

Swaraj Engines

13 November 2017

Reuters: SWAR.BO; Bloomberg: SWE IN

Strong Realisation Drives Earnings Growth

Swaraj Engines' (SEL) 2QFY18 earnings were 5% above our estimate, despite lower-than-expected volume growth, as higher realisation offset the impact of slightly lower volume. Volume for the quarter stood at 24,948 units (up 11% YoY) versus our estimate of 25,665 units. However, strong realisation (up 5% YoY) on the back of a rich product mix comprising higher HP tractor engines and price hikes taken to pass on the increase in commodity costs resulted in net sales coming in 2% above our estimate. Higher horse power (HP) 54HP engines are witnessing strong volume traction and the same is expected to continue in the coming quarters as well. Swaraj Engines will start manufacturing 60HP tractor engines in the coming quarters and there are chances of 65HP tractor engine launch in FY19, which should further drive product mix improvement. EBITDA margin for the quarter at 16.8% improved 51bps YoY and 20bps QoQ in a rising commodity price environment and was 30bps above our estimate. It is noteworthy that margin expansion on YoY basis in a rising commodity price environment is commendable. We continue to like SEL because of its robust financials and high dividend payout. Further, we believe that improvement in the rural economy because of a good monsoon and improved sentiment should continue to drive tractor segment's growth in FY18/FY19. We have cut our volume estimates by 1%/4% for FY18/FY19, respectively, and our earnings estimate for FY18 stands marginally revised upwards, but for FY19 it has been cut 6%. We have also introduced our FY20 estimates with volume estimate of 117,435 units and EPS estimate of Rs95. We have rolled forward our target price and multiple to September quarter 2019 estimated earnings and retained our Accumulate rating on SEL with a revised target price of Rs2,056 (23x September quarter 2019 estimated earnings) from Rs2,050 earlier.

Strong realisation: SEL's 2QFY18 volume at 24,948 units grew 11% YoY and was 4% below our estimate of 15% YoY growth. This compares to strong 31% YoY growth each for Mahindra & Mahindra and Escorts during the quarter. However, despite lower volume, net sales at Rs2.1 bn were 3% above our estimate because of strong 5% YoY growth in realisation. Realisation growth on QoQ basis stood at 0.4%, indicating that the company went for price hikes. In 2QFY18, product mix of SEL was also richer with higher HP tractor engines' contribution rising, which also led to improvement in the product mix for the quarter.

EBITDA margin Improves, despite the rise in commodity prices: EBITDA margin of SEL during the quarter improved 51bps YoY and 17bps QoQ as a rich product mix and price hikes helped the company. It is noteworthy that the company reported a sharp increase in margins at a time when raw material prices have been on the rise, which is commendable. Absolute EBITDA for the quarter at Rs351mn grew 20% YoY and was 4% above our estimate because of strong margins.

Valuation: We continue to believe the tractor growth momentum will continue on the back of pent-up demand and improved sentiment backed by a normal monsoon. After a drought-hit FY15/FY16, tractor sales recovered sharply in FY17 and we expect the growth momentum over FY18E/FY19E to continue. We like SEL because of its strong financials and quality earnings. We expect strong double-digit EBITDA and PAT CAGR over FY17-FY19E for SEL backed by demand recovery and market share gains. We have rolled forward our target price and multiple to September quarter 2019 estimated earnings and retained our Accumulate rating on SEL with a revised target price of Rs2,056 (23x September quarter 2019 estimated earnings) from Rs2,050 earlier.

