Subros Limited

Robust outlook driven by buoyant end-market demand

4Q FY21 Update

Outlook & Valuation

With 65% of FY21 revenues coming from the Suzuki group (Maruti Suzuki and Suzuki Motor Gujarat combined), management expects the Suzuki group’s contribution to be 65% to 70% in the next 3 years. Tata Motors and Mahindra & Mahindra are amongst other major customers of Subros with the company commanding shares of ~20% and ~30% of the thermal products’ business generated from the OEMs. Management has a revenue target of Rs 100 crore from Home AC in FY22 (Rs 88 crore or 5% revenue contribution in FY21). With capacity utilisation of 50% to 55% in 4Q FY21, the Home AC unit 100 crore from Home AC in FY22 (Rs 88 crore or 5% revenue contribution in FY21). With capacity utilisation of 50% to 55% in 4Q FY21, the Home AC unit

with 65% of FY21 revenues coming from the Suzuki group (Maruti Suzuki and Suzuki Motor Gujarat combined), management expects the Suzuki group’s contribution to be 65% to 70% in the next 3 years. Tata Motors and Mahindra & Mahindra are amongst other major customers of Subros with the company commanding shares of ~20% and ~30% of the thermal products’ business generated from the OEMs. Management has a revenue target of Rs 100 crore from Home AC in FY22 (Rs 88 crore or 5% revenue contribution in FY21). With capacity utilisation of 50% to 55% in 4Q FY21, the Home AC unit

The company’s products except compressors are platform-agnostic and consequently its existing HVAC technology can be readily used in EV platforms. Going forward, management sees growth to be in line with the Indian auto industry while expecting the bus, railways, truck AC and refrigerated truck businesses to expand. The company seeks to manage raw material cost through value analysis / value engineering and alternate sourcing with a focus on localisation to mitigate FX fluctuations. Cost optimisation through consolidation of plants and optimisation of shifts/working days will benefit operating profitability while capex controls will positively impact cash flows. The Subros stock has appreciated 34% since we initiated coverage with a BUY rating on 17 September 2020. Basis expectations of robust sales growth, driven by buoyant end-market demand, and improvement in profitability, we reiterate a BUY rating with a price target of Rs 385 (at 22.0x FY23E EPS) and an upside of 18% from current levels.

Key Financial Metrics (Consolidated)

<table>
<thead>
<tr>
<th>Rs crore</th>
<th>FY19A</th>
<th>FY20A</th>
<th>FY21A</th>
<th>FY22E</th>
<th>FY23E</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating revenue</td>
<td>2,124.5</td>
<td>1,992.8</td>
<td>1,795.7</td>
<td>2,142.2</td>
<td>2,523.5</td>
</tr>
<tr>
<td>Growth</td>
<td>-6.2%</td>
<td>-9.9%</td>
<td>8.6%</td>
<td>9.7%</td>
<td>10.3%</td>
</tr>
<tr>
<td>EBITDA</td>
<td>228.2</td>
<td>189.0</td>
<td>153.8</td>
<td>207.8</td>
<td>254.9</td>
</tr>
<tr>
<td>EBITDA margin</td>
<td>10.7%</td>
<td>9.5%</td>
<td>8.6%</td>
<td>9.7%</td>
<td>10.1%</td>
</tr>
<tr>
<td>PAT</td>
<td>76.3</td>
<td>84.9</td>
<td>47.4</td>
<td>81.7</td>
<td>114.1</td>
</tr>
<tr>
<td>PAT margin</td>
<td>3.6%</td>
<td>4.3%</td>
<td>2.6%</td>
<td>3.8%</td>
<td>4.5%</td>
</tr>
<tr>
<td>Diluted EPS (Rs)</td>
<td>12.37</td>
<td>13.00</td>
<td>7.26</td>
<td>12.52</td>
<td>17.49</td>
</tr>
</tbody>
</table>

Source: Company data; Khambatta Research
Subros Limited

Result Analysis

Subros reported numbers in line with / marginally higher than our expectations as business rebounded sharply during 2H FY21, especially in 4Q FY21. This was in contrast to the degrowth in 1H FY21 as operations remained suspended during a major part of 1Q FY21 owing to the covid outbreak and ensuing lockdown. Robust 4Q FY21 growth was driven by the PV and Home AC verticals, resulting in operating leverage. For the full year, CoGS percentage was higher due to a rise in commodity prices, escalation in import logistic cost and changes in product mix. FY21 employee benefit expenses were lower in absolute terms due to the closure in 1Q FY21 while both CoGS and depreciation were higher in percentage terms due to lower sales. While lower debt levels and declining interest rates led to a fall in finance cost during 4Q FY21 and FY21, full-year margins were negatively affected due to a lower revenue base.

Financial Performance (Consolidated)

<table>
<thead>
<tr>
<th>Rs crore</th>
<th>4Q FY20</th>
<th>4Q FY21</th>
<th>Y-o-y</th>
<th>FY20</th>
<th>FY21</th>
<th>Y-o-y</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating revenue</td>
<td>458.5</td>
<td>659.9</td>
<td>43.9%</td>
<td>1,992.8</td>
<td>1,795.7</td>
<td>-9.9%</td>
</tr>
<tr>
<td>EBITDA</td>
<td>41.6</td>
<td>63.9</td>
<td>53.4%</td>
<td>189.0</td>
<td>153.8</td>
<td>-18.7%</td>
</tr>
<tr>
<td>EBITDA margin</td>
<td>9.1%</td>
<td>9.7%</td>
<td>60 bps</td>
<td>9.5%</td>
<td>8.6%</td>
<td>-92 bps</td>
</tr>
<tr>
<td>PAT</td>
<td>16.7</td>
<td>26.2</td>
<td>57.6%</td>
<td>84.9</td>
<td>47.4</td>
<td>-44.2%</td>
</tr>
<tr>
<td>PAT margin</td>
<td>3.6%</td>
<td>4.0%</td>
<td>34 bps</td>
<td>4.3%</td>
<td>2.6%</td>
<td>-162 bps</td>
</tr>
<tr>
<td>EPS (Rs)</td>
<td>2.55</td>
<td>4.02</td>
<td>57.7%</td>
<td>13.00</td>
<td>7.26</td>
<td>-44.1%</td>
</tr>
</tbody>
</table>

Source: Company data; Khambatta Research
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 companies. 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 broking 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 conflicts of interest 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.
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.