Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Suprajit Engineering Ltd

Empowering amidst challenges

Automobiles	Sharekhan code: SUPRAJIT
Reco/View: Buy ↔	CMP: **Rs. 346**
	Price Target: **Rs. 403** ↔

↑ 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		↔	

ESG Disclosure Score NEW

ESG RISK RATING 21.25

Updated Dec 08, 2022

Medium Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

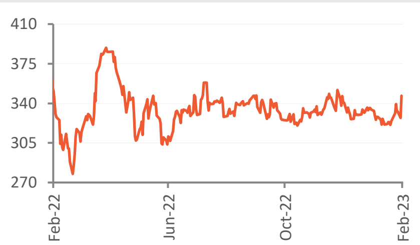
Company details

Market cap:	Rs. 4,840 cr
52-week high/low:	Rs. 398 / 272
NSE volume: (No of shares)	1.90 lakh
BSE code:	532509
NSE code:	SUPRAJIT
Free float: (No of shares)	7.7 cr

Shareholding (%)

Promoters	44.6
FII	5.1
DII	15.6
Others	34.6

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	3.2	3.6	1.2	-12.6
Relative to Sensex	1.4	5.0	-3.3	-17.0

Sharekhan Research, Bloomberg

Summary

- We reiterate a Buy on Suprajit Engineering Ltd with an unchanged PT of Rs. 403, on the back of its diversified, de-risked and innovation-driven business model.
- Except for non-auto business (SENA) all other divisions are expected to perform well in Q4FY23. Consolidating European business to eliminate margin volatility.
- LDC business has turned around – inline with management's earlier guidance.
- Stock trades at P/E multiple of 17.1x and EV/EBITDA multiple of 9.8x its FY25E estimates.

Led by healthy gross margin expansion, Suprajit Engineering (SEL) reported operating performance above estimates. LDC division turned around EBITDA positive – in line with management's earlier indications. The revenue declined by 3.3%q-o-q to Rs 692 crore (against our estimate of Rs 687 crore) led by 4.1% q-o-q decline in automotive cable revenue and 21.0% q-o-q decline in SENA division. Gross margin expanded by 160 bps q-o-q and translated into 70 bps q-o-q expansion in EBITDA margin to 11.7% (against our estimate of 11.2%). The weak performance in SENA division is attributed to headwinds in the North American non-automotive segment. The automotive cable division and SENA division reported 370 bps q-o-q and 510 bps q-o-q contraction in EBITDA margin respectively, while PLD division reported 340 bps q-o-q expansion in an EBITDA margin. LDC division registered operating profit at Rs 6.7crore compared to operating loss of Rs 1.6 crore in Q2FY23. With this operating performance and 76.2% q-o-q decline in other income the APAT decline by 16.8% q-o-q to Rs 38 crore against our estimate of Rs 45 crore. Other income went down due to MTM forex loss on forward contracts. Going forward, the management assumes healthy performance across the divisions in Q4FY23 led by new business opportunities and robust order pipeline, except in SENA division. The performance of the SENA division is expected to be impacted in Q4FY23 due to a slowdown in the non-automotive segment in the North American region. Going ahead, the company expects margin improvement driven by operational efficiencies, new product additions and RM cost tailwinds.

Key positives

- Gross margin expanded by 160 bps q-o-q and resulted into 70 bps q-o-q expansion in EBITDA margin to 11.7%.
- PLD division registered 340 bps q-o-q expansion in EBITDA margin to 10.9%
- LDC business turned around on EBITDA level. LDC division reported EBITDA at 3.7% in Q3FY23 compared to a loss at the EBITDA level in Q2FY23
- Sector wise revenue break up in 9M FY23: Automotive- 34%, 2W- 26%, Aftermarket- 19%, Non-Automotive 22%.
- Geography wise revenue break up in 9M FY23: Global 52% and domestic 48%.

Key negatives

- Other expenses as a percentage of sales expanded by 100 bps q-o-q and partially netted off the benefit of soft raw material cost.
- Automotive cable and SENA division registered 370 bps q-o-q and 510 bps q-o-q contraction in EBITDA margin.

Management Commentary

- The performance of the SENA division will be impacted in Q4FY23 due to headwinds in North American non-automotive market.
- The dependence on the two-wheeler segment has been reduced due to diversification in different segments and different geographies.
- SEL is consolidating its European operations to reduce cost and improve profitability .

