

24 April 2019

## Swaraj Engines

*Profitability maintained despite muted volumes; maintaining a Buy*

Rating: **Buy**

Target Price: ₹2,139

Share Price: ₹1,412

We continue to expect positive growth for tractor industry in FY20 driven by government subsidies and expect Swaraj Engines to benefit. However, we expect lower growth in FY20 and FY21 and thus expect earnings growth to be muted. We maintain a Buy on the stock at a revised TP of ₹2,139 (earlier ₹2,312)

**Expected state subsidy schemes to ensure tractor growth.** Various state schemes would ensure growth in FY20 and thus we expect 10% volume growth for Swaraj Engines in FY20 and 3% growth as we enter the peak cycle.

**Expect strong growth in engine volumes.** We continue to expect Swaraj Engines to clock a 4% CAGR in volumes over FY19-21, to 113,953 units. The FY19 expansion plan would expand capacity from 105,000 units now to 120,000.

**Expect margin to be stable.** While the expected volume growth would be margin-accretive, increasing raw material costs would restrict significant margin expansion. We expect the FY20 and FY21 EBITDA margins to hold at 15.5% levels.

**Q4 FY19 result takeaways.** Swaraj Engines' volumes declined 4% q/q (flat y/y), while realisations were up 3.4% y/y, down 0.1% q/q, leading to overall sales growth of 3.4% y/y, decline of 3.6% q/q. Despite increase in other expenses to sales by 40bps sequentially, the EBITDA margin expanded by 50bps q/q driven by gross margin expansion of 90bps. Gross profit per engine was up 4% q/q and EBITDA per engine was up 3% q/q.

**Valuation.** We expect a 10% CAGR in earnings over FY19-21 to ₹998m. With the company's lean cost structure and strong balance sheet, we value the stock at 26x FY21 (assigning lower multiple for lower growth) EPS of ₹82.3 and arrive at a revised TP of ₹2,139 (earlier ₹2,312). We maintain a Buy

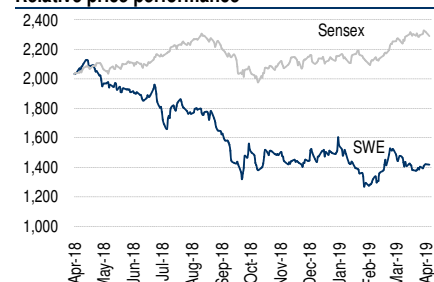
**Risk:** Constrained volume growth in M&M tractors.

Key data	SWE IN / SWAR.BO
52-week high / low	₹2112 / 1256
Sensex / Nifty	38629 / 11601
3-m average volume	\$0.1m
Market cap	₹17bn / \$245.3m
Shares outstanding	12m

Shareholding pattern (%)	Mar'19	Dec'18	Sep'18
Promoters	50.73	50.73	50.74
- of which, Pledged	0	0	0
Free float	49.27	49.27	49.26
- Foreign institutions	2.62	2.57	2.59
- Domestic institutions	11.22	11.39	12.67
- Public	35.43	35.31	34.00

Estimates revision (%)	FY20e	FY21e
Sales	0.0%	0.0%
EBITDA	-1.7%	-2.3%
PAT	-8.1%	-7.5%

### Relative price performance



Source: Bloomberg

Key financials (YE Mar)	FY17	FY18	FY19	FY20e	FY21e
Sales (₹ m)	6,661	7,712	8,717	9,756	10,180
Net profit (₹ m)	688	801	824	954	998
EPS (₹)	55.4	66.0	67.9	78.6	82.3
PE (x)	26.6	30.2	20.8	18.0	17.2
EV / EBITDA (x)	15.3	18.6	12.2	9.5	8.7
PBV (x)	6.5	10.6	7.2	6.2	5.4
RoE (%)	25.2	31.3	35.3	37.2	33.8
RoCE (%)	24.5	30.8	34.4	36.2	33.0
Dividend yield (%)	2.8	3.8	4.3	3.4	3.4
Net debt / equity (x)	-0.8	-0.7	-0.4	-1.0	-1.1