ACCUMULATE

Sector: Automobile Ancillary

CMP: Rs1,917

Target Price: Rs2,056

Upside: 7%

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Key Data

Current Shares O/S (mn)	12.4
Mkt Cap (Rsbn/US\$m)	23.8/448.9
52 Wk H / L (Rs)	2,518/1,202
Daily Vol. (3M NSE Avg.)	3,549

Price Performance (%)

	1 M	6 M	1 Yr
Swaraj Engines	(6.1)	7.3	43.3
Nifty Index	1.5	9.8	24.4

Source: Bloomberg

Y/E March (Rsmn)	2QFY17	1QFY18	2QFY18	YoY (%)	QoQ (%)
Net revenues	1,789	1,940	2,087	16.6	7.6
Raw material costs	1,328	1,429	1,558	17.3	9.0
Gross profit	461	511	529	14.7	3.5
Gross margin (%)	25.8	26.3	25.3	(43bps)	(101bps)
Staff costs	76	81	89	17.3	9.8
Staff exp. as % of sales	4.2	4.2	4.3	3bps	9bps
Other expenses	94	107	89	(4.9)	(16.9)
OE as % of sales	5.2	5.5	4.3	(97)	(126)
Total expenditure	1,988	2,159	2,294	15.4	6.3
EBITDA	292	323	351	20.3	8.7
EBITDAM (%)	16.3	16.6	16.8	51bps	17bps
Depreciation	42	42	42	1.2	0.2
Other income	45	48	51	13.3	5.8
PBT	295	329	360	22.0	9.3
Tax	102	114	125	21.9	9.4
Effective tax rate (%)	193	215	235	22bps	9bps
Net profit	10.8	11.1	11.3	50	18
NPM (%)	15.5	17.3	18.9	22bps	9bps
EPS (Rs)	1,789	1,940	2,087	16.6	7.6

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 1: Financial summary

Y/E March (Rsmn)	FY15	FY16	FY17	FY18E	FY19E
Revenue	5,397	5,259	6,661	7,903	9,730
YoY (%)	(11.3)	(2.6)	26.7	18.6	23.1
EBITDA	747	736	1,047	1,304	1,606
% of sales	13.8	14.0	15.7	16.5	16.5
Adj. PAT	518	512	688	905	1,107
YoY (%)	(22.7)	(1.1)	34.3	31.5	22.3
EPS (Rs)	41.7	41.2	55.4	72.9	89.1
ROE (%)	24.5	24.0	27.7	34.7	43.7
ROCE (%)	18.7	18.1	24.9	32.2	39.0
P/E (x)	43.9	44.3	33.0	25.1	20.5
EV/EBITDA (x)	28.5	28.5	21.2	17.0	13.5
P/BV (x)	10.7	10.6	8.0	9.5	8.5

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Metrics

Y/E March (Rsmn)	2QFY17	1QFY18	2QFY18	YoY (%)	QoQ (%)
Engines sold	22,395	23,287	24,948	11.4	7.1
RM costs as % of sales	74.2	73.7	74.7	43bps	101bps
Staff costs as % of sales	4.2	4.2	4.3	3bps	9bps
Other expenses as % of sales	5.2	5.5	4.3	(97bps)	(126bps)
Gross margin (%)	25.8	26.3	25.3	(43bps)	(101bps)
EBITDA margin (%)	16.3	16.6	16.8	51bps	17bps
ETR (%)	34.7	34.6	34.6	(3bps)	2bps
PAT margin (%)	10.8	11.1	11.3	50bps	18bps

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Change in estimates

(Rsmn)	New estimates			Old estimates			Change (%)		
	FY18E	FY19E	FY20E	FY18E	FY19E	FY20E	FY18E	FY19E	FY20E
Volume	93,819	1,06,953	1,17,435	94,642	1,11,393	-	(0.9)	(4.0)	-
Net sales	7,910	9,439	10,666	7,903	9,730	-	0.1	(3.0)	-
EBITDA	1,305	1,510	1,707	1,304	1,606	-	0.1	(6)	-
EBITDA margin (%)	16.5	16.0	16.0	16.5	16.5	-	-	(50)bps	-
PAT	906	1,041	1,180	905	1,107	-	0.1	(5.9)	-
EPS (Rs)	72.9	83.8	95.0	72.8	89.1	-	0.1	(5.9)	-

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: Deviation of our estimates from actual performance in 2QFY18

