

## Healthy macros in place; B/S strength unmatched...

Swaraj Engines (SEL) reported healthy Q2FY21 numbers amid record quarterly volumes (34,489 engines, up 31.3% YoY). Net revenues rose 31.2% YoY (entirely volume led, ASPs flat) to ₹ 292 crore, tracking a strong quarter for the domestic tractor industry. Margins rose 20 bps YoY to 13.7% courtesy savings in employee & other expenses with consequent PAT up 7% YoY to ₹ 27 crore. SEL would be expanding capacities by 15,000 units per annum to 1.5 lakh units per annum, to be funded by internal accruals.

## Buoyant tractor industry fortunes provide growth momentum

The domestic tractor industry has been leading the post-Covid domestic automotive recovery by being the only segment with consistently positive YoY growth post May 2020. Post the blip in April-May 2020, the industry has posted average of ~40% YoY rise in retail volumes each month in June-September, with the print for October coming in at ~53,000 units, up ~50% YoY. Lower spread incidence of the pandemic in semi urban and rural areas along with other tailwinds such as strong income support from crop sowing, well-spread sufficient rainfall and continued government support in the form of spends on agriculture and rural development has helped insulate the industry from the otherwise widespread demand sluggishness. The industry is expected to post relatively healthy 5-7% growth in FY21E. Domestic market leader M&M (41.2% market share as of FY20) would also benefit. SEL offers a play on the rural economy courtesy M&M (anchor client), where it supplies engines to Swaraj brand of tractors (~30% of M&M's tractor portfolio). Further consolidation of M&M's market position along with any incremental wallet share from the company are additional growth levers for SEL. We build 7.3% engine volume CAGR for the company in FY20-23E.

## Margin improvement to complement strong financials

Margins for FY21E are expected to dip to ~13%, largely tracking a subdued performance in Q1FY21. However, from FY22E onwards, SEL is seen climbing back to erstwhile 14-15% trajectory amid operating leverage benefits. On the B/S front, SEL remains a debt-free, cash rich company with cash & liquid investments worth ~₹ 182 crore on books as of FY20 (~10% of current market cap). Negative working capital cycle demonstrates the strength of the business model. It has a track record of robust capital efficiency (30% RoE, 34% RoCE, 163% RoIC as of FY20), while cash generation track record is also excellent (CFO and FCF positive in each of the past 10 years) with present CFO yield at ~5% (FY20-23E).

## Valuation & Outlook

We expect FY20-23E sales, PAT CAGR at 8.2%, 9.0%, respectively. SEL provides an auxiliary play on domestic tractor industry (rural economy) as well as M&M. Its strong B/S, ~70%+ dividend payout & healthy capital efficiency merit continued premium valuations, in our view. We value SEL at ₹ 1,710 i.e. 24x P/E on FY22E & FY23E average EPS (₹ 71.2) & retain **BUY**.

### Key Financial Summary

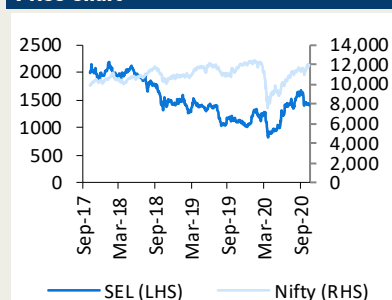
Key Financials	FY19	FY20	FY21E	FY22E	FY23E	CAGR (FY20-23E)
Net Sales	871.7	773.3	812.1	906.8	980.0	8.2%
EBITDA	131.7	100.4	99.2	122.6	137.5	11.0%
EBITDA Margins (%)	15.1	13.0	12.2	13.5	14.0	
Net Profit	82.4	71.0	65.7	80.8	92.1	9.0%
EPS (₹)	67.9	58.6	54.2	66.6	75.9	
P/E	20.6	23.9	25.8	21.0	18.4	
RoNW (%)	34.6	30.1	27.0	29.3	30.0	
RoCE (%)	47.1	34.0	32.1	35.9	36.5	