Source: Company, Anand Rathi Research

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## Quick Glance – Financials and Valuations

**Fig 1 – Income statement (₹ m)**

Year-end: Mar	FY17	FY18	FY19	FY20e	FY21e
Volumes	82,297	92,022	99,638	1,10,302	1,13,953
Net revenues (₹ m)	6,661	7,712	8,717	9,756	10,180
Growth (%)	26.7	15.8	13.0	11.9	4.3
Raw Material	4,955	5,743	6,566	7,307	7,625
Emp + other expenses	661	752	835	934	984
<b>EBITDA</b>	<b>1,045</b>	<b>1,216</b>	<b>1,317</b>	<b>1,515</b>	<b>1,571</b>
EBITDA margins (%)	15.7	15.8	15.1	15.5	15.4
- Depreciation	163	168	195	221	226
Other income	172	189	154	168	184
Interest expenses	0	10	1	0	0
Extraordinary items	-	-	-	-	-
PBT	1,054	1,227	1,274	1,461	1,529
Effective tax rate (%)	35	35	35	35	35
+ Associates / (minorities)					
Net income	688	801	824	954	998
Adjusted income	688	801	824	954	998
WANS	12	12	12	12	12
FDEPS (₹ / sh)	55.4	66.0	67.9	78.6	82.3

**Fig 3 – Cash-flow statement (₹ m)**

Year-end: Mar	FY17	FY18	FY19	FY20e	FY21e
PBT	883	1,048	1,274	1,293	1,345
+ Non-cash items	163	168	195	221	226
Oper. prof. before WC	851	969	1,469	1,175	1,224
- Incr. / (decr.) in WC	-153	91	526	-1,207	-53
Others incl. taxes	366	426	450	507	531
Operating cash-flow	832	699	494	2,214	1,092
- Capex (tang. + intang.)	63	226	336	30	50
Free cash-flow	769	472	157	2,184	1,042
Acquisitions					
- Div.	493	643	730	584	584
+ Equity raised (buyback)		-704		-1	0
+ Debt raised					
- Fin investments	385	272	77	-2	-
- Misc. (CFI + CFF)	-162	-172	-14	-168	-184
Net cash-flow	54	-974	-636	1,769	642

Source: Company, Anand Rathi Research

**Fig 5 – Price movement**



Source: Bloomberg

**Fig 2 – Balance sheet (₹ m)**

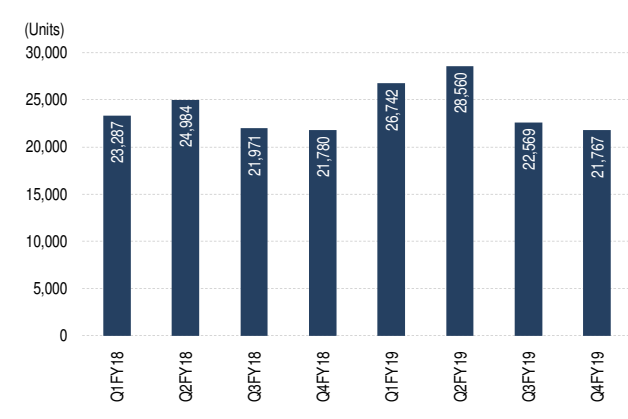
Year-end: Mar	FY17	FY18	FY19	FY20e	FY21e
Share capital	124	121	121	121	121
Net worth	2,834	2,285	2,380	2,748	3,162
Debt	-	-	-	-	-
Minority interest	-	-	-	-	-
DTL / (Asset)	63	58	72	72	72
<b>Capital employed</b>	<b>2,896</b>	<b>2,343</b>	<b>2,451</b>	<b>2,820</b>	<b>3,234</b>
Net tangible assets	909	916	1,084	912	736
Net intangible assets	1	1	14	14	14
Goodwill					
CWIP (tang. & intang.)	8	60	20	-	-
Investments (strategic)					
Investments (financial)	492	763	841	838	838
Current assets (ex cash)	515	913	1,518	1,200	1,241
Cash	1,796	822	186	1,956	2,598
Current liabilities	825	1,132	1,211	2,100	2,194
Working capital	-310	-219	307	-900	-953
<b>Capital deployed</b>	<b>2,896</b>	<b>2,343</b>	<b>2,451</b>	<b>2,820</b>	<b>3,234</b>
Contingent liabilities	-	-	-	-	-

