

Suprajit Engineering Ltd (SEL)

- Niche play in the Auto Ancillary Space

Recommendation : Buy
CMP : Rs 126.7
Sector : Auto Ancillaries

NSE Code : SUPRAJIT
BSE Code : 532509

Financial break up

Market Cap (Rs. Cr) : 1769
EPS (FY19) : 9.60
PE : 13.20
Face Value : Rs.1/-

Share Holding Pattern:

Promoters : 44.57
Others : 55.43

Background: SEL manufactures & distributes automotive cables, non-automotive cables and halogen lights. The company is a niche player in manufacturing of mechanical control cables. SEL's products consist mainly control cables, speedo cables and other components for automobiles. The Company supplies its products to Original Equipment Manufacturers (OEMs) and the aftermarket apart from exporting its products to various countries. SEL is the largest manufacturer of control cables for two-wheelers in India and it exports to 50+ countries. The company is a dominant supplier in India for cables and is a preferred supplier for OEMs.

Market Leader - Cables

SEL is a dominant cable player with ~80% market share in the Indian two-wheeler OEM industry. Its market share was close to 65% in FY15 and has been improving gradually even after achieving such a high level of share. Lower cost, good quality & trust among OEMs led to continuous improvement in its market share. The company has a capacity to produce 250mn cables p.a., which will be increased to 300mn cables p.a. by FY20 end

Enhancing Four wheeler presence

The company has entered into manufacturing cables for four-wheelers, post acquisition of Shah Concabs Pvt. Ltd. in the year 2002. Shah Concabs was the leading manufacturer of cables for commercial vehicles in India. In addition, Pricol Ltd has sold its Speedo cables business to SEL in FY15. This was an entry point for SEL to serve India's passenger vehicle OEMs. The company's market share in four wheelers is gradually improving from ~20% in FY15 to close to 30% in FY19, this was majorly on account of the addition of new clients in its kitty and increasing share of business from existing clients.

Marquee Clientele

SEL is a cable supplier to a wide range of global and domestic automotive customers. SEL is one of the world leader in manufacturing of 2W cables and is a dominant & preferred supplier to almost all the OEMs in India as well as Overseas. Over the years, it has kept on increasing its market share in 4Ws mainly by adding new OEMs.

Outlook & Valuation

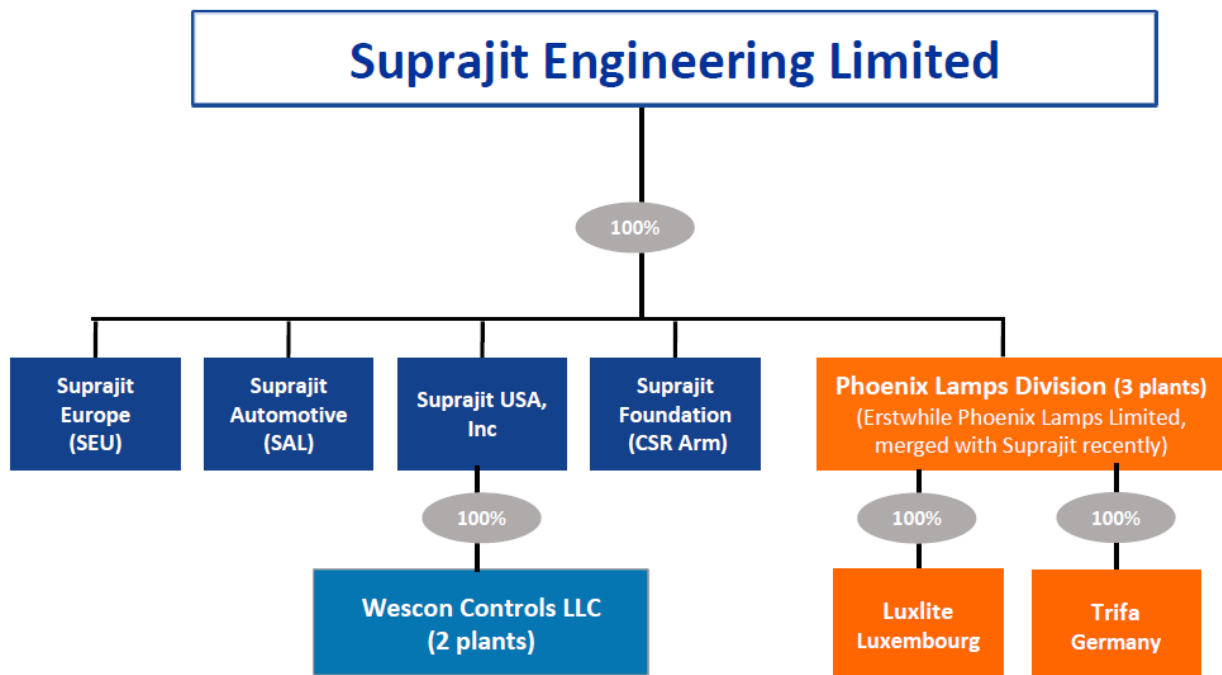
We recommend a **Buy** on SEL for long term investors. Given the Market Leadership, Enhancing four wheeler presence, Marque clientele, Multiple products and Multiple segments are key positives for the stock. At the CMP of INR 126.70, the stock trades at 13.20x Consolidated EPS of FY19. The key risks to the business include Steep increase in Raw Material cost, Slowdown in Automotive sector and Steep competition from peers are the key risks of the company.

