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Suprajit Engineering Ltd

LDC biz's recovery on track; outlook positive

Automobiles	Sharekhan code: SUPRAJIT
Reco/View: Buy ↔	CMP: **Rs. 332**
	Price Target: **Rs. 386** ↔

↑ Upgrade ↔ Maintain ↓ Downgrade

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Company details

Market cap:	Rs. 4,644 cr
52-week high/low:	Rs. 478 / 272
NSE volume: (No of shares)	1.80 lakh
BSE code:	532509
NSE code:	SUPRAJIT
Free float: (No of shares)	7.7 cr

Shareholding (%)

Promoters	44.6
FII	5.4
DII	15.2
Others	34.7

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	1.5	0.2	7.4	-13.3
Relative to Sensex	-4.1	-2.8	-9.1	-14.9

Sharekhan Research, Bloomberg

Summary

- Suprajit Engineering Ltd.'s (SEL's) Q2FY23 results exceeded expectations, led by a sharp improvement in LDC biz's operational performance. Revenue, EBITDA and PAT beat estimates by 4.7%, 27.8% and 30%, respectively.
- We maintain our positive view of the company and expect its LDC biz to be EBITDA positive from Q3 and margin normalisation in FY24E. Suprajit's earnings to clock a 24.3% CAGR during FY2022-FY2024E, driven by a 27.2% revenue CAGR, partially offset by a 50bps decline in EBITDA margins.
- Stock trades at of P/E multiple of 17.2x and EV/EBITDA multiple of 11.6x its FY24E estimates.
- We reiterate a Buy on Suprajit Engineering Limited with an unchanged PT of Rs.386, factoring its robust value proposition to its domestic and global clients and comfortable valuations.

Suprajit Engineering Ltd's (SEL's) Q2FY23 results exceeded expectations, led by sharp improvement in LDC biz's operational performance. Revenue, EBITDA and PAT beat estimates by 4.7%, 27.8% and 30%, respectively. Consolidated revenues improved robustly by 45% y-o-y and 11% q-o-q to Rs. 716 crores in Q2FY23, driven by strong show across divisions and consolidation of the light duty cable (LDC) division. Consolidated EBITDA margins expanded 260bps q-o-q to 11%, led by improved operational performance of LDC biz. As a result, EBITDA and PAT improved 45.8% q-o-q and 67.5% q-o-q at Rs. 79 crores and Rs.46 crore, respectively. The management was cautiously optimistic about the sales recovery in India and globally. The management maintains a revenue target of ~$95 million for the LDC business unit in the current year and expects its EBITDA margin to be double-digit over the next 2-3 years. The company highlighted the risks of geo-political tensions in the near term. We expect the company's performance to improve from Q3FY23 onwards. We remain positive on Suprajit as the company continues strengthening its value proposition to its domestic and global clients, aided by a leadership position in the domestic cable business and locational advantage over its global peers. We remain positive on Suprajit's growth prospects and, thus, retain our Buy on the stock.

Key positives

- Q2FY23 results exceeded expectations, led by a sharp improvement in LDC biz's operational performance. Revenue, EBITDA and PAT beat estimates by 4.7%, 27.8% and 30%, respectively.
- The Company has largely passed on the cost increase to its customers globally.
- Consolidated EBITDA margins expanded 260bps q-o-q to 11%, led by improvement in operational performance of LDC biz.

Key negatives

- In respect of the LDC biz, the company took price hikes in the non-auto space, while it continues to negotiate with auto clients for price increases. The management expects to conclude some price increase in Q3.

Management Commentary

- The Management was optimistic about sales recovery but highlighted geo-political tension, which could adversely impact the supply situation, if the situation worsens.
- LDC division is expected to have close to annual revenue of $95 million in revenue with double-digit EBITDA over the next 2-3 years.
- New launches are expected to enter markets over the next few quarters, focusing on EV markets.