**Fig 4 – Ratio analysis**

Year-end: Mar	FY17	FY18	FY19	FY20e	FY21e
P/E (x)	26.6	30.2	20.8	18.0	17.2
EV / EBITDA (x)	15.3	18.6	12.2	9.5	8.7
EV / Sales (x)	2.4	2.9	1.8	1.5	1.3
P/B (x)	6.5	10.6	7.2	6.2	5.4
RoE (%)	25.2	31.3	35.3	37.2	33.8
RoCE (%) - after tax	24.5	30.8	34.4	36.2	33.0
RoIC (%) - after tax	71.4	64.6	45.1	63.9	147.1
DPS (₹ / sh)	39.7	53.0	60.2	48.2	48.2
Dividend yield (%)	2.8	3.8	4.3	3.4	3.4
Dividend payout (%) - incl. DDT	71.6	80.3	88.6	61.3	58.5
Net debt / equity (x)	-0.8	-0.7	-0.4	-1.0	-1.1
Receivables (days)	7	7	8	5	5
Inventory (days)	19	20	26	27	27
Payables (days)	46	55	51	46	48
CFO : PAT %	121.0	87.3	59.9	232.2	109.5

Source: Company, Anand Rathi Research

**Fig 6 – Quarterly volume trend**

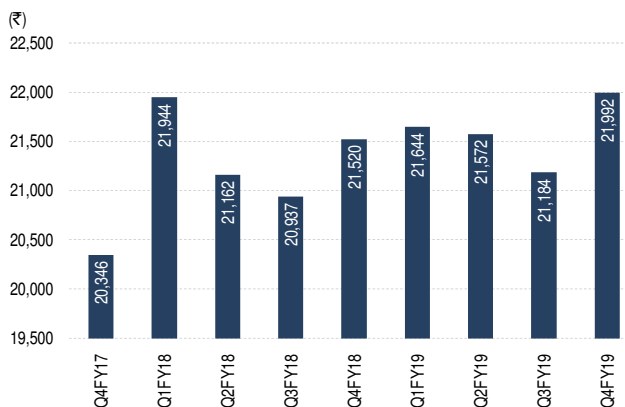


Source: Company

**Gross-profit-per-engine and EBITDA-per-engine trends**

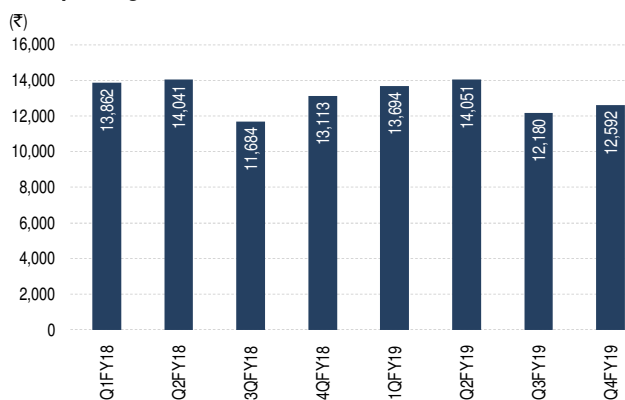
Over the last eight quarters, driven by a richer product mix and cost-control measures the company has done consistently well on both gross profit per engine and EBITDA per engine.