Investment Arguments

Company Profile:

SEL , manufactures & distributes automotive cables, non-automotive cables and halogen lights. The company is a niche player in manufacturing of mechanical control cables. SEL's products consist mainly control cables, speedo cables and other components for automobiles. The Company supplies its products to Original Equipment Manufacturers (OEMs) and the aftermarket apart from exporting its products to various countries.

SEL is the largest manufacturer of control cables for two-wheelers in India and it exports to 50+ countries. The company is a dominant supplier in India for cables and is a preferred supplier for OEMs. In the past, the company was only supplying to two-wheeler OEMs and over the period, it has diversified in all auto & non-auto segments viz. two-wheelers, three- wheelers, passenger vehicles, commercial vehicles, tractors, construction equipments, etc. Moreover, the company is also geographically well diversified. SEL's plants are strategically located close to the automobile hubs in North, West and South zones in India. In addition, Wescon Controls LLC has two plants one each in the US & Mexico. A small plant of Suprajit is in the UK as well. In total, Suprajit Group has 23 plants (20 in domestic & three at international location). The Company's subsidiaries include Suprajit Automotive Private Limited (SAL), and Suprajit Europe Limited.



Business Segments

SUPRAJIT: Manufacturing of automotive cables. SEL's engineering division has about 30 years of experience mainly is in manufacturing of automotive cables and has 14 plants in India apart from a tech centre in UK.

WESCON: Manufacturing of non-automotive cables. Wescon Controls LLC has more than 70 years of experience in manufacturing of non-automotive cables and controls. It has a plant in the USA and another one in Mexico.

PHOENIX: Manufacturing of Halogen Lamps. The Phoenix Lamps division with over 25 years of experience is into manufacturing of halogen lamps and has two sub-brands, which is Trifa and Luxlite. Phoenix has three plants in India and two each in Germany & Luxembourg.

SEL is among the global leaders in manufacturing of automotive cables and halogen lamps. It is the one of the world's largest manufacturer of 2W cables and is a dominant & preferred supplier in domestic as well as overseas OEMs. Moreover, it exports to 50+ countries.

SEL manufactures in a very large scale and hence, it gives this mass manufacturer a competitive cost advantage. The company has the ability to setup modular capacities at low capex for dynamic growth.

De-risking Initiatives

Multiple Segments: SEL has diversified from a single segment (two wheeler) to multiple segments i.e 3Ws, 4Ws, CVs, Non-Auto, Exports, Aftermarket, etc.

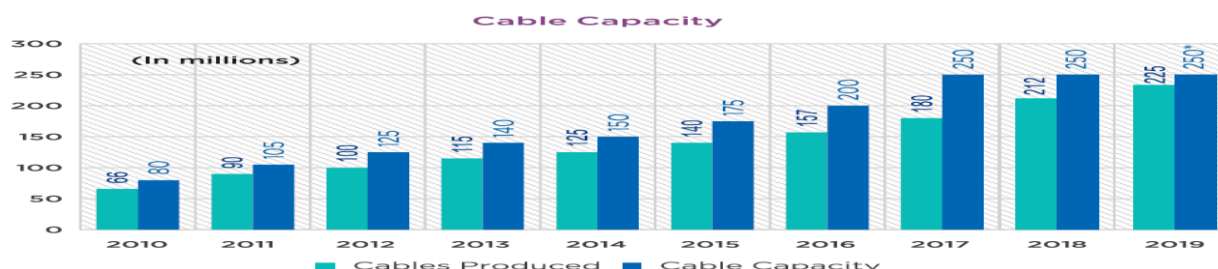
Multiple Customers: SEL started with one customer i.e TVS Motors, and has however, now almost has all the players in automotive, non-automotive as well as under lamps division.