Source: ICICI Direct Research, Company

### Particulars

Particular	₹ crore
Market Capitalization	1,697.5
Total Debt (FY20)	0.0
Cash & Investments (FY20)	182.5
EV (FY20)	1,515.0
52 week H/L (₹)	1709 / 807
Equity capital	12.1
Face value (₹)	10.0

### Price chart



### Key Highlights

- Revenues up 31% YoY in Q2FY21 amid equal growth in engine volumes. Margins up 20 bps YoY to 13.7% tracking savings in employee and other costs
- Strong growth momentum in domestic tractor industry post Covid provides visibility on topline front
- Capital efficient, debt free business with excellent cash generation and dividend payout record
- Maintain BUY with revised target price of ₹ 1,710

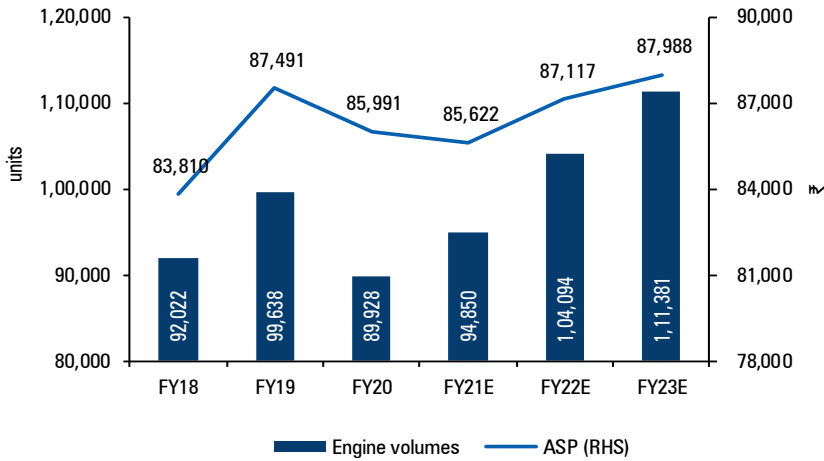
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## Financial story in charts

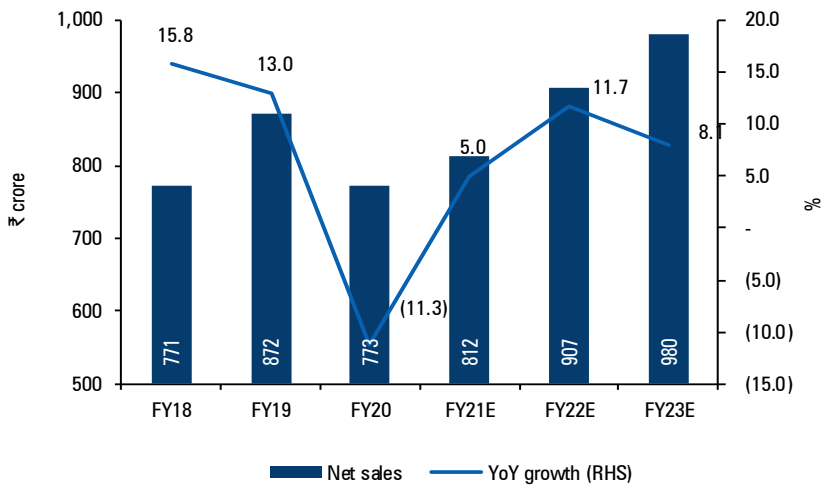
Exhibit 1: Trend in volumes and realisations