**Fig 7 – Gross profit per engine**



Source: Company

**Fig 8 – EBITDA per engine**



Source: Company

## Quarterly result update

Fig 9 – Quarterly performance (₹ m)

Year-end: Mar	Q1 FY17	Q2 FY17	Q3 FY17	Q4 FY17	Q1 FY18	Q2 FY18	Q3 FY18	Q4 FY18	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19
<b>Volume</b>	20,910	22,395	19,150	19,842	23,287	24,984	21,971	21,780	26,742	28,560	22,569	21,767
Y/Y (%)	13.7	18.6	49.1	42.0	11.4	11.6	14.7	9.8	14.8	14.3	2.7	(0.1)
Q/Q (%)	49.7	7.1	(14.5)	3.6	17.4	7.3	(12.1)	(0.9)	22.8	6.8	(21.0)	(3.6)
<b>Average Realization</b>	81,760	79,888	80,820	81,025	83,300	83,517	83,410	85,060	87,697	86,495	88,050	87,963
Y/Y (%)	(1.4)	(1.0)	(1.2)	(0.2)	1.9	4.5	3.2	5.0	5.3	3.6	5.6	3.4
Q/Q (%)	0.7	(2.3)	1.2	0.3	2.8	0.3	(0.1)	2.0	3.1	(1.4)	1.8	(0.1)
<b>Net sales</b>	<b>1,710</b>	<b>1,789</b>	<b>1,548</b>	<b>1,608</b>	<b>1,940</b>	<b>2,087</b>	<b>1,833</b>	<b>1,853</b>	<b>2,345</b>	<b>2,470</b>	<b>1,987</b>	<b>1,915</b>
Y/Y (%)	12.1	17.4	47.2	41.8	13.5	16.6	18.4	15.2	20.9	18.4	8.4	3.4
Q/Q (%)	50.8	4.7	(13.5)	3.9	20.7	7.6	(12.2)	1.1	26.6	5.3	(19.6)	(3.6)
Other operating income	7											
	<b>1,717</b>	<b>1,789</b>	<b>1,548</b>	<b>1,608</b>	<b>1,940</b>	<b>2,087</b>	<b>1,833</b>	<b>1,853</b>	<b>2,345</b>	<b>2,470</b>	<b>1,987</b>	<b>1,915</b>
Y/Y (%)	12.1	16.8	46.6	41.0	13.0	16.6	18.4	15.2	20.9	18.4	8.4	3.4
Q/Q (%)	50.6	4.2	(13.5)	3.9	20.7	7.6	(12.2)	1.1	26.6	5.3	(19.6)	(3.6)
<b>EXPENDITURE</b>												
(Incr.) / decr. in stock-in-trade	26	(13)	(37)	51	(42)	32	(24)	18	4	(32)	20	(79)
<b>Materials</b>	1,254	1,341	1,181	1,153	1,471	1,526	1,396	1,366	1,762	1,886	1,490	1,515
% of sales	74.5	74.2	73.9	74.9	73.7	74.7	74.9	74.7	75.3	75.1	75.9	75.0
Y/Y (%)	10.2	15.5	42.9	42.3	11.7	17.3	20.0	14.9	23.6	19.0	9.9	3.8
Q/Q (%)	51.3	3.8	(13.9)	5.3	18.7	9.0	(11.9)	0.8	27.6	5.0	(18.6)	(4.8)
Gross margin (%)	25.47	25.77	26.10	25.11	26.34	25.34	25.10	25.30	24.68	24.94	24.06	25.00
<b>Staff cost</b>	73	76	81	81	81	89	89	89	96	100	99	97
% of sales	4.2	4.2	5.2	5.0	4.2	4.3	4.8	4.8	4.1	4.1	5.0	5.1
Y/Y (%)	4.7	(10.0)	7.5	28.5	10.8	17.3	10.2	10.8	18.6	13.2	11.8	8.8