Our Call

Valuation - Maintain Buy with an unchanged PT of Rs. 386: Suprajit would continue to gain wallet share from customers in the cable segment (domestic PV segment, by higher sourcing by global OEM and acquisition of LDC unit) and Phoenix Lamps (increased sourcing by Osram). Further, the company would continue to enter new segments in the non-automotive cable division. We expect FY2023E and FY2024E to be a strong year, driven by normalisation of economic activity, improving demand, new launches and the acquisition of the LDC division. Operating leverage and cost-control measures would help to keep the margins firm, though the near-term challenges would keep margins under check. The recent acquisition of the LDC unit could impact profitability in the medium term, while the revenue contribution is expected to increase by ~20%. Propelled by a robust business outlook and prudent capital allocation, we expect Suprajit's earnings to report a 24.3% CAGR during FY2022-FY2024E, driven by a 27.2% revenue CAGR, partially offset by a 50 bps decline in EBITDA margins. The stock trades at a P/E multiple of 17.2x and EV/EBITDA multiples of 11.6x its FY24E estimates, which is trading below its historical average. We retain our Buy rating on the stock with an unchanged price target (PT) of Rs.386.

Key Risks

Chips supply shortage, rising commodity prices, and transportation constraints remain key concerns. Moreover, delayed approval from OEMs for incremental business may affect performance.

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Revenues	1,641	1,840	2,567	2,978
Growth (%)	5.0	12.2	39.5	16.0
EBIDTA	237	260	311	405
OPM (%)	14.4	14.1	12.1	13.6
Net Profit	143	173	197	267
Growth (%)	37.3	21.3	13.8	35.7
EPS	10.3	12.5	14.2	19.3
P/E	32.2	26.5	23.3	17.2
P/BV	4.7	4.2	3.6	3.1
EV/EBIDTA	20.5	18.3	15.5	11.6
ROE (%)	14.7	15.7	15.6	18.1
ROCE (%)	15.9	16.2	17.6	20.9

Source: Company; Sharekhan estimates

Key Highlights of Q2FY23 results and conference call

Strong performance in Q2FY23:

Positive management commentary: Q2FY23 results exceeded expectations, led by sharp improvement in LDC biz's operational performance. Revenue, EBITDA and PAT beat estimates by 4.7%, 27.8% and 30%, respectively. Consolidated revenues improved robustly by 45% y-o-y and 11% q-o-q to Rs. 716 crores in Q2FY23, driven by solid show across divisions and consolidation of the light duty cable (LDC) division. The company has largely passed on the cost increase to its customers globally. In respect of the LDC biz, the company took price hikes in the non-auto space, while it continues to negotiate with auto clients for price increases. The management expects to conclude some price increase in Q3. Consolidated EBITDA margins expanded 260bps q-o-q to 11%, led by improved operational performance of LDC biz. As a result, EBITDA and PAT improved 45.8% q-o-q and 67.5% q-o-q at Rs. 79 crore and Rs.46 crore, respectively.

Auto cable business: Suprajit continues strengthening its value proposition to its domestic and global clients. SEL has won new businesses in Europe and has successfully launched a few cables with new customers. The company has a strong foothold in the cables business in the automotive segment, holding 30-35% market share. The company has a 60-65% market share in the two-wheeler cables business. As per estimates shared by the company, Suprajit has a 40-45% market share in the cable business in India, including the non-automotive business. Suprajit's success is its ability to produce low-cost cables among domestic players, aided by its operational efficiency and dedicated plants for respective clients. Among global peers, the company benefits from its locational cost advantage. Corresponding to the cable business, Suprajit has similar cost advantages in its lamps division, where its key global competitors include Philips India Limited. A lean and low-cost employee structure and scale of operations help Suprajit maintain its competitive benefits across its product lines – Automotive cables, non-automotive cables and lamps business division.

Non-auto cable business: The operational performance is improving. The management is optimistic about winning new contracts and improving operational performance in the future. The company is witnessing strong traction in US market, aided by new launches and established client relationships.

Capex plans on track: The planned expansion at Narasapura, near Bangalore, will be completed in the coming months. The new facility for an aftermarket cable operation at Bommasandra Industrial Area, Bangalore, is progressing as per the plan. Phoenix Lamps Division (PLD) completed its expansion this quarter to augment specific capacities. The capex for FY23E is estimated to be ~Rs. 140 crore. The management is assessing the LDC division capex, which it expects to be ~US $ 2-3 million in FY23E.