(Rsmn)	Actual 2QFY18	Our estimate 2QFY18	Deviation (%)
Net sales	1,809	2,042	(11.4)
EBITDA	298	337	(11.4)
Net profit	199	224	(11.2)

Source: Nirmal Bang Institutional Equities Research

Exhibit 5: P/E chart



Source: Nirmal Bang Institutional Equities Research

Exhibit 6: EV/EBITDA chart



Source: Nirmal Bang Institutional Equities Research

Financials

Exhibit 7: Income statement

Y/E March (Rsmn)	FY16	FY17	FY18E	FY19E	FY20E
Net Sales	5,259	6,661	7,910	9,439	10,666
% growth	(2.6)	26.7	18.8	19.3	13.0
Raw Material	3,957	4,955	5,854	7,032	7,946
Staff	268	310	419	500	565
Other expenses	296	349	332	396	448
Total Expenditure	4,521	5,615	6,605	7,929	8,960
EBITDA	738	1,047	1,305	1,510	1,707
% growth	(1.3)	41.9	24.7	15.7	13.0
EBITDA margin (%)	14.0	15.7	16.5	16.0	16.0
Other income	163	172	205	223	244
Interest	0	1	1	1	1
Gross Profit	1,302	1,706	2,057	2,407	2,720
% growth	(0.3)	31.1	20.6	17.0	13.0
Depreciation	138	163	153	169	178
Profit Before Tax	762	1,055	1,356	1,563	1,771
% growth	(2.0)	38.3	28.6	15.3	13.3
Tax	249	366	451	522	592
Effective tax rate (%)	32.6	34.7	33.2	33.4	33.4
Net Profit	514	688	906	1,041	1,180
% growth	(0.8)	34.0	31.6	15.0	13.3
EPS (Rs)	41.4	55.4	72.9	83.8	95.0
% growth	(0.8)	34.0	31.6	15.0	13.3
DPS (Rs)	33	40	50	55	55
Payout (%)	80	72	69	66	58

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 9: Balance sheet

Y/E March (Rsmn)	FY16	FY17	FY18E	FY19E	FY20E
Equity	124	124	124	124	124
Reserves	2,511	2,710	2,864	3,083	3,441
Net worth	2,635	2,834	2,988	3,208	3,565
Net Deferred Tax Liab	76	63	63	63	63
LT Liabilities/provisions	25	29	29	29	29
Total Loans	-	-	-	-	-
Liabilities	2,736	2,926	3,080	3,299	3,657
Gross Block	1,932	1,958	1,991	2,141	2,231
Depreciation	918	1,048	1,250	1,419	1,597
Net Block	1,015	910	741	722	634
Capital work-in-progress	3	8	8	8	8
LT Investments	3	2	2	2	2
Other long-term assets	42	38	38	38	38
Inventories	277	261	320	407	489
Debtors	75	131	122	172	223
Cash	1,078	487	1,255	1,573	1,875
Cash equivalents	7	20	814	1,131	1,433
Other bank balance	1070	467	442	442	442
ST Investments	104	489	489	489	689
Other Current assets	770	1,395	1,062	1,062	1,062
Total Current assets	2,304	2,762	3,248	3,703	4,338
Trade payables	540	701	864	1,080	1,270
Other current liabilities/provisions	90	95	95	95	95
Total current liabilities	630	796	959	1,175	1,365
Net current assets	1,673	1,966	2,290	2,528	2,974
Total Assets	2,736	2,925	3,080	3,299	3,657

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 8: Cash flow

Y/E March (Rsmn)	FY16	FY17	FY18E	FY19E	FY20E
PBT	762	1,055	1,356	1,563	1,771
(Inc.)/Dec in working capital	130	150	112	79	56
Cash flow from operations	892	1,204	1,468	1,643	1,827
Other income	(161)	(169)	(184)	(213)	(213)
Other expenses	(1)	5	-	-	-
Depreciation	138	163	153	169	178
Tax paid	(238)	(379)	(451)	(522)	(592)
Net cash from operations	630	824	987	1,076	1,201
Capital expenditure	(271)	(62)	(33)	(150)	(90)
Net cash after capex	359	762	954	926	1,111
Other investing activities	134	(257)	586	212	12
Cash from Financial Activities	(492)	(492)	(746)	(821)	(821)
Opening cash	6	7	20	814	1,131
Closing cash	7	20	814	1,131	1,433
Change in cash	1	13	794	318	302