Q/Q (%)	16.1	3.7	6.6	0.1	0.1	9.8	0.1	0.7	7.2	4.8	(1.1)	(2.0)
<b>Other expenditure</b>	81	94	93	83	107	89	115	94	117	114	104	107
% of sales	4.7	5.2	6.0	5.2	5.5	4.3	6.2	5.1	5.0	4.6	5.2	5.6
Y/Y (%)	2.4	33.0	76.9	17.2	33.4	(4.9)	22.6	12.8	8.8	28.3	(9.3)	14.5
Q/Q (%)	13.5	16.5	(0.4)	(11.0)	29.2	(16.9)	28.4	(18.2)	24.7	(2.1)	(9.2)	3.3
Expenses capitalised												
<b>Total expenses</b>	<b>1,433</b>	<b>1,497</b>	<b>1,318</b>	<b>1,368</b>	<b>1,617</b>	<b>1,736</b>	<b>1,576</b>	<b>1,567</b>	<b>1,979</b>	<b>2,069</b>	<b>1,712</b>	<b>1,641</b>
<b>EBITDA</b>	<b>284</b>	<b>292</b>	<b>230</b>	<b>240</b>	<b>323</b>	<b>351</b>	<b>257</b>	<b>286</b>	<b>366</b>	<b>401</b>	<b>275</b>	<b>274</b>
Y/Y (%)	27.5	28.3	80.3	49.8	13.7	20.3	11.7	19.0	13.4	14.4	7.1	(4.0)
Q/Q (%)	77.2	2.7	(21.2)	4.3	34.6	8.7	(26.8)	11.3	28.2	9.6	(31.5)	(0.3)
<b>OPM (%)</b>	<b>16.5</b>	<b>16.3</b>	<b>14.9</b>	<b>14.9</b>	<b>16.6</b>	<b>16.8</b>	<b>14.0</b>	<b>15.4</b>	<b>15.6</b>	<b>16.2</b>	<b>13.8</b>	<b>14.3</b>
Other income	47	45	44	37	48	51	49	41.4	39	38.6	40.3	36.4
Interest	0	0	1	0	-	-	-	10	1	-	-	0
Depreciation	40	42	40	42	42	42	42	42	47	48	47	53
<b>Profit before tax</b>	<b>291</b>	<b>295</b>	<b>234</b>	<b>234</b>	<b>329</b>	<b>360</b>	<b>264</b>	<b>275</b>	<b>357</b>	<b>391.9</b>	<b>268.0</b>	<b>258</b>
Provision for taxation	101	102	81	82	114	125	91	97	126	138	95	91
Tax Rate (%)	34.7	34.7	34.7	34.9	34.6	34.6	34.7	35.1	35.3	35.3	35.3	35.4
<b>Profit after tax</b>	<b>190</b>	<b>193</b>	<b>153</b>	<b>153</b>	<b>215</b>	<b>235</b>	<b>172</b>	<b>179</b>	<b>231</b>	<b>254</b>	<b>173</b>	<b>167</b>
Y/Y (%)	21.4	23.9	83.0	30.8	13.2	22.1	12.6	17.2	7.3	8.0	0.6	(6.8)
Q/Q (%)	63.0	(62.5)	(20.5)	(0.3)	41.0	(65.8)	(26.7)	3.7	29.0	10.0	(31.7)	(4.0)
<b>PAT Margin</b>	<b>11.1</b>	<b>10.8</b>	<b>9.9</b>	<b>9.5</b>	<b>11.1</b>	<b>11.3</b>	<b>9.4</b>	<b>9.6</b>	<b>9.8</b>	<b>10.3</b>	<b>8.7</b>	<b>8.7</b>
<b>EPS</b>	<b>15.3</b>	<b>15.5</b>	<b>12.3</b>	<b>12.3</b>	<b>17.3</b>	<b>18.9</b>	<b>13.9</b>	<b>14.7</b>	<b>19.0</b>	<b>20.9</b>	<b>14.3</b>	<b>13.7</b>

