share Cap	0.0	0.0	0.0	0.0	
Others	-0.2	-14.9	-9.5	12.1	
CF from financing activities	(73.0)	(73.1)	(58.0)	(48.5)	
Net Cash flow	-29.0	-6.4	9.9	11.3	
Opening Cash	106.8	77.8	71.4	81.3	
Closing Cash	77.8	71.4	81.3	92.5	

Source: Company, ICICI Direct Research

Exhibit 9: Balance Sheet					₹ crore
(Year-end March)	FY19	FY20	FY21E	FY22E	
Liabilities					
Equity Capital	12.1	12.1	12.1	12.1	
Reserve and Surplus	225.9	223.8	238.6	274.5	
Total Shareholders funds	238.0	235.9	250.8	286.6	
Total Debt	0.0	0.0	0.0	0.0	
Deferred Tax Liability	7.2	4.6	4.6	4.6	
Minority Interest / Others	0.0	0.0	0.0	0.0	
Total Liabilities	245.2	240.5	255.4	291.2	
Assets					
Gross Block	243.0	257.0	272.0	287.0	
Less: Acc Depreciation	134.5	154.7	175.8	198.6	
Net Block	108.4	102.3	96.3	88.5	
Capital WIP	2.0	4.0	4.0	4.0	
Total Fixed Assets	110.4	106.4	100.3	92.5	
Investments	85.5	112.2	101.1	136.1	
Inventory	47.4	37.0	42.0	45.4	
Debtors	18.7	4.1	21.0	22.7	
Loans and Advances	0.0	0.0	0.0	0.0	
Other Current Assets	18.6	19.2	19.0	20.6	
Cash	77.8	71.4	81.3	92.5	
Total Current Assets	162.6	131.7	163.3	181.3	
Current Liabilities	113.0	105.4	105.0	113.6	
Provisions	8.1	9.1	9.1	9.8	
Current Liabilities & Prov	121.1	114.6	114.1	123.4	
Net Current Assets	41.5	17.2	49.2	57.8	
Others Assets	7.8	4.7	4.7	4.7	
Application of Funds	245.2	240.5	255.4	291.2	

Source: Company, ICICI Direct Research

Exhibit 10: Key ratios					
(Year-end March)	FY19	FY20	FY21E	FY22E	
Per share data (₹)					
EPS	67.9	58.6	60.1	69.5	
Cash EPS	84.1	75.2	77.5	88.3	
BV	196.2	194.5	206.7	236.3	
DPS	50.0	40.0	40.0	50.0	
Cash Per Share (Incl Invst)	134.6	151.4	150.4	188.5	
Operating Ratios (%)					
EBITDA Margin	15.1	13.0	13.8	14.8	
PAT Margin	9.5	9.2	9.5	10.2	
Inventory days	19.9	17.5	20.0	20.0	
Debtor days	7.8	2.0	10.0	10.0	
Creditor days	47.3	49.8	50.0	50.0	
Return Ratios (%)					
RoE	34.6	30.1	29.1	29.4	
RoCE	47.1	34.0	33.9	34.7	
RoIC	152.0	162.8	129.9	181.1	
Valuation Ratios (x)					
P/E	22.3	25.8	25.2	21.7	
EV / EBITDA	12.7	16.4	15.6	13.1	
EV / Net Sales	1.9	2.1	2.2	1.9	
Market Cap / Sales	2.1	2.4	2.4	2.2	
Price to Book Value	7.7	7.8	7.3	6.4	
Solvency Ratios					
Debt/EBITDA	0.0	0.0	0.0	0.0	
Debt / Equity	0.0	0.0	0.0	0.0	
Current Ratio	0.7	0.5	0.7	0.7	
Quick Ratio	0.3	0.2	0.4	0.4	

Source: Company, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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