* Note: Does not include other bank balance

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 10: Key ratios

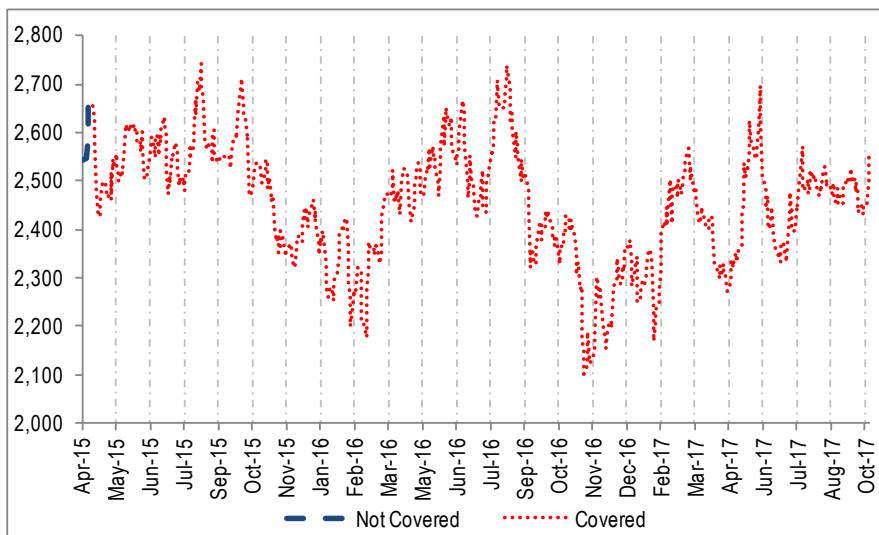
Y/E March	FY16	FY17	FY18E	FY19E	FY20E
Profitability & Return ratios					
EBITDA margin (%)	14.0	15.7	16.5	16.0	16.0
EBIT margin (%)	11.4	13.3	14.6	14.2	14.3
Net profit margin (%)	9.8	10.3	11.4	11.0	11.1
ROE (%)	21.6	25.2	31.1	33.6	34.8
ROCE (%)	18.1	24.9	29.7	31.5	32.2
Working capital & Liquidity ratios					
Receivables (days)	5	6	6	7	8
Inventory (days)	21	15	15	16	17
Payables (days)	47	46	48	50	52
Cash Conversion Cycle (WC days)	(21)	(25)	(27)	(27)	(27)
Net WC-ex cash (days)	16	57	52	40	40
Current ratio (x)	3.7	3.5	3.4	3.2	3.2
Quick ratio (x)	3.2	3.1	3.1	2.8	2.8
Valuation ratios					
EV/Sales (x)	4.3	3.5	2.9	2.4	2.1
EV/EBITDA (x)	30.8	22.3	17.3	14.7	12.9
P/E (x)	46.3	34.6	26.3	22.9	20.2
P/BV (x)	9.0	8.4	8.0	7.4	6.7

Source: Company, Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price (Rs)	Target price (Rs)
13 October 2015	Buy	846	1,168
20 October 2015	Buy	877	1,168
11 January 2016	Buy	956	1,168
29 January 2016	Buy	855	1,152
15 June 2016	Accumulate	1,116	1,220
29 July 2016	Buy	1,161	1,429
24 November 2016	Buy	1,380	1,591
03 February 2017	Buy	1,444	1,679
14 February 2017	Buy	1,425	1,765
9 May 2017	Accumulate	1,829	2,050

Rating track graph



Disclaimer

Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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