Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Suprajit Engineering Ltd

Robust value proposition

Automobiles	Sharekhan code: SUPRAJIT
Reco/View: Buy ↔	CMP: **Rs. 336**	Price Target: **Rs. 403** ↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- We reiterate a Buy on the company with a revised PT of Rs.403, factoring its robust value proposition to its domestic and global clients and comfortable valuations.
- Suprajit Engineering Ltd. (SEL) has evolved as a well-diversified and de-risked company through a continuous focus on improving technology, widening its product portfolio, enhancing content per vehicle, increasing geographical penetration and building multiple brands.
- Expect its LDC biz to be EBITDA positive from Q3 and margin normalisation in FY24E. As a result, SEL's earnings to clock a 24.3% CAGR during FY2022-FY2024E.
- Stock trades at comfortable valuations at P/E multiple of 14.9x and EV/EBITDA multiple of 9.8x its FY25E estimates.

We remain positive on Suprajit Engineering Ltd.'s (SEL's) growth prospects, aided by its leadership position in the domestic cable business and locational advantage over its global peers. The company has evolved as a well-diversified and de-risked company through a continuous focus on improving technology, widening its product portfolio, enhancing content per vehicle, increasing geographical penetration and building multiple brands. The recently acquired Light Duty Cable (LDC) business has witnessed a sharp improvement in operational performance, which has led the performance near to breakeven during the Q2FY23. 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. We remain positive on Suprajit's growth prospects and, thus, retain our Buy rating on the stock.

- **Diversified and de-risked business model:** SEL has evolved as a well-diversified and de-risked company over through continuous focus on improving technology, widening product portfolio, enhancing content per vehicle, increasing geographical penetration and building multiple brands. Over the last two and half decades, the company's profile has changed considerably, led by strategic acquisitions in its core expertise areas and successfully integrating various business verticals, while gaining market share across segments and geographies.
- **LDC division's progress on track:** The LDC business has witnessed a 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 negative 4.5% in Q1FY23. The LDC division also won some new businesses during the Q2 and will go into production in 1-2 years. In 5-7 years, the orders/revenue are expected to be substantial, with EBITDA margins settling in double-digits.
- **Management remains positive on growth prospects:** The management remains positive on the outlook, though noted risk of geo-political tensions. The company expects its exports to grow robustly going forward, with share of exports improving to ~55% in FY23E from 40% in FY22. The capex plans remain intact with FY23E capex at ~Rs140 crore, while the LDC division Capex is expected to be ~US $ 2-3 million in FY23E. SEL's earnings is expected 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.

Our Call

Valuation - Maintain Buy with a revised PT of Rs.403: 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 years, driven by the normalisation of economic activity, improving demand, new launches and the acquisition of the LDC division. 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 14.9x and EV/EBITDA multiples of 9.8x its FY25E estimates, trading below its historical average. We retain our Buy rating on the stock with a revised price target (PT) of Rs.403.

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	FY25E
Revenues	1,641	1,840	2,567	2,978	3,300
Growth (%)	5.0	12.2	39.5	16.0	10.8
EBIDTA	237	260	311	405	465
OPM (%)	14.4	14.1	12.1	13.6	14.1
Net Profit	143	173	197	267	313
Growth (%)	37.3	21.3	13.8	35.7	17.0
EPS	10.3	12.5	14.2	19.3	22.6
P/E	32.6	26.9	23.6	17.4	14.9
P/BV	4.8	4.2	3.7	3.1	2.7
EV/EBIDTA	20.7	18.5	15.7	11.8	9.8
ROE (%)	14.7	15.7	15.6	18.1	18.1
ROCE (%)	15.9	16.2	17.6	20.9	21.4