LDC business: The LDC business has witnessed s sharp improvement in operational performance, which has led the performance near to breakeven during the Q2FY23. The EBITDA margin for the LDC division for Q2FY23 improved to negative 0.9% versus 4.5% in Q1FY23. LDC won some new businesses and will go into production in 1-2 years. In 5-7 years time frame, the orders/revenue are expected to be large. The current installed capacity of LDC division is 106 million cables per annum. With this acquisition, the group's cable installed capacity will increase to 400+ million cables per year. The new acquisition would significantly increase and strengthen Suprajit's global presence in the cables business, with a deeper reach in the automotive market. The company will get access to new customers in the global market, which will help it increase its revenue. However, the margins are expected to remain under pressure over next two quarters.

Results (Consolidated) Rs cr

Particulars	Q2FY23	Q2FY22	YoY %	Q1FY23	QoQ %
Revenues	716	494	45.0	645	11.0
Total operating expenses	637	414	54.1	591	7.8
EBITDA	79	80	(1.7)	54	45.8
Depreciation	24	15	63.5	24	0.9
Interest	8	4	117.3	6	26.9
Other income	22	15	43.2	18	19.8
PBT	69	77	(10.7)	42	62.5
Tax	23	23	0.1	15	53.6
Adjusted PAT	46	54	(15.3)	27	67.5
Reported PAT	46	50	(7.7)	27	67.5
Adjusted EPS (Rs)	3.3	3.9	(15.3)	2.0	67.5

Source: Company, Sharekhan Research

Key Ratios (Consolidated)

Particulars	Q2FY23	Q2FY22	YoY (bps)	Q1FY23	QoQ (bps)
Gross margin (%)	39.5	42.6	(310)	40.4	(90)
EBIDTA margin (%)	11.0	16.2	(520)	8.4	260
EBIT margin (%)	7.6	13.3	(560)	4.7	300
Net profit margin (%)	6.4	10.9	(460)	4.2	220
Effective tax rate (%)	33.5	29.9	360	35.5	(200)

Source: Company, Sharekhan Research

Divisional Performance Rs cr

Particulars	Q2FY23	Q2FY22	YoY %	Q1FY23	QoQ %
Phoenix Lamps Division (Including Trifa & Luxlite)					
Operating revenue	910.3	925.4	(1.6)	835.2	9.0
EBITDA (Operational)	68.2	89.2	(23.6)	46.0	48.3
EBITDA margin (%)	7.5	9.6	(210 bps)	5.5	200 bps
SENA Division (including India and Wescon US)					
Operating revenue	1,264.3	1,010.7	25.1	1,174.8	7.6
EBITDA (Operational)	178.1	115.1	54.7	123.5	44.2
EBITDA margin (%)	14.1	11.4	270 bps	10.5	360 bps
LDC Divison					
Operating revenue	1,689.4	-	NA	1,596.3	5.8
EBITDA (Operational)	(15.7)	-	NA	(72.4)	NA
EBITDA margin (%)	(0.9)	NA	NA	(4.5)	360 bps

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Demand remains strong, while near-term supply disruption remains a challenge

The business outlook for the automotive segment is expected to improve as economic activities normalise. Automotive demand is expected to recover in the two-wheeler and four-wheeler segments, aided by pent-up demand and increased personal mobility transport. Rural and semi-urban market remain buoyant on robust farm income from the previous year, with a large reservoir and early arrival of monsoon. Recovery in export destinations is auguring well for the sector. Moreover, exports provide a huge growth potential, given India's cost-effective manufacturing, being geographically closer to key markets of Middle East and Europe and being the second largest producer of key raw material, steel. Auto component exports are expected to grow from $15 billion to $80 billion by FY2027.