We expect SEL to clock 7.3% volume CAGR over FY20-23E to 1.11 lakh units

Source: Company, ICICI Direct Research

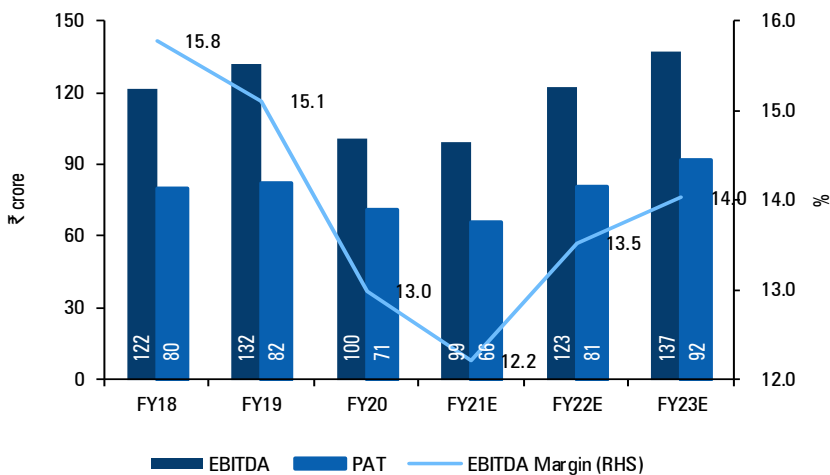
Exhibit 2: Topline trend



SEL's revenues are expected to grow at CAGR of 8.2% over FY20-23E

Source: Company, ICICI Direct Research

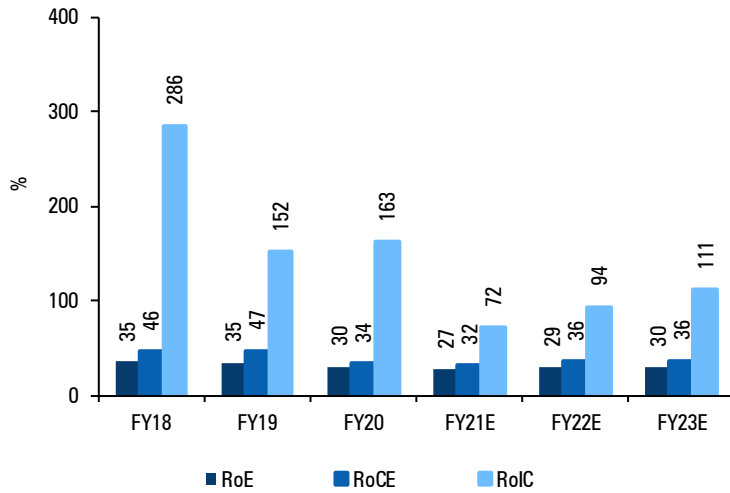
Exhibit 3: Trend in EBITDA, EBITDA margins and PAT



Margins seen rebounding from lows touched in FY20, supported by a rise in volumes. Erstwhile margin trajectory of ~14-15% is seen being reclaimed by FY23E. We expect PAT to grow at 9.0% CAGR over FY20-23E

Source: Company, ICICI Direct Research

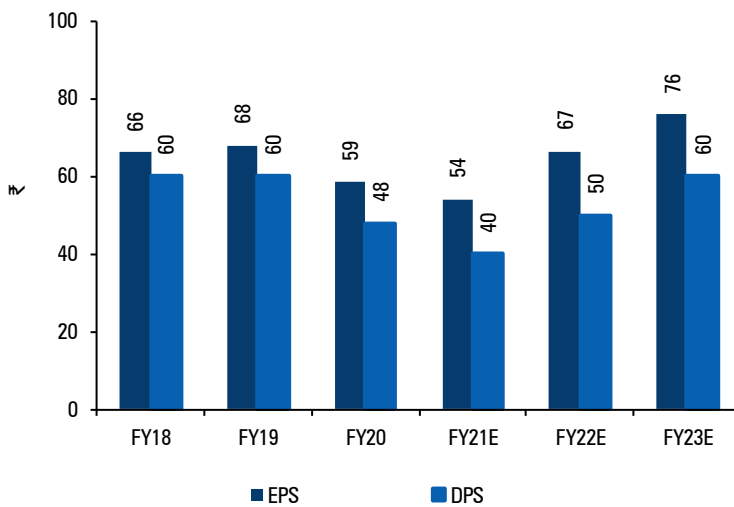
Exhibit 4: Trend in return ratios



Return ratio profile is among the industry's best, with RoI > 70% courtesy large cash reserves as a percentage of net worth