Source: Company; Sharekhan estimates

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		↔	

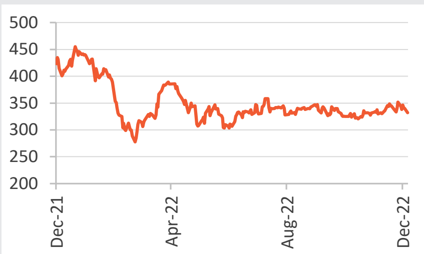
Company details

Market cap:	Rs. 4,700 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

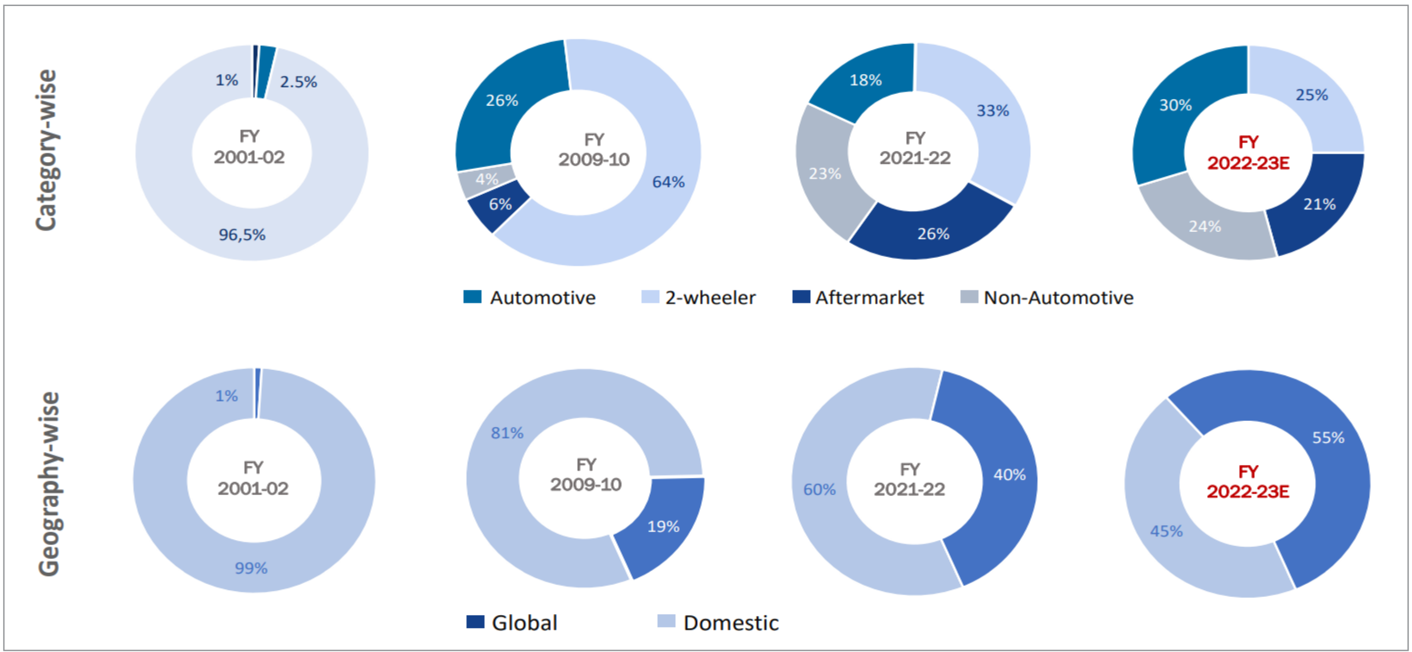
(%)	1m	3m	6m	12m
Absolute	-1.6	-4.3	7.2	-21.5
Relative to Sensex	-1.7	-7.5	-6.6	-27.9