Multiple Products: SEL started with Mechanical Control Cables and has over the years added multi-products in its kitty viz. Mechanical Control Cables, Speedometers, Other auto components, Cable based assemblies and Automotive halogen lamps.

Multiple Location: SEL initially had its manufacturing plants from Karnataka & has gradually expanded in all the states of India and now exports to 50+ countries globally.

Enhanced Cable Capacity

SEL is a dominant cable player with ~80% market share in the Indian two-wheeler OEM industry. Its market share was close to 65% in FY15 and has been improving gradually even after achieving such a high level of share. Lower cost, good quality & trust among OEMs led to continuous improvement in its market share. The company has a capacity to produce 250mn cables p.a., which will be increased to 300mn cables p.a. by FY20 end (the earlier plan was to expand it to 325mn cables p.a.). The capacity expansion has curtailed down looking at the weak domestic automotive industry. SEL expects the balance capacity expansion of 25mn to come by FY21 end.



Based on research by various agencies, there is no impact of BS6 on the number of cables. In fact, its price per cable will increase due to little increase in cable's length along with some technical specification changes. Hence, BS6 is neutral on volumes, while its positive for realisation.

Mechanical cables are going to stay for a long time as 1) it is cost effective, 2) OEM would have to reduce load on battery in EVs and 3) they are highly flexible in dealing with car components. Over the years, number of cables increased in a vehicle, now its stable. Most of the time when technology changes, one old application goes and one new comes. Hence, there is no impact on number of cables.

In domestic, SEL's ~69% of two-wheeler revenue comes from OEMs, while ~31% from aftermarket. The two-wheeler export revenue is just ~2%. The company already have ~80% OEM market share in the domestic, hence we believe that chances are less to expand it further. However, we expect the two-wheeler revenue to grow in-line with the industry and Suprajit would be able to maintain its market share.

On the other side, there is immense potential in two-wheeler domestic aftermarket (estimated size is about Rs 11.8bn). SEL already has a wide & a deeper reach with 300 dealers spread across India. These dealers in turn sells to multi-touch points in the farthest corner of India.

The company plans to expand its dealers' network further. Hence, the combination of 'top of the mind brand' along with distribution reach expansion would increase the aftermarket sales as % of revenue contribution in total revenues in the coming years. Moreover, the margins are higher in aftermarket vis-à-vis selling directly to OEMs.

Enhancing presence in 4 wheelers

The company has entered into manufacturing cables for four-wheelers, post acquisition of Shah Concabs Pvt. Ltd. in the year 2002. Shah Concabs was the leading manufacturer of cables for commercial vehicles in India. In addition, Pricol Ltd has sold its Speedo cables business to SEL in FY15. This was an entry point for SEL to serve India's passenger vehicle OEMs. SEL's derives close to 30% of auto cables revenue by selling components to four wheelers.

The company's market share in four wheelers is gradually improving from ~20% in FY15 to close to 30% in FY19, this was majorly on account of the addition of new clients in its kitty and increasing share of business from existing clients. SEL is not a direct vendor to Maruti Suzuki and has been supplying few cables as a tier-II vendor.

On an average, 9+ cables are required in four-wheelers vis-à-vis 5 cables in two & three wheelers. Moreover, the average price per cable in four-wheeler is much higher at about ~Rs 90/piece as compared to Rs 45/piece for two-wheelers. Hence, the company believes that 1) the opportunities in four-wheelers are enormous as the pool size is large on account of lower penetration and 2) volumes as well as realisation to gradually increase as the company generates more revenues from passenger and commercial vehicles.

Japanese headquartered, HI-LEX, which derives major revenues for supplying cables to four wheelers is the closest competitor of SEL. HI-LEX major customer is Maruti Suzuki and has dominant market share in the passenger vehicle industry.