Source: Company, ICICI Direct Research

Exhibit 5: Trend in EPS and DPS



SEL has consistently paid out ~70% of earnings as dividends, with present dividend yield at ~3.5%

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	20.6	11.7	34.6	47.1
FY20	773.3	-11.3	58.6	-13.8	23.9	15.1	30.1	34.0
FY21E	812.1	5.0	54.2	-7.5	25.8	15.8	27.0	32.1
FY22E	906.8	11.7	66.6	22.9	21.0	12.5	29.3	35.9
FY23E	980.0	8.1	75.9	14.0	18.4	10.9	30.0	36.5

Source: Company, ICICI Direct Research

## Financial Summary

Exhibit 7: Profit and loss statement				
	₹ crore			
(Year-end March)	FY20	FY21E	FY22E	FY23E
<b>Net Sales</b>	<b>773.3</b>	<b>812.1</b>	<b>906.8</b>	<b>980.0</b>
Other Operating Income	-	-	-	-
Total Operating Income	773.3	812.1	906.8	980.0
Growth (%)	47.0	5.0	11.7	8.1
Raw Material Expenses	592.5	630.5	689.2	744.8
Employee Expenses	41.8	43.0	47.8	50.6
Other Operating Expense	38.6	39.5	47.2	47.1
Total Operating Expenditure	672.9	712.9	784.2	842.5
<b>EBITDA</b>	<b>100.4</b>	<b>99.2</b>	<b>122.6</b>	<b>137.5</b>
Growth (%)	36.5	(1.2)	23.6	12.1
Depreciation	20.1	21.1	23.6	25.5
Interest	0.0	-	-	-
Other Income	12.8	10.2	8.9	11.1
<b>PBT</b>	<b>93.1</b>	<b>88.3</b>	<b>108.0</b>	<b>123.1</b>
Exceptional Item	-	-	-	-
Total Tax	22.0	22.6	27.2	31.0
<b>PAT</b>	<b>71.0</b>	<b>65.7</b>	<b>80.8</b>	<b>92.1</b>
Growth (%)	38.8	(7.5)	22.9	14.0
<b>EPS (₹)</b>	<b>58.6</b>	<b>54.2</b>	<b>66.6</b>	<b>75.9</b>

Source: Company, ICICI Direct Research

Exhibit 8: Cash flow statement				
	₹ crore			
(Year-end March)	FY20	FY21E	FY22E	FY23E
<b>Profit after Tax</b>	<b>71.0</b>	<b>65.7</b>	<b>80.8</b>	<b>92.1</b>
Add: Depreciation	20.1	21.1	23.6	25.5
(Inc)/dec in Current Assets	24.5	(66.6)	(14.8)	(11.4)
Inc/(dec) in CL and Provisions	(6.6)	6.3	14.1	10.9
Others	0.0	-	-	-
<b>CF from operating activities</b>	<b>109.1</b>	<b>26.5</b>	<b>103.6</b>	<b>117.0</b>
(Inc)/dec in Investments	(27.3)	55.0	(30.0)	(35.0)
(Inc)/dec in Fixed Assets	(16.1)	(20.0)	(20.0)	(20.0)
Others	1.0	-	-	-
<b>CF from investing activities</b>	<b>(42.4)</b>	<b>35.0</b>	<b>(50.0)</b>	<b>(55.0)</b>
Issue/(Buy back) of Equity	-	-	-	-
Inc/(dec) in loan funds	-	-	-	-
Dividend paid & dividend tax	(58.2)	(48.5)	(60.7)	(72.8)
Inc/(dec) in Share Cap	-	-	-	-
Others	(14.9)	(9.5)	12.1	12.1
<b>CF from financing activities</b>	<b>(73.1)</b>	<b>(58.0)</b>	<b>(48.5)</b>	<b>(60.7)</b>
Net Cash flow	(6.5)	3.5	5.1	1.3
Opening Cash	77.9	71.4	74.9	80.0
<b>Closing Cash</b>	<b>71.4</b>	<b>74.9</b>	<b>80.0</b>	<b>81.3</b>