Sharekhan Research, Bloomberg

Diversified and de-risked business model

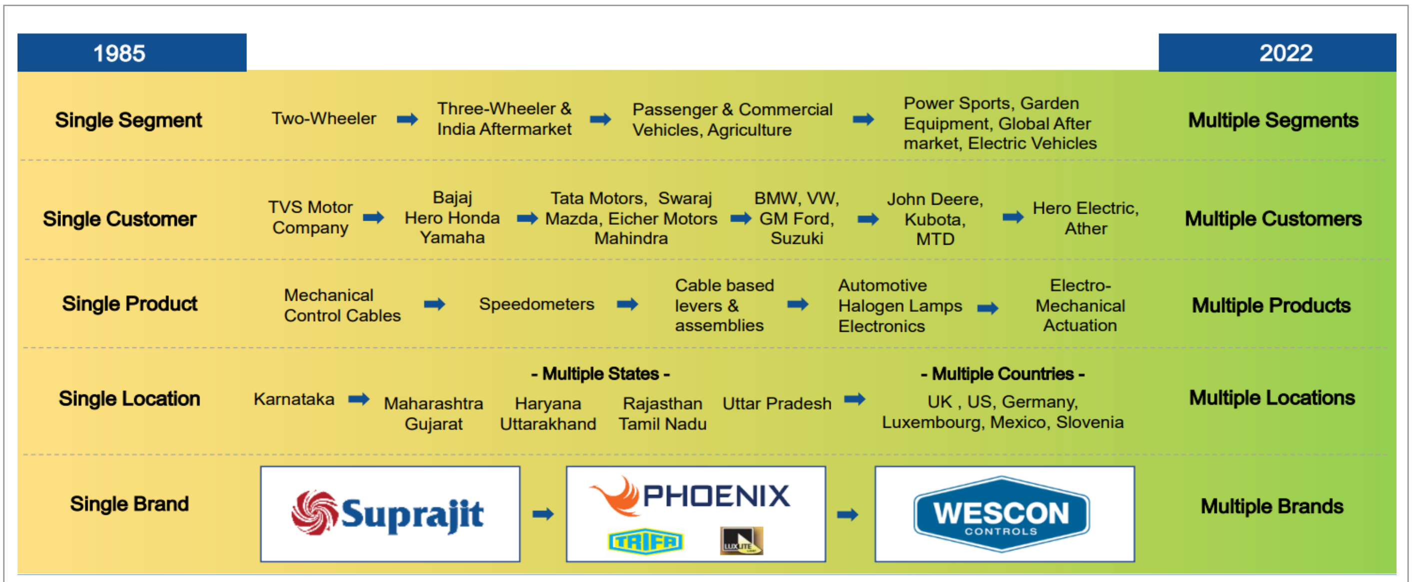
SEL has evolved as a well-diversified and de-risked company through a continuous focus on improving technology, widening product portfolio, enhancing content per vehicle, increasing geographical penetration and building multiple brands. Over the last two and half decades, the company's profile has changed considerably, led by strategic acquisitions in its core expertise areas and successfully integrating various business verticals while gaining market share across segments and geographies.

Diversification driving SEL's business growth



Source: Company's Investor Presentation; Sharekhan Research

De-risking business model through strong organic growth, capacity expansion and strategic acquisitions



Source: Company's Investor Presentation; Sharekhan Research

LDC division's progress on track

The LDC business has witnessed a 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. The LDC division also won some new businesses during Q2 and will go into production in 1-2 years. In 5-7 years, the orders/revenue are expected to be substantial with EBITDA margins settling in double-digits. The current installed capacity of the 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 SEL's global presence in the cable 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.

Auto cable business

SEL 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 a 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.