Source: Company

## Valuation

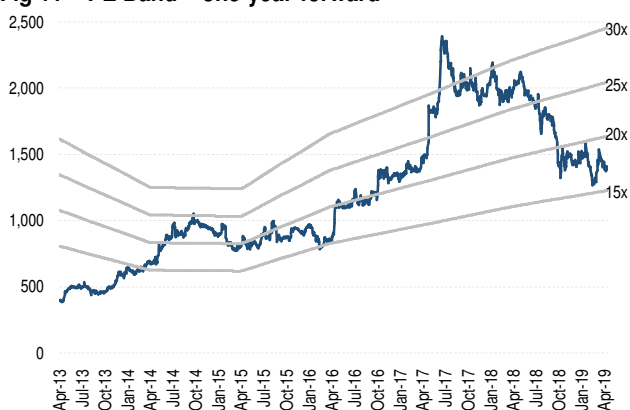
We expect a 10% CAGR in earnings over FY19-21 to ₹998m. With the company’s lean cost structure and strong balance sheet, we value the stock at 26x FY21 (assigning lower multiple for lower growth) EPS of ₹82.3 and arrive at a revised TP of ₹2,139 (earlier ₹2,312). We maintain a Buy.

**Fig 10 – Change in estimates**

₹ m	Old estimates		Revised estimates		Change (%)	
	FY20	FY21	FY20	FY21	FY20	FY21
Revenue	9,756	10,180	9,756	10,180	0.0	0.0
EBITDA	1,541	1,608	1,515	1,571	-1.7	-2.3
EPS (₹)	86	89	79	82	-8.1	-7.5

Source: Anand Rathi Research

**Fig 11 – PE Band – one-year-forward**



Source: Bloomberg, Anand Rathi Research

**Fig 12 – One-year-forward PE Standard Deviation**



Source: Bloomberg, Anand Rathi Research

### Risk

- Constrained growth in M&M tractor volumes

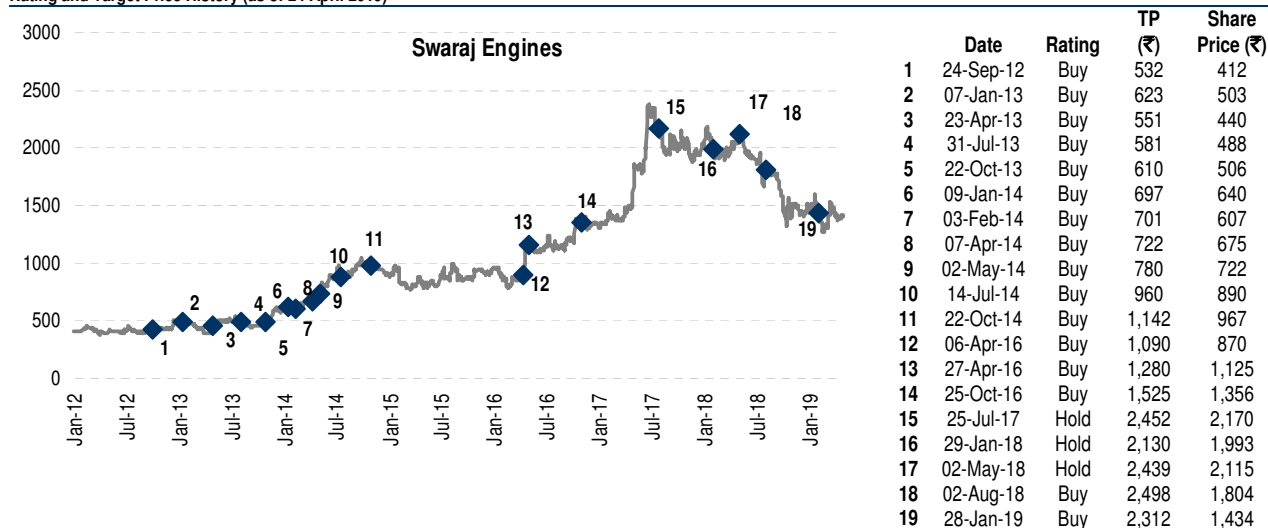
## Appendix

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#### Ratings Guide (12 months)

	Buy	Hold	Sell
Large Caps (>US\$1bn)	>15%	5-15%	<5%
Mid/Small Caps (<US\$1bn)	>25%	5-25%	<5%

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