Subros Limited

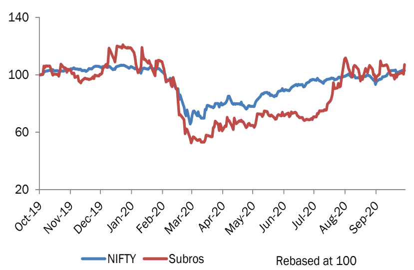
27 October 2020

The early bounce-back is a harbinger of good times to come

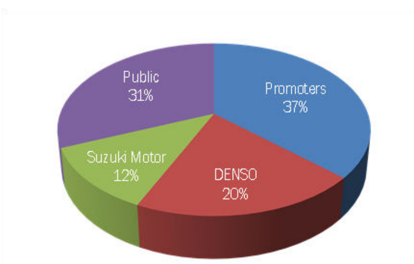
BUY

Sector	: Auto Ancillaries
Target Price	: Rs 365
Current Market Price	: Rs 265
Market Cap	: Rs 1,726 crore
52-week High/Low	: Rs 300/117
Daily Avg Vol (12M)	: 1,13,185
Face Value	: Rs 2
Beta	: 1.30
Pledged Shares	: 0%
Year End	: March
BSE Scrip Code	: 517168
NSE Scrip Code	: SUBROS
Bloomberg Code	: SUBR IN
Reuters Code	: SUBR.NS
Nifty	: 11,768
BSE Sensex	: 40,146
Analyst	: Ritwik Bhattacharjee

Price Performance



Shareholding Pattern



2Q FY21 Update

Result Highlights

- 2Q FY21 revenues declined by 8% y-o-y, witnessing significant improvement from the 87% y-o-y decline in 1Q FY21. Consequently, 1H FY21 saw a degrowth of 50% y-o-y which is attributable to the COVID-19 outbreak/lockdown and its impact on business operations and demand.
- While 2Q FY21 EBITDA increased by 21% y-o-y, 1H FY21 EBITDA was down 76% on account of the operating loss recorded in 1Q FY21.
- PAT bounced back strongly in 1Q FY21 with a y-o-y growth of 34%. Overall for the first half, PAT decline was recorded at 112% y-o-y.

Outlook & Valuation

While sales recovered strongly following a near-washout in the first quarter, 2Q FY21 revenues were lower on a y-o-y basis due to lower contribution from the home AC segment and slow recovery of the CV segment. 2Q FY21 EBITDA margin was higher by 280 bps on a y-o-y basis on account of higher localisation and favourable product mix including lower revenues from the low-margin home AC segment. Going forward, home AC volumes are expected to ramp up with management expecting annual contribution of Rs 200-250 crore (~10% of total revenues) from the segment over the next 2-3 years. The import ban on ACs with refrigerants will help domestic manufacturers like Subros. With most railway tenders remaining on hold during the lockdown, an annual run-rate of Rs 25-30 crore can be expected once railway tenders open with a preference for local players. Management plans to incur a capex of Rs 50-60 crore, out of which Rs 25-30 crore will be for R&D. Debt has reduced by approximately Rs 100 crore on a q-o-q basis with further paring by Rs 20-25 crore expected in 3Q FY21. The Subros stock has appreciated by 9% since our BUY rating on 17 September 2020. Based on an early recovery in profits and margin expansion, we upgrade our profit forecasts. Retaining a target P/E multiple of 22.0x, we increase our price target to Rs 365, maintaining a BUY rating with an upside of 38%.

Key Financial Metrics (Consolidated)

Rs crore	FY19A	FY20A	FY21E	FY22E	FY23E
Operating revenue	2,124.5	1,992.8	1,652.0	1,985.7	2,351.1
Growth		*-6.2%*	*-17.1%*	*20.2%*	*18.4%*
EBITDA	228.2	189.0	148.7	192.6	235.1
EBITDA margin	*10.7%*	*9.5%*	*9.0%*	*9.7%*	*10.0%*
PAT	76.3	84.6	34.7	85.4	108.2
PAT margin	*3.6%*	*4.2%*	*2.1%*	*4.3%*	*4.6%*
Diluted EPS (Rs)	12.37	13.00	5.32	13.09	16.58

Source: Company data; Khambatta Research

Tel: +91-(0)22 4027 3300
Fax: +91-(0)22 6641 3377
www.khambattasecurities.com

Financial Performance (Standalone)

Rs crore	2Q FY20	2Q FY21	Y-o-y	1H FY20	1H FY21	Y-o-y
Operating revenue	496.5	458.1	-7.7%	1,068.7	531.9	-50.2%
EBITDA	44.1	53.5	21.4%	99.2	23.6	-76.2%
EBITDA margin	*8.9%*	*11.7%*	*280 bps*	*9.3%*	*4.4%*	*-484 bps*
PAT	13.2	17.7	33.9%	55.0	(6.3)	-111.5%
PAT margin	*2.7%*	*3.9%*	*120 bps*	*5.1%*	*-1.2%*	*-633 bps*
EPS (Rs)	2.03	2.72	34.0%	8.43	(0.97)	-111.5%

Source: Company data; Khambatta Research

This space has been intentionally left blank

Tel: +91-(0)22 4027 3300
Fax: +91-(0)22 6641 3377
www.khambattasecurities.com

Guide to Khambatta's research approach

Valuation methodologies

We apply the following absolute/relative valuation methodologies to derive the 'fair value' of the stock as a part of our fundamental research:

DCF: The Discounted Cash Flow (DCF) method values an estimated stream of future free cash flows discounted to the present day, using a company's WACC or cost of equity. This method is used to estimate the attractiveness of an investment opportunity and as such provides a good measure of the company's value in absolute terms. There are several approaches to discounted cash flow analysis, including Free Cash Flow to Firm (FCFF), Free Cash Flow to Equity (FCFE) and the Dividend Discount Model (DDM). The selection of a particular approach depends on the particular company being researched and valued.