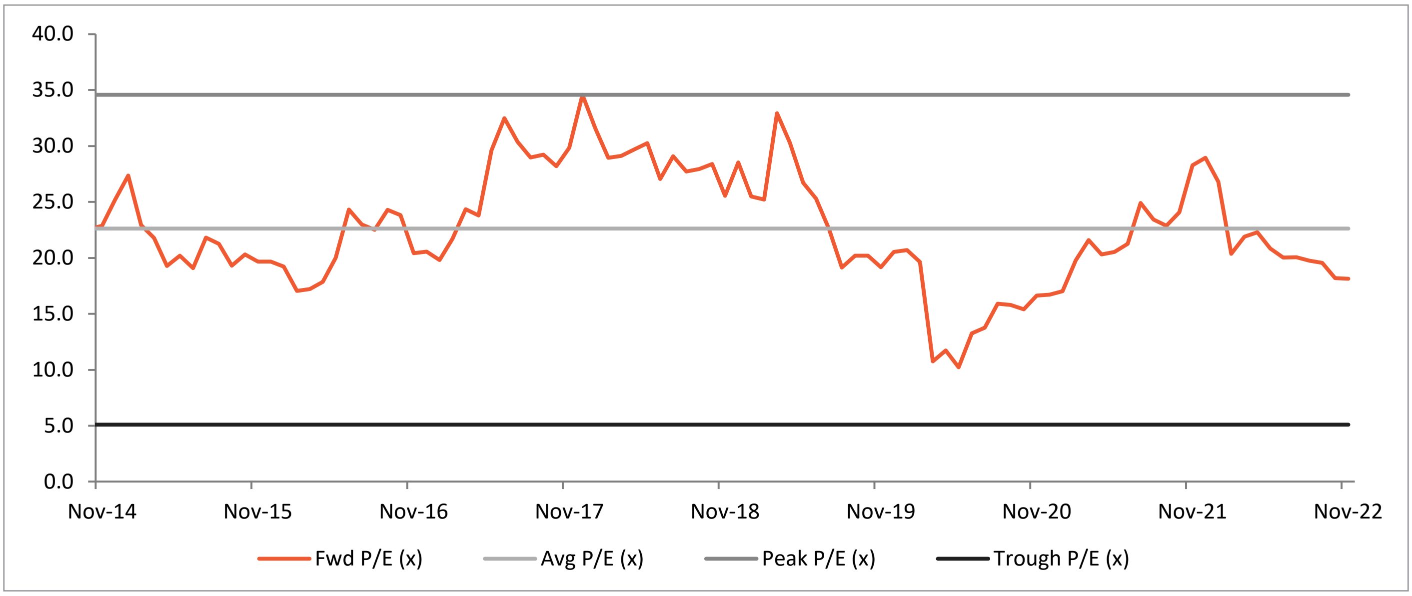
■ Company outlook - Beneficiary of two-wheeler and PV demand

Suprajit is one of the largest manufacturers of mechanical control cables with a presence in both automotive and non-automotive segments. Revenue growth has been healthy in the pre-COVID regime, driven by a steady offtake and diversification into the aftermarket and exports segments. The company has entered segments such as lamps , started catering to non-automotive segments through acquisitions, and has augmented capacities in the cables business. The company has been gaining market share in the domestic cable division with an increased share of business with automotive clients. The company's market share in two-wheelers is 60-65%, while that for the automotive industry is at 30-35%. Market share for the Indian market is at 40-45%. In non-automotive cables, the company is planning to enter new segments such as medical device equipment, consumer durables, and agriculture and construction equipment, which would drive growth. We remain positive on Suprajit as the company continues to strengthen its value proposition to its domestic and global clients, aided by a leadership position in the domestic cable business and locational advantage over its global peers.