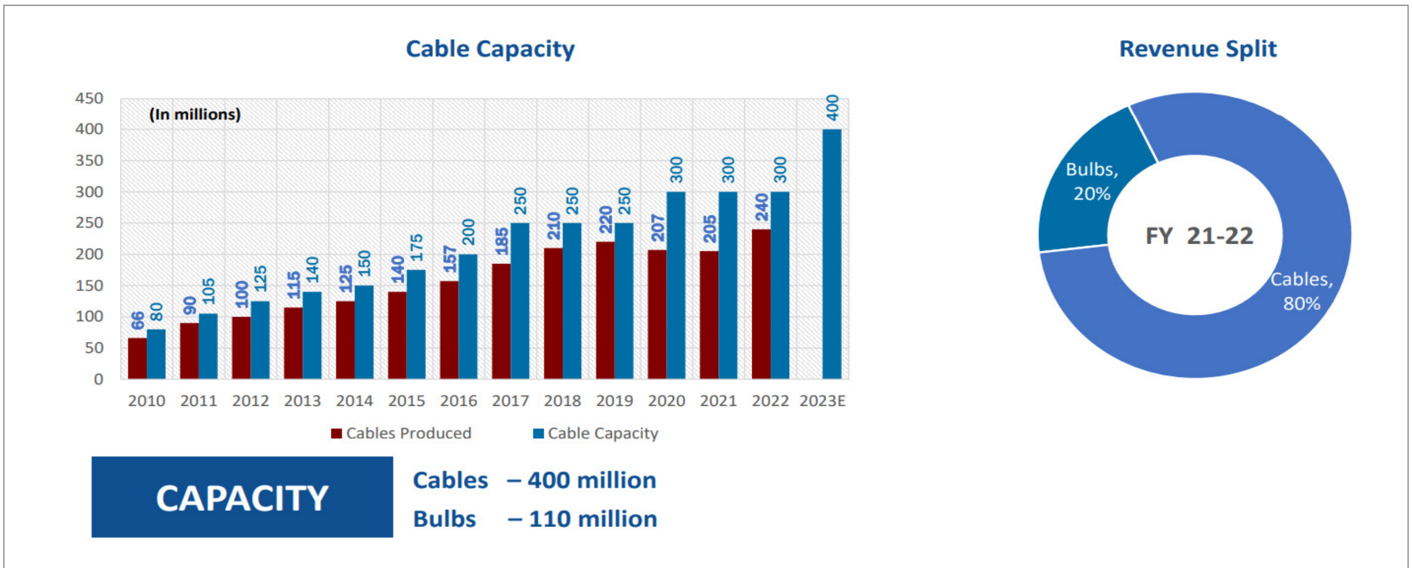
Non-auto cable business

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 the 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.

Continuous investments in core business help it to maintain dominant market shares



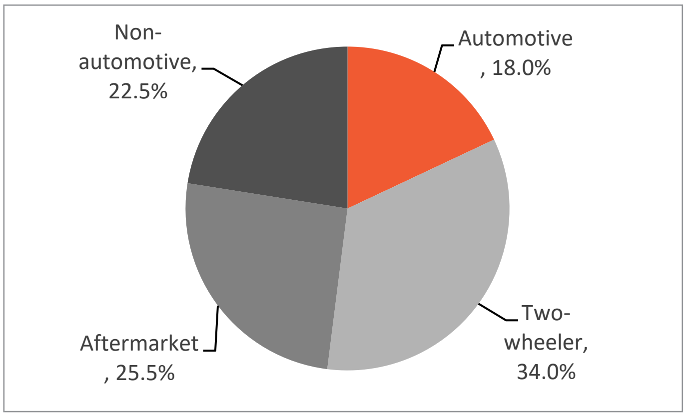
Source: Company's Investor Presentation; Sharekhan Research

Management remains positive on growth prospects

The management remains positive on the outlook, though noted risk of geo-political tensions. The company expects its exports to grow robust going forward, with share of exports improving to ~55% in FY23E from 40% in FY22. 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. The capex plans remain in-tact with FY23E capex at ~Rs140 crore, while the LDC division capex is expected to be ~US $ 2-3 million in FY23E. SEL's earnings is expected 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.

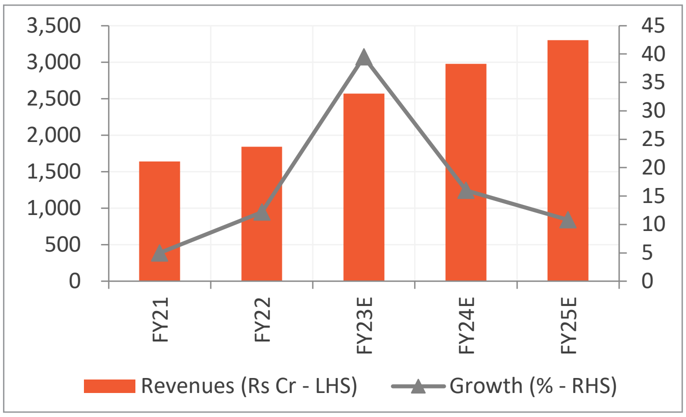
Financials in charts

Revenue Mix (%)