ERE: The Excess Return to Equity (ERE) method takes into consideration the absolute value of a company's return to equity in excess of its cost of equity discounted to the present day using the cost of equity. This methodology is more appropriate for valuing banking stocks than FCFF or FCFE methodologies.

Relative valuation: In relative valuation, various comparative multiples or ratios including Price/Earnings, Price/Sales, EV/Sales, EV/EBITDA, Price/Book Value are used to assess the relative worth of companies which operate in the same industry/industries and are thereby in the same peer group. Generally our approach involves the use of two multiples to estimate the relative valuation of a stock.

Other methodologies such as DuPont Analysis, CFROI, NAV and Sum-of-the-Parts (SOTP) are applied where appropriate.

Stock ratings

Buy recommendations are expected to improve, based on consideration of the fundamental view and the currency impact (where applicable) by at least 15%.

Hold recommendations are expected to improve, based on consideration of the fundamental view and the currency impact (where applicable) between 5% and 15%.

Sell recommendations are expected to improve up to 5% or deteriorate, based on consideration of the fundamental view and the currency impact (where applicable).

Analyst Certification

I/We, Research Analysts and authors, hereby certify that all of the views expressed in this research report accurately reflect our views about the subject securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

Terms & Conditions and Other Disclosures:

Khambatta Securities Limited (Khambatta Securities) is a full-service, integrated merchant banking and is, inter alia, engaged in the business of stock brokering and distribution of financial products.

Khambatta Securities is one of the merchant bankers. We and our associates might have investment banking and other business relationship with companies covered by our Investment Research Department. Khambatta Securities generally prohibits its analysts, persons reporting to analysts and their relatives from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover.

The information and opinions in this report have been prepared by Khambatta Securities and are subject to change without any notice. The report and information contained herein is strictly confidential and meant solely for the selected recipient and may not be altered in any way, transmitted to, copied or distributed, in part or in whole, to any other person or to the media or reproduced in any form, without prior written consent of Khambatta Securities. While we would endeavor to update the information herein on a reasonable basis, Khambatta Securities is under no obligation to update or keep the information current. Also, there may be regulatory, compliance or other reasons that may prevent Khambatta Securities from doing so.

This report is based on information obtained from public domain and is believed to be reliable, but no independent verification has been made nor is its accuracy or completeness guaranteed. This report and information herein is solely for informational purpose and shall not be used or considered as an offer document or solicitation of offer to buy or sell or subscribe for securities or other financial instruments. Though disseminated to all the customers simultaneously, not all customers may receive this report at the same time. Khambatta Securities will not treat recipients as customers by virtue of their receiving this report. Nothing in this report constitutes investment, legal, accounting and tax advice or a representation that any investment or strategy is suitable or appropriate to your specific circumstances. The securities discussed and opinions expressed in this report may not be suitable for all investors, who must make their own investment decisions, based on their own investment objectives, financial positions and needs of specific recipient. This may not be taken in substitution for the exercise of independent judgment by any recipient. The recipient should independently evaluate the investment risks. The value and return on investment may vary because of changes in interest rates, foreign exchange rates or any other reason. Khambatta Securities accepts no liabilities whatsoever for any loss or damage of any kind arising out of the use of this report. Past performance is not necessarily a guide to future performance. Investors are advised to understand the risks associated before investing in the securities markets. Actual results may differ materially from those set forth in projections. Forward-looking statements are not predictions and may be subject to change without notice.

Khambatta Securities or its associates might have received any compensation from the companies mentioned in the report during the period preceding twelve months from the date of this report for services in respect of investment banking or merchant banking, brokerage services or other advisory services.
Khambatta Securities encourages independence in research report preparation and strives to minimize conflict in preparation of research report. Khambatta Securities or its analysts do not receive any compensation or other benefits from the companies mentioned in the report or third party in connection with preparation of the research report. Accordingly, neither Khambatta Securities nor Research Analysts have any material conflict of interest at the time of publication of this report.

Tel: +91-(0)22 4027 3300
Fax: +91-(0)22 6641 3377
www.khambattasecurities.com

It is confirmed that Research Analysts of this report have not received any compensation from the companies mentioned in the report in the preceding twelve months. Compensation of our Research Analysts is not based on any specific merchant banking, investment banking or brokerage service transactions.

The Research Analysts engaged in preparation of this Report (a) may or may not have any financial interests in the subject company or companies mentioned in this report; (b) do not own 1% or more of the equity securities of the subject company mentioned in the report as of the last day of the month preceding the publication of the research report; (c) do not have any other material conflict of interest at the time of publication of the research report.

It is confirmed that Research Analysts do not serve as an officer, director or employee of the companies mentioned in the report.

Neither the Research Analysts nor Khambatta Securities have been engaged in market making activity for the companies mentioned in the report.

We submit that no material disciplinary action has been taken on Khambatta Securities by any Regulatory Authority impacting Equity Research Analysis activities.

This report has been prepared by Khambatta Securities. Khambatta Securities has reviewed the report and, in so far as it includes current or historical information, it is believed to be reliable, although its accuracy and completeness cannot be guaranteed.