Source: Company, ICICI Direct Research

Exhibit 9: Balance Sheet				
	₹ crore			
(Year-end March)	FY20	FY21E	FY19E	FY23E
<b>Liabilities</b>				
Equity Capital	12.1	12.1	12.1	12.1
Reserve and Surplus	223.8	231.5	263.7	295.1
<b>Total Shareholders funds</b>	<b>235.9</b>	<b>243.6</b>	<b>275.8</b>	<b>307.2</b>
Total Debt	-	-	-	-
Deferred Tax Liability	4.6	4.6	4.6	4.6
Minority Interest / Others	-	-	-	-
<b>Total Liabilities</b>	<b>240.5</b>	<b>248.2</b>	<b>280.4</b>	<b>311.8</b>
<b>Assets</b>				
Gross Block	257.0	277.0	297.0	317.0
Less: Acc Depreciation	154.7	175.8	199.4	224.8
Net Block	102.3	101.2	97.6	92.2
Capital WIP	4.0	4.0	4.0	4.0
<b>Total Fixed Assets</b>	<b>106.4</b>	<b>105.2</b>	<b>101.7</b>	<b>96.2</b>
Investments	112.2	57.2	87.2	122.2
Inventory	37.0	40.1	44.7	48.3
Debtors	4.1	66.8	74.5	80.5
Loans and Advances	-	-	-	-
Other Current Assets	19.2	20.2	22.5	24.3
<b>Cash</b>	<b>71.4</b>	<b>74.9</b>	<b>80.0</b>	<b>81.3</b>
Total Current Assets	131.7	201.9	221.8	234.5
Current Liabilities	105.4	111.3	124.2	134.2
Provisions	9.1	9.6	10.8	11.6
Current Liabilities & Prov	114.6	120.9	135.0	145.9
<b>Net Current Assets</b>	<b>17.2</b>	<b>81.0</b>	<b>86.8</b>	<b>88.7</b>
Others Assets	4.7	4.7	4.7	4.7
<b>Application of Funds</b>	<b>240.5</b>	<b>248.2</b>	<b>280.4</b>	<b>311.8</b>

Source: Company, ICICI Direct Research

Exhibit 10: Key ratios				
(Year-end March)	FY20	FY21E	FY19E	FY23E
<b>Per share data (₹)</b>				
EPS	58.6	54.2	66.6	75.9
Cash EPS	75.2	71.6	86.0	96.9
BV	194.5	200.8	227.4	253.3
DPS	40.0	40.0	50.0	60.0
Cash Per Share (Incl Invst)	151.4	108.9	137.9	167.8
<b>Operating Ratios (%)</b>				
EBITDA Margin	13.0	12.2	13.5	14.0
PAT Margin	9.2	8.1	8.9	9.4
Inventory days	17.5	18.0	18.0	18.0
Debtor days	2.0	30.0	30.0	30.0
Creditor days	49.8	50.0	50.0	50.0
<b>Return Ratios (%)</b>				
RoE	30.1	27.0	29.3	30.0
RoCE	34.0	32.1	35.9	36.5
RoIC	162.8	72.0	93.8	111.3
<b>Valuation Ratios (x)</b>				
P/E	23.9	25.8	21.0	18.4
EV / EBITDA	15.1	15.8	12.5	10.9
EV / Net Sales	2.0	1.9	1.7	1.5
Market Cap / Sales	2.2	2.1	1.9	1.7
Price to Book Value	7.2	7.0	6.2	5.5
<b>Solvency Ratios</b>				
Debt/EBITDA	-	-	-	-
Debt / Equity	-	-	-	-
Current Ratio	0.5	1.1	1.1	1.1
Quick Ratio	0.2	0.7	0.7	0.7

Source: Company, ICICI Direct Research

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Sell: < -15%



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