

Buy

Suprajit Engineering Ltd

Industry: Auto and Auto Components

Industry View: Overweight

Initiating Coverage

“Superior Connection”

Suprajