

## Muted growth prospects to weigh on superior financials

**About the stock:** Swaraj Engines (SEL) is involved in manufacturing diesel engines for M&M's Swaraj brand of tractors. It is headquartered at Mohali (Punjab).

- Steady ~13% compounding of revenues, EBITDA, PAT over past five years
- Net cash positive b/s; consistent cash flow generation; highly capital efficient player with history of >30% return ratios & high dividend payouts

**Q3FY22 Results:** SEL reported muted Q3FY22 results.

- Diesel engine volumes were at 23,836 units, down 24% YoY
- Net sales declined 13% YoY to ₹ 238 crore tracking 2.3% QoQ ASP increase
- Margins dipped to 12.3%, down 160 bps QoQ
- Consequent PAT was down 19% YoY to ₹ 20 crore

**What should investors do?** The stock appreciated at ~2% CAGR from ~₹ 1,420 in January 2017 over the past five years, underperforming the broader Nifty Auto index.

- We downgrade the stock from BUY to **HOLD** amid muted growth expectations in the tractor space on high base of FY21.

**Target Price and Valuation:** Introducing FY24E, we now value SEL at ₹ 1,720 i.e. 15x P/E on FY23-24E average EPS of ~₹115/share (earlier target price ₹ 2,135).

### Key triggers for future price performance:

- Play on farm mechanisation courtesy ~32% volume share of M&M's tractor sales via Swaraj brand of tractors
- Superlative return ratios profile along with positive CFO, FCF generation
- Attractive dividend play, with present dividend yield at ~5%
- Sales, PAT to grow at 12%, 16.5% CAGR, respectively, in FY21-24E, building in ~6% volume CAGR

**Alternate Stock Idea:** In our auto- ancillary coverage we like JK Tyre.

- Walking the talk on b/s deleveraging, sweating of assets & capital efficiency.
- BUY with a target price of ₹ 185

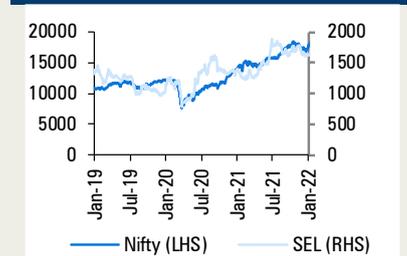
### Particulars

Particular	₹ crore
Market Capitalization	1,855.1
Total Debt (FY21)	0.0
Cash & Investments (FY21)	151.4
EV (FY21)	1,703.7
52 week H/L (₹)	1990 / 1255
Equity capital	12.1
Face value (₹)	10.0

### Shareholding pattern

	Mar-21	Jun-21	Sep-21	Dec-21
Promoter	52.2	52.2	52.2	52.2
FII	1.6	1.9	1.5	1.9
DII	10.4	10.7	9.1	8.9
Other	35.8	35.3	37.3	37.1

### Price Chart



### Recent event & key risks

- Posted muted Q3FY22 results.
- Key Risk:** (i) Lower-than-expected gross margin trajectory, (ii) More than expected increase in tractor sales, consequent engine sales

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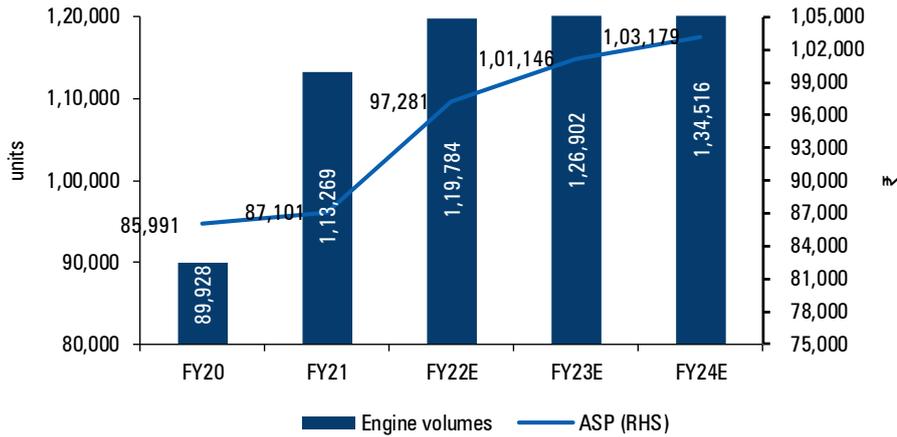
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### Key Financial Summary

Key Financials	FY19	FY20	FY21	5 year CAGR (FY16-21)	FY22E	FY23E	FY24E	3 year CAGR (FY21-24E)
Net Sales	871.7	773.3	986.6	13.4%	1,165.3	1,283.6	1,387.9	12.0%
EBITDA	131.7	100.4	135.7	13.0%	160.1	180.2	197.7	13.4%
EBITDA Margins (%)	15.1	13.0	13.8		13.7	14.0	14.2	
Net Profit	82.4	71.0	92.6	12.6%	115.2	132.2	146.2	16.5%
EPS (₹)	67.9	58.6	76.2		94.9	108.9	120.5	
P/E	22.5	26.1	20.1		16.1	14.1	12.7	
RoNW (%)	34.6	30.1	33.0		37.1	38.2	38.2	
RoCE (%)	47.1	34.0	41.3		45.5	46.2	45.8	

### Financial story in charts

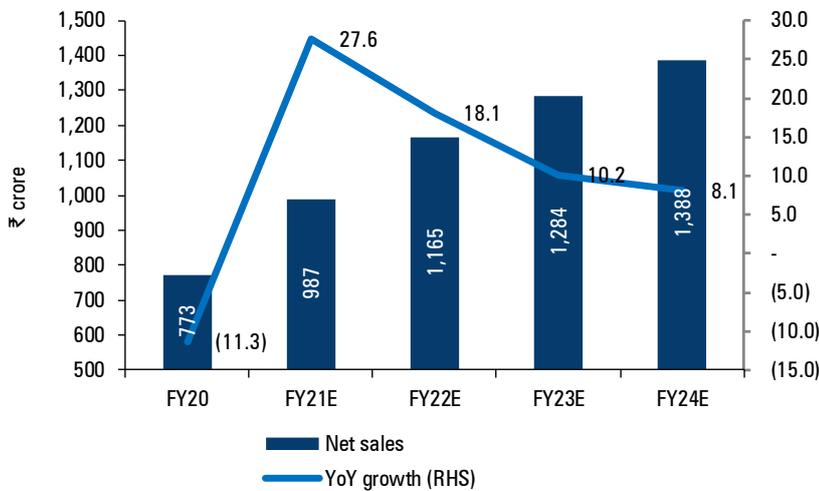
Exhibit 1: Trend in volumes and ASPs



SEL is seen posting 5.9% volume CAGR in FY21-24E with ASP seen increasing at 5.8% CAGR in that time

Source: Company, ICICI Direct Research

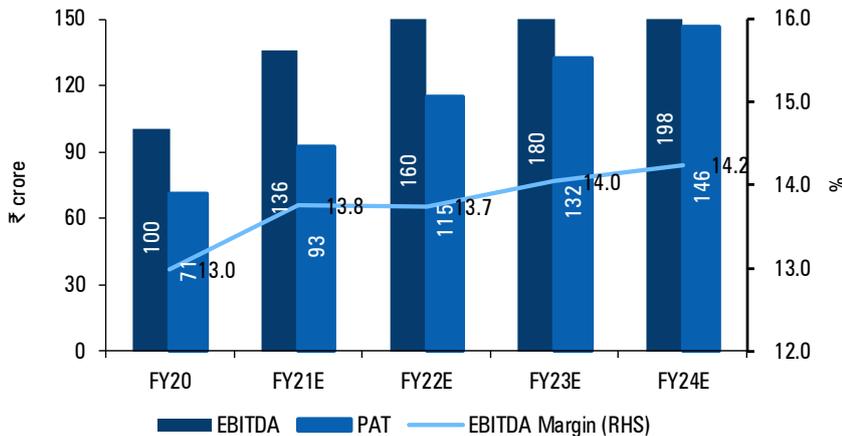
Exhibit 2: Trend in topline



Net sales are expected to grow at 12% CAGR over FY21-24E to ₹ 1,388 crore

Source: Company, ICICI Direct Research

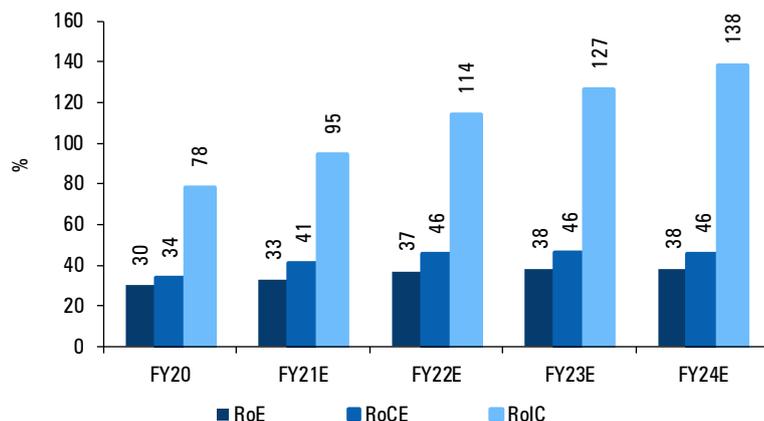
Exhibit 3: Trend in margins and profitability



We expect margins to reach 14.2% by FY24E on higher operating leverage, with PAT seen growing at 16.5% CAGR over FY21-24E to ₹ 146 crore

Source: Company, ICICI Direct Research

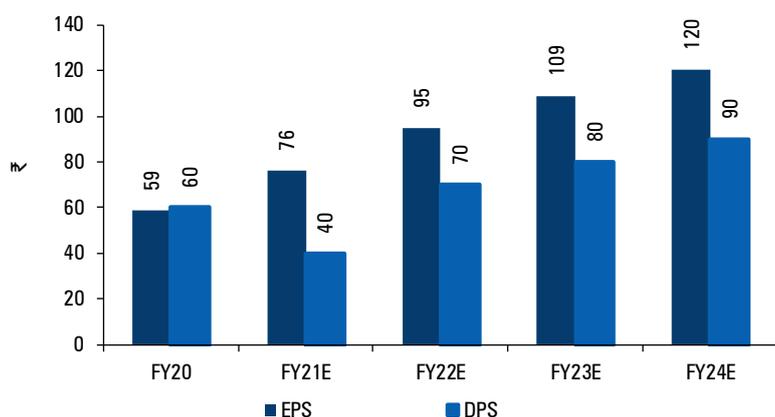
Exhibit 4: Trend in return ratios



With healthy double-digit return ratios and high dividend payouts, SEL is poised to continue to post industry-leading return ratios in future

Source: Company, ICICI Direct Research

Exhibit 5: Trend in EPS and DPS



Dividend payout ratio is expected at ~74% in FY22E, FY23E & FY24E; thereby offering a healthy dividend yield of ~5%

Source: Company, ICICI Direct Research

Exhibit 6: Valuation Summary

	Sales (₹ cr)	Growth (%)	EPS (₹)	Growth (%)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
FY19	871.7	13.0	67.9	2.8	22.5	12.9	34.6	47.1
FY20	773.3	-11.3	58.6	-13.8	26.1	17.2	30.1	34.0
FY21	986.6	27.6	76.2	30.2	20.1	12.6	33.0	41.3
FY22E	1165.3	18.1	94.9	24.4	16.1	10.5	37.1	45.5
FY23E	1283.6	10.2	108.9	14.8	14.1	9.1	38.2	46.2
FY24E	1387.9	8.1	120.5	10.6	12.7	8.1	38.2	45.8

Source: Company, ICICI Direct Research

## Financial Summary

Exhibit 7: Profit and loss statement				
	₹ crore			
(Year-end March)	FY21	FY22E	FY23E	FY24E
<b>Net Sales</b>	<b>986.6</b>	<b>1,165.3</b>	<b>1,283.6</b>	<b>1,387.9</b>
Other Operating Income	-	-	-	-
Total Operating Income	986.6	1,165.3	1,283.6	1,387.9
Growth (%)	27.6	18.1	10.2	8.1
Raw Material Expenses	765.7	912.1	1,003.7	1,082.6
Employee Expenses	42.9	45.1	48.2	52.1
Other Operating Expense	42.3	47.9	51.3	55.5
Total Operating Expenditure	850.9	1,005.2	1,103.3	1,190.2
<b>EBITDA</b>	<b>135.7</b>	<b>160.1</b>	<b>180.2</b>	<b>197.7</b>
Growth (%)	35.1	18.0	12.6	9.7
Depreciation	19.8	18.6	20.5	22.2
Interest	-	0.1	-	-
Other Income	8.6	13.3	17.7	20.8
<b>PBT</b>	<b>124.5</b>	<b>154.7</b>	<b>177.4</b>	<b>196.3</b>
Exceptional Item	-	-	-	-
Total Tax	31.9	39.5	45.2	50.0
<b>PAT</b>	<b>92.6</b>	<b>115.2</b>	<b>132.2</b>	<b>146.2</b>
Growth (%)	30.3	24.4	14.8	10.6
<b>EPS (₹)</b>	<b>76.2</b>	<b>94.9</b>	<b>108.9</b>	<b>120.5</b>

Source: Company, ICICI Direct Research

Exhibit 8: Cash flow statement				
	₹ crore			
(Year-end March)	FY21	FY22E	FY23E	FY24E
<b>Profit after Tax</b>	<b>92.6</b>	<b>115.2</b>	<b>132.2</b>	<b>146.2</b>
Add: Depreciation	19.8	18.6	20.5	22.2
(Inc)/dec in Current Assets	(94.2)	9.6	(20.1)	(17.7)
Inc/(dec) in CL and Provisions	62.6	(9.5)	17.0	15.0
Others	-	0.1	-	-
<b>CF from operating activities</b>	<b>80.8</b>	<b>133.9</b>	<b>149.6</b>	<b>165.7</b>
(Inc)/dec in Investments	76.9	(30.0)	(30.0)	(35.0)
(Inc)/dec in Fixed Assets	(5.9)	(20.0)	(20.0)	(20.0)
Others	(4.8)	-	-	-
<b>CF from investing activities</b>	<b>66.3</b>	<b>(50.0)</b>	<b>(50.0)</b>	<b>(55.0)</b>
Issue/(Buy back) of Equity	0.0	-	-	-
Inc/(dec) in loan funds	-	-	-	-
Dividend paid & dividend tax	(48.5)	(85.0)	(97.1)	(109.2)
Inc/(dec) in Share Cap	-	-	-	-
Others	0.5	(0.1)	-	-
<b>CF from financing activities</b>	<b>(48.0)</b>	<b>(85.0)</b>	<b>(97.1)</b>	<b>(109.2)</b>
Net Cash flow	99.0	(1.1)	2.5	1.4
Opening Cash	18.2	117.3	116.2	118.7
<b>Closing Cash</b>	<b>117.3</b>	<b>116.2</b>	<b>118.7</b>	<b>120.1</b>

Source: Company, ICICI Direct Research

Exhibit 9: Balance Sheet				
	₹ crore			
(Year-end March)	FY21	FY22E	FY23E	FY24E
<b>Liabilities</b>				
Equity Capital	12.1	12.1	12.1	12.1
Reserve and Surplus	268.4	298.6	333.6	370.6
<b>Total Shareholders funds</b>	<b>280.5</b>	<b>310.7</b>	<b>345.7</b>	<b>382.7</b>
Total Debt	-	-	-	-
Deferred Tax Liability	0.6	0.6	0.6	0.6
Minority Interest / Others	-	-	-	-
<b>Total Liabilities</b>	<b>281.1</b>	<b>311.3</b>	<b>346.3</b>	<b>383.3</b>
<b>Assets</b>				
Gross Block	265.6	285.6	305.6	325.6
Less: Acc Depreciation	174.4	193.1	213.6	235.8
Net Block	91.1	92.5	92.0	89.8
Capital WIP	1.3	1.3	1.3	1.3
<b>Total Fixed Assets</b>	<b>92.5</b>	<b>93.8</b>	<b>93.3</b>	<b>91.1</b>
Investments	34.9	64.9	94.9	129.9
Inventory	61.7	63.9	70.3	76.1
Debtors	113.4	95.8	105.5	114.1
Loans and Advances	13.4	15.9	17.5	18.9
Other Current Assets	19.2	22.7	25.0	27.0
<b>Cash</b>	<b>117.3</b>	<b>116.2</b>	<b>118.7</b>	<b>120.1</b>
Total Current Assets	325.0	314.3	337.0	356.2
Current Liabilities	168.7	159.6	175.8	190.1
Provisions	8.5	8.1	8.9	9.6
Current Liabilities & Prov	177.2	167.7	184.7	199.8
<b>Net Current Assets</b>	<b>147.8</b>	<b>146.6</b>	<b>152.2</b>	<b>156.4</b>
Others Assets	5.9	5.9	5.9	5.9
<b>Application of Funds</b>	<b>281.1</b>	<b>311.3</b>	<b>346.3</b>	<b>383.3</b>

Source: Company, ICICI Direct Research

Exhibit 10: Key ratios				
(Year-end March)	FY21	FY22E	FY23E	FY24E
<b>Per share data (₹)</b>				
EPS	76.2	94.9	108.9	120.5
Cash EPS	92.5	110.2	125.8	138.8
BV	231.1	256.0	284.8	315.3
DPS	69.0	70.0	80.0	90.0
Cash Per Share (Incl Invst)	125.3	149.1	175.9	205.9
<b>Operating Ratios (%)</b>				
EBITDA Margin	13.8	13.7	14.0	14.2
PAT Margin	9.4	9.9	10.3	10.5
Inventory days	22.8	20.0	20.0	20.0
Debtor days	41.9	30.0	30.0	30.0
Creditor days	62.4	50.0	50.0	50.0
<b>Return Ratios (%)</b>				
RoE	33.0	37.1	38.2	38.2
RoCE	41.3	45.5	46.2	45.8
RoIC	94.7	114.4	126.5	138.4
<b>Valuation Ratios (x)</b>				
P/E	20.1	16.1	14.1	12.7
EV / EBITDA	12.6	10.5	9.1	8.1
EV / Net Sales	1.7	1.4	1.3	1.2
Market Cap / Sales	1.9	1.6	1.4	1.3
Price to Book Value	6.6	6.0	5.4	4.9
<b>Solvency Ratios</b>				
Debt/EBITDA	-	-	-	-
Debt / Equity	-	-	-	-
Current Ratio	1.2	1.2	1.2	1.2
Quick Ratio	0.8	0.8	0.8	0.8

Source: Company, ICICI Direct Research

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Reduce: -15% to -5%;

Sell: <-15%



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