Phoenix Lamps Division

The Phoenix Lamps Division (PLD) is the market leader in automotive halogen lamps in India with ~70% market share of OEMs. It generates 70% of revenues from OEMs, while the balance from the aftermarket. PLD serves domestic as well as export customers from plants, which are located in Noida with an annual production capacity of 87mn lamps. Its wholly owned subsidiaries (Trifa Lamps and Luxlite) operate as the marketing arm of Phoenix. These companies sell lamps in the EU market and exploring possibilities in other markets as well.

To de-risk SEL's dependence on cables business, SEL has completed acquisition of Phoenix Lamps in FY17, which is into manufacturing of various types of automotive bulbs. Suprajit officially merged Phoenix Lamps in FY17 due to delay in approvals from various agencies and the case was moved from the High Court to NCLT, Bengaluru. The company has lost a few of its major customers like Hella due to quality issues. SEL management known for its trust & loyalty among customers has taken serious steps and installed a new state of the art production line along with a few critical balancing equipment in other lines. It has spent about Rs 300mn to improve process quality and productivity.

PLD's main competitors in domestic are Philips and Osram, while Korean and Chinese players competing in the export markets. We believe SEL has the advantage of location, quality, speed and flexibility to stay and grow in the auto lighting market. In domestic market, PLD has the largest capacity of 87mn bulbs (plus addition of 25mn bulbs post Osram's plant acquisition). Its nearest competitor has 30mn of capacity.

After Market Potential

The aftermarket is mostly unorganised, highly fragmented & its majority of the demand is fulfilled by unorganised players. However, post GST, the management has observed a gradual shift towards organised sector. The aftermarket potential is enormous in terms of volumes. Margins are also higher than OEMs.

The overall market size for cables in the aftermarket is close to Rs ~18bn across all the segments in automobile industry and should grow faster than domestic OEM cable industry. SEL generates close to 21% of total revenues from aftermarket and has been taking serious steps to increase its already widened distribution reach spread across India. It has 300 direct dealers, which in turn sells to thousands of touch points. The king-sized opportunity in aftermarket could help the company to further derisk its business from the cyclical in the automobile industry. Channel checks suggest, SEL is considered as a 'top of the mind' brand due to its superior quality & lower complaints.

Export Opportunities

SEL's revenues from exports has been growing and there has been a sharp uptick observed since FY17 on account of Wescon Controls LLC, USA acquisition. Total exports have grown at a CAGR ~22% during FY07-FY19 as compared to ~18% CAGR growth in domestic for the same period.

Phoenix only supplies to 'aftermarket' in international countries, while OEMs are still unexplored. Hence, any addition of vehicle manufacturer could uplift its volumes.

Moreover, it is present in few countries and have made firm plans to strategically expand in multiple geographies. Phoenix doesn't supply to non-auto segment in export markets. Hence, exploring this unchartered territory could lift its volumes higher in the coming years.

SEL's major OEM clients in exports are BMW, VW, John Deere, MTD, Kubota and Honda. We think there is a good potential to grow the export business for cables as well as lamps and export revenues to grow faster than domestic business majorly due to untapped opportunities in the aftermarket.

Entry into medical equipment device industry

SEL is exploring medical equipment device industry (wheel chairs, hospital beds, etc) where mechanical cables are used. This opportunity is big enough & will continue to grow in the years ahead. It is also exploring other industries viz. Agriculture and Construction Equipment where mechanical cables are used. Size of the business for each of these segments is in the range of \$25-75mn in North America. The company is approaching new customers in these industries, but it takes time to dislodge the existing competitor and get into with OEMs. At present, it doesn't have any specific contracts.

Margins in these new industries are similar to current margins. SEL's strategy is to give three options to OEMs viz. Made in US, Made in Mexico and Made in India cables. It is getting good leads and expect to get new business.

The company has a long list of already established clients in the domestic market, hence it would be easy for SEL to cross-sell to OEMs present in tractors, construction equipment industry and other unexplored areas.

Non-auto cables are mostly linked to the growth of tractors, construction equipment machinery & outdoor power equipment industries. Wescon is trying to expand in Europe and South American countries, while the company expects to explore more possibilities in the domestic market.

Marque Clientele

SEL is a cable supplier to a wide range of global and domestic automotive customers. SEL is one of the world leader in manufacturing of 2W cables and is a dominant & preferred supplier to almost all the OEMs in India as well as Overseas. Over the years, it has kept on increasing its market share in 4Ws mainly by adding new OEMs.

Customers – Automotive



SEL is a leader in 2Ws and supplies to almost all the leading global and domestic two wheeler manufacturers. Under non-automotive division, SEL supplies specialist cables to many leading global & domestic customers. SEL believes that the opportunity in non-automotive is immeasurable, as the company can possibly think of entering in the future into manufacturing of cables required in Aircrafts, Consumer Durable Products and many more segments where mechanical cables are required.

Customers – Two Wheeler



Customers – Non Automotive



Key Risks

Increase in the Raw Material Prices: SEL is heavily dependent on the key raw materials viz. Steel, PVC, Rubber, Plastic and Brass. The increase in the volatility of these key materials can have an impact on its financials. The sudden and continuous increase in the commodities and major raw material prices can bring down its overall margins. Although, the company has some pass through clause with its major customers.

Slowdown in the Automotive Sector: The Company's growth is dependent on the Automotive Industry, which in turn depends upon the macro-economic stability. Any decline in the growth of the automotive industry can impact the performance of SEL. However, the long term outlook for the automotive industry remains robust with rising income levels, strong macro-economic fundamentals and easy availability of finance.

Competition: There is no major listed competitor and hence the company will continue to get the scarcity premium. To deal with the unlisted & foreign competition, the company undertakes continuous R&D activities and develops low priced products with the quality of global standards.

Financials

P&L

P&L (Rs Mn)	FY18	FY19	FY20E	FY21E	FY22E
Net Sales	14311	15899	15901	17858	20197
Total Expenses	11946	13571	13737	15354	17315
EBITDA	2365	2328	2164	2504	2882
Depreciation	372	410	517	592	613
EBIT	1993	1918	1647	1912	2269
Interest	271	246	258	269	281
Other Income	212	380	358	378	385
PBT	1934	2052	1747	2021	2373
Tax	549	714	440	509	597
PAT	1385	1338	1307	1512	1776

Balance Sheet

Balance Sheet (Rs Mn)	FY18	FY19	FY20E	FY21E	FY22E
Sources of Funds					
Share Capital	140	140	140	140	140
Reserves & Surplus	6409	7611	8674	9904	11348
Networth	6549	7751	8814	10044	11488
Total Debt	3455	3621	3805	3964	4142
Deferred Tax Liabilities	521	635	635	713	806
Other Liabilities	2494	2466	2406	2739	3138
Total Liabilities	13019	14473	15660	17460	19574
Application of Funds					
Net Block	5448	5540	6119	6300	5906
Capital Work in Progress	25	266	266	285	266
Total Fixed Assets	5473	5806	6385	6585	6172
Other Non Current Assets	274	377	327	367	416
Total Current Assets	7272	8290	8948	10508	12986
Total Assets	13019	14473	15660	17460	19574

Cash Flow Statement

Cash Flow Statement (Rs Mn)	FY18	FY19	FY20E	FY21E	FY22E
Operating profit before working capital changes	2449	2651	2520	2880	3265
Net change in working capital	37	-526	180	-169	-226
Cash Flow from Operating activities	2173	1448	2261	2202	2441
Capital Expenditure	-250	-587	-1119	-838	-247
Free Cash Flow	1923	861	1142	1364	2194
Cash Flow from Investing activities	-1250	-890	-1118	-1047	-497
Cash Flow from Financing activities	-845	-418	-302	-375	-422
Net Change in Cash	78	140	841	780	1522

Key Financial ratio's

Key Ratio's	FY18	FY19	FY20E	FY21E	FY22E
EBITDA Margins(%)	16.5	14.6	13.6	14.0	14.3
EBIT Margin(%)	13.93	12.06	10.36	10.71	11.23
PBT Margin(%)	13.51	12.91	10.99	11.32	11.75
PAT Margin(%)	9.68	8.42	8.22	8.47	8.79
Inventory(Days)	108	108	105	102	100
Debtors(Days)	74	67	65	64	63
Creditors(Days)	83	70	70	70	70
Cash Conversion cycle(Days)	98	105	100	96	93
ROE(%)	23.5	18.7	15.8	16.0	16.5
ROCE(%)	16.6	14.0	12.5	12.9	13.4
Debt-Equity(x)	0.5	0.5	0.4	0.4	0.4
Basic EPS(Rs)	9.9	9.6	9.3	10.8	12.7

Disclaimer

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