Our Call

Valuation - Maintain Buy with an unchanged PT of Rs.403: With a continued focus on diversification, de risking-business models and technology improvement, SEL has evolved as an established player in the domestic as well as in the overseas markets. Brand equity is helping in expanding customer bandwidth, while innovation is helping in launching new products and leading to enhancement in content per vehicle. Amidst geopolitical risk, inflationary pressure in Europe and slowdown in the North American automotive market the management has shared a positive outlook in Q4Fy23 for all its segments except SENA (non-automotive division). SENA division is expected to remain laggard in Q4FY23 due to a slowdown in the non-automotive market in North America. With the turnaround of the LDC division and soft commodity prices, the company continue to consolidate its European business to eliminate margin volatility in the medium term. The stock trades at a P/E multiple of 17.1x and EV/EBITDA multiples of 9.8x its FY25E estimates, trading below its historical average. We retain our Buy rating on the stock with an unchanged price target (PT) of Rs.403.

Key Risks

Inflationary pressure in the overseas market, 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	1,640.9	1,840.5	2,701.5	3,133.8	3,472.0
Growth (%)	5.0	12.2	46.8	16.0	10.8
EBIDTA	236.7	259.9	297.2	376.1	489.6
OPM (%)	14.4	14.1	11.0	12.0	14.1
Net Profit	142.7	173.1	157.2	200.0	279.8
Growth (%)	37.3	21.3	(9.2)	27.2	39.9
EPS	10.3	12.5	11.4	14.5	20.2
P/E	33.5	27.7	30.5	23.9	17.1
P/BV	4.9	4.3	3.9	3.4	3.0
EV/EBIDTA	21.3	19.1	17.0	13.2	9.8
ROE (%)	14.7	15.7	12.8	14.4	17.3
ROCE (%)	15.9	16.2	15.7	17.1	20.8

Source: Company; Sharekhan estimates

Key Conference call takeaways

- **Mixed outlook:** In the domestic market, while the business from the four-wheeler segment has been improving the demand from entry-level two-wheeler segment has yet to improve. The Chinese business was impacted due to covid related concerns in Q3FY23 but is expected to improve in Feb and March led by the opening of markets. European business continues to face inflationary concerns led by higher energy cost. The non-automotive business in the US has been facing a challenging situation due to inflationary-related headwinds.
- **Automotive cable division:** Mix is shifting towards 4W: The increased production in the four-wheeler segment, healthy penetration in aftermarket segment and price recovery have supported the automotive cable division's performance in Q3FY23. However, the weak performance in the two-wheeler segment has impacted the growth momentum, while the export of cables was impacted due to geopolitical issues. Though input costs including container cost is coming down the company would have to pass it on to the customers over the period.
- **LDC division: turned around:** With a turnaround in the LDC segment at the EBITDA level the management maintained its earlier guidance of a double-digit margin in the LDC segment by the end of FY24. The turnaround was largely led by improvement in operational efficiencies.
- **SENA division (non-automotive division):** likely to remain laggard: The performance of the non-automotive segment was largely impacted due to weakness in North American non-automotive market. Though the company has been driving performance by adding new customers the sharp revival in the SENA division would be led by the improvement in the North American business environment. The performance of the SENA division is expected to remain subdued in Q4FY23.
- **PLD division: consolidation in Europe:** Improvement in operational efficiency, better price realization and reduction in gas prices translated into 340 bps q-o-q expansion in EBITDA margin in the PLD division. The management is consolidating European business, and this would further improve the performance of the PLD division in the coming period.

Results (Consolidated) **Rs cr**

Particulars	Q3FY23	Q3FY22	YoY %	Q2FY23	QoQ %
Revenues	692	479	44.4	716	(3.3)
Total operating expenses	611	425	43.7	637	(4.1)
EBITDA	81	54	49.6	79	2.8
Depreciation	25	14	71.9	24	3.4
Interest	10	3	238.3	8	35.0
Other income	5	8	(35.8)	22	(76.2)
PBT	51	45	14.1	69	(25.9)
Tax	13	13	(0.1)	23	(43.9)
Adjusted PAT	38	32	19.9	46	(16.8)
Reported PAT	38	32	19.9	46	(16.8)
Adjusted EPS (Rs)	2.7	2.3	19.9	3.3	(16.8)

Source: Company, Sharekhan Research

Key Ratios (Consolidated)

Particulars	Q3FY23	Q3FY22	YoY (bps)	Q2FY23	QoQ (bps)
Gross margin (%)	41.1	39.3	180	39.5	160
EBIDTA margin (%)	11.7	11.3	40	11.0	70
Net profit margin (%)	5.5	6.6	(110)	6.4	(90)
Effective tax rate (%)	25.4	29.0	(360)	33.5	(810)

Source: Company, Sharekhan Research

Divisional Performance Rs cr

Particulars	Q3FY23	Q3FY22	YoY %	Q2FY23	QoQ %
Automotive cables					
Operating revenue	316.3	285.2	10.9	329.7	(4.1)
EBITDA (Operational)	55.3	46.1	20.0	55.6	(0.5)
EBITDA margin (%)	17.5	16.2	-	16.9	-
Phoenix Lamps Division (Including Trifa & Luxlite)					
Operating revenue	96.6	92.1	4.9	91.0	6.1
EBITDA (Operational)	10.5	4.9	114.4	6.8	54.4
EBITDA margin (%)	10.9	5.3	-	7.5	-
SENA Division (including India and Wescon US)					
Operating revenue	99.8	101.9	(2.1)	126.4	(21.0)
EBITDA (Operational)	9.0	9.6	(6.0)	17.8	(49.4)
EBITDA margin (%)	9.0	9.4	-	14.1	-
LDC Divison					
Operating revenue	179.4	-	-	168.9	6.2
EBITDA (Operational)	6.7	-	-	(1.6)	-
EBITDA margin (%)	3.7	-	-	-	-
Total					
Operating revenue	692.1	479.3	44.4	716.1	(3.3)
EBITDA (Operational)	81.5	60.6	34.5	78.7	3.6
EBITDA margin (%)	11.8%	12.6%	-	11.0%	-

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 markets remain buoyant on robust farm income from the previous year, with a large reservoir and early arrival of monsoon. A 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.

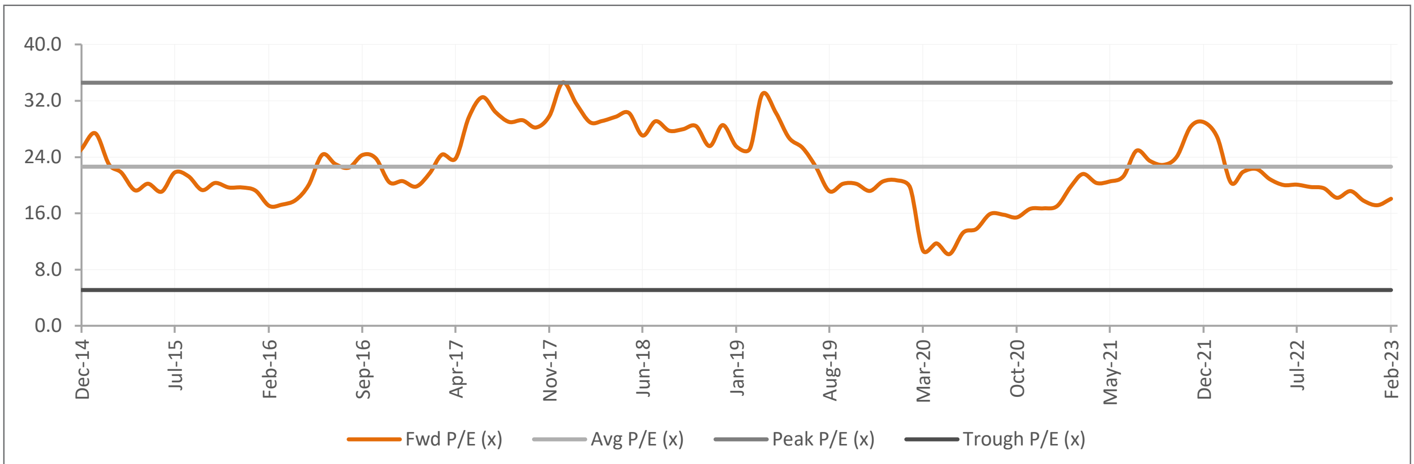
■ Company Outlook – Beneficiary of two-wheeler and PV demand

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 an unchanged PT of Rs.403

With a continued focus on diversification, de risking- business model and technology improvement, SEL has evolved as an established player in the domestic as well as in the overseas markets. Brand equity is helping in expanding customer bandwidth, while innovation is helping in launching new products and leading to enhancement in content per vehicle. Amidst geopolitical risk, inflationary pressure in Europe and a slowdown in North American automotive market the management has shared a positive outlook in Q4Fy23 for all its segments except SENA (non-automotive division). SENA division is expected to remain laggard in Q4FY23 due to slowdown in a non-automotive market in North America. With the turnaround of LDC division and soft commodity prices, the company continue to consolidate its European business to eliminate margin volatility in medium term. The stock trades at a P/E multiple of 17.1x and EV/EBITDA multiples of 9.8x its FY25E estimates, trading below its historical average. We retain our Buy rating on the stock with an unchanged 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	346	27.7	30.5	23.9	19.1	17.0	13.2	16.2	15.7	17.1
Sundram Fasteners	988	44.9	41.0	29.9	26.2	23.5	17.7	21.4	16.1	20.0
Bosch	17,830	43.2	36.3	27.7	32.7	25.6	18.9	13.9	15.6	18.2

*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, the UK, the 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%. The 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 & Group CEO
Peter Greensmith	CEO-Suprajit Europe
Steve Fricker	CEO-Wescon Controls
Medappa Gowda J	CFO & Company Secretary

Source: Company Website

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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