■ Valuation - Maintain Buy with an unchanged PT of Rs. 386

Suprajit would continue to gain wallet share from customers in the cable segment (domestic PV segment, by higher sourcing by global OEM and acquisition of LDC unit) and Phoenix Lamps (increased sourcing by Osram). Further, the company would continue to enter new segments in the non-automotive cable division. We expect FY2023E and FY2024E to be a strong year, driven by normalization of economic activity, improving demand, new launches and the acquisition of the LDC division. Operating leverage and cost-control measures would help to keep the margins firm, though the near-term challenges would keep margins under check. The recent acquisition of the LDC unit could impact profitability in the medium term, while the revenue contribution is expected to increase by ~20%. Propelled by a robust business outlook and prudent capital allocation, we expect Suprajit's earnings to report a 24.3% CAGR during FY2022-FY2024E, driven by a 27.2% revenue CAGR, partially offset by a 50 bps decline in EBITDA margins. The stock trades at a P/E multiple of 17.2x and EV/EBITDA multiples of 11.6x its FY24E estimates, which is trading below its historical average. We retain our Buy rating on the stock with an unchanged price target (PT) of Rs.386.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Companies	CMP (Rs/ Share)	P/E (x)			EV/EBITDA (x)			ROCE (%)		
		FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Suprajit Engineering	332	26.5	23.3	17.2	18.3	15.5	11.6	16.2	17.6	20.9
Schaeffler India*	3,059	76.0	53.4	41.6	48.9	34.5	26.8	30.9	32.9	32.0
Sundram Fasteners	899	40.9	27.5	21.8	23.8	17.8	13.9	21.4	21.4	23.5

*Source: Company; Sharekhan Research; * Financials are for CY2021, CY2022E and CY2023E*

About company

Suprajit is a global leader in the automotive cable and halogen bulb industry. With a competitive manufacturing base in India, UK, US, and Mexico, along with technical and logistical supports worldwide, the company provides optimal product development and manufacturing solutions to its domestic and international customers. With a CAGR of over 25%, Suprajit has one of the largest manufacturing capacities in the world with 300+ million cables per year and 110+ million bulbs per year. Suprajit is a well-diversified company deriving 60% of its revenue from global operations, while 40% is derived domestically. 2W is the largest segment contributing 37% to revenue, while 20% of revenue is derived from the automotive (4W) segment. Aftermarket constitutes 23% of revenue, while the non-automotive segment includes 20% of revenue.

Investment theme

Suprajit is one of the largest manufacturers of mechanical control cables with a presence in both automotive and non-automotive segments. Revenue growth has been healthy in the pre-COVID regime, driven by steady offtake and diversification into aftermarket and export segments. The company continues strengthening its value proposition to its domestic and global clients, aided by its leadership position in the domestic cable business and locational advantage over its global peers. Suprajit's success is its ability to produce low-cost cables among domestic players, aided by its operational efficiency and dedicated plants for respective clients. The company has entered segments such as lamps , started catering to non-automotive segments through acquisitions, and has augmented capacities in the cables business. The company has been gaining market share in the domestic cable division with an increased share of business with automotive clients. The company's market share in 2W is 60-65%, while that for the automotive business at 30-35%. Market share in the Indian market is 40-45%. The aftersales market both at Suprajit and Phoenix Lamps division has been strong, along with encouraging offtake from OEMs. We expect Suprajit to benefit from strong demand witnessed in domestic and export markets, aided by a recovery in economic activities. The company will also benefit from its CAPEX plan strategy, which will help it capitalize further in the next peak season.

Key Risks

- Chips supply shortage, rising commodity prices, and transportation constraints remain key concerns.
- Delayed approval from OEMs for incremental business could impact performance.

Additional Data

Key management personnel

Ajith Rai	Executive Chairman
Mohan N.S.	Managing Director and Group CEO
Peter Greensmith	CEO-Suprajit Europe
Steve Fricker	CEO-Wescon Controls
Medappa Gowda J	CFO and Company Secretary

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	SUPRIYAJITH FAMILY TRUST	38.0
2	DSP Small Cap Fund	5.3
3	HDFC Small Cap Fund	5.2
4	Sundaram-Clayton Ltd.	4.1
5	Kula Ajith Kumar Rai	2.7
6	TVS Motor Co. Ltd.	2.1
7	Shobita Punja	1.4
8	Emerging Securities Pvt. Ltd.	1.4
9	India Capital Fund Limited	1.4
10	Kula Ramprasad Rai	1.3

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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