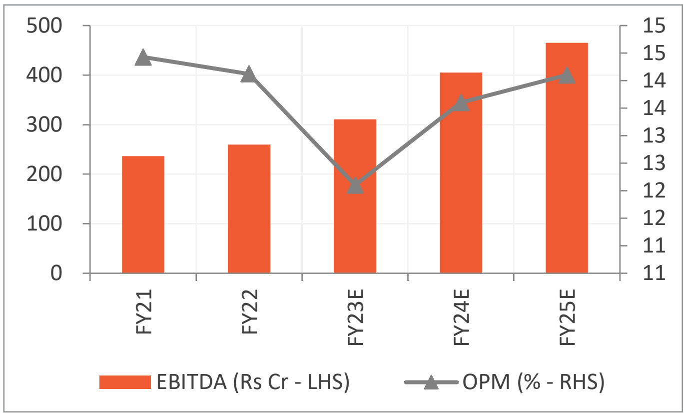
Source: Company, Sharekhan Research

Revenue and Growth Trend



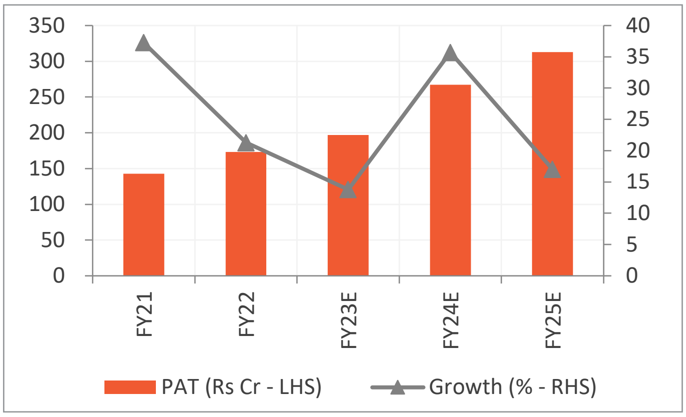
Source: Company, Sharekhan Research

EBITDA and OPM Trend



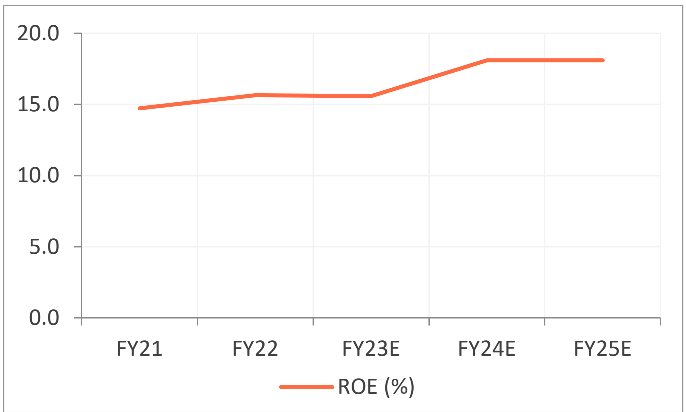
Source: Company, Sharekhan Research

PAT and Growth Trend



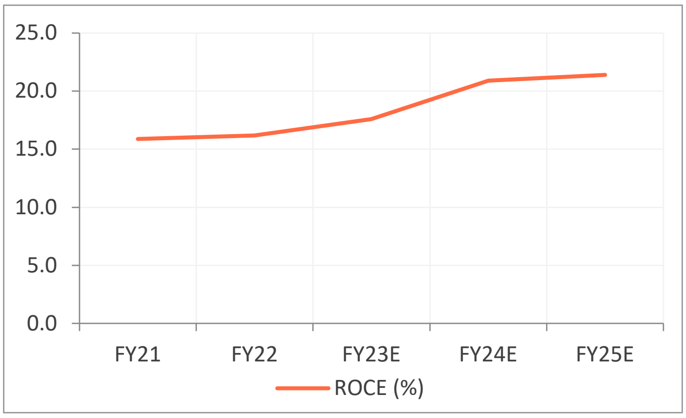
Source: Company, Sharekhan Research

RoE Trend



Source: Company, Sharekhan Research

RoCE Trend



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 a pent-up demand and increased personal mobility transport. Rural and semi-urban markets 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 considerable growth potential, given India's cost-effective manufacturing, being geographically closer to key markets of the 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.

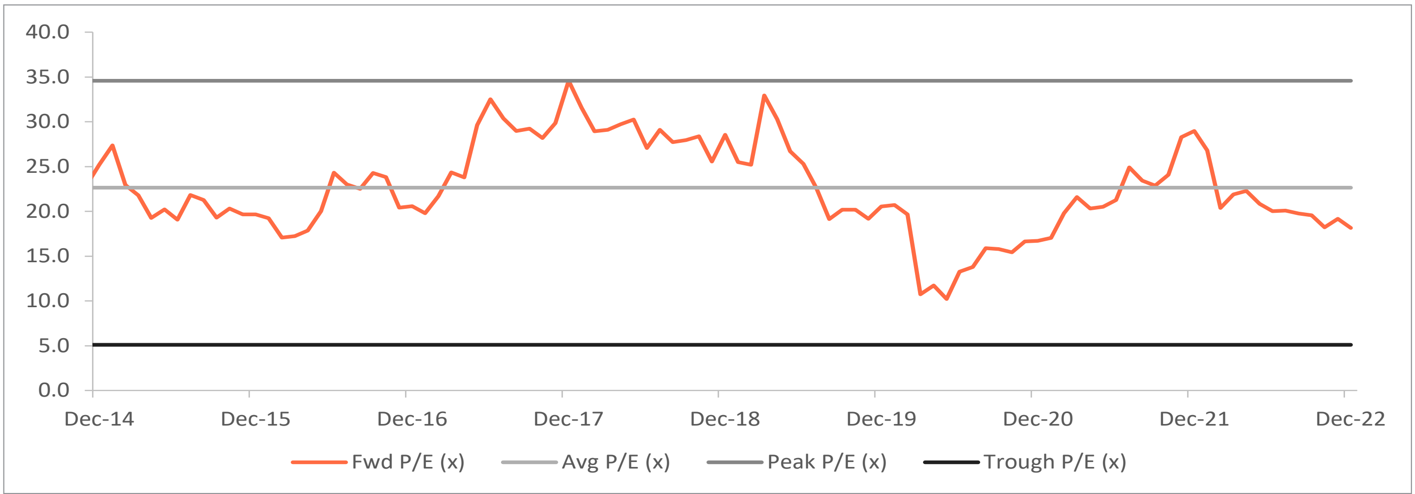
■ Company outlook - Beneficiary of two-wheeler and PV demand

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 export 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 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 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.

■ Valuation - Maintain Buy with a revised PT of Rs. 403

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 the normalisation of economic activity, improving demand, new launches and the acquisition of the LDC division. 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 14.9x and EV/EBITDA multiples of 9.8x its FY25E estimates, trading below its historical average. We retain our Buy rating on the stock with a revised price target (PT) of Rs.403.

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	336	26.9	23.6	17.4	18.5	15.7	11.8	16.2	17.6	20.9
Schaeffler India*	2,782	69.1	48.6	37.8	44.4	31.3	24.3	30.9	32.9	32.0
Sundram Fasteners	958	43.6	29.3	23.2	25.4	19.0	14.9	21.4	21.4	23.5
Bosch	17,623	42.7	30.4	24.9	32.3	23.3	18.5	13.9	18.1	19.3

*Source: Company Data; 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 support 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% is derived from the automotive (4W) segment. Aftermarket constitutes 23% of revenue, while the non-automotive segment includes 20%.

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 the 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 capitalise 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 Investment Managers Pvt Ltd	7.4
3	HDFC Asset Management Co Ltd	5.3
4	India Capital Fund Ltd	2.8
5	Rai Kula Ajith Kumar	2.8
6	RAI K AJITH KUMAR	2.8
7	Shobita Punja	1.4
8	RAI KULA RAMAPRASAD	1.3
9	Rai Supriya Ajit	1.3
10	Emerging Securities Pvt Ltd	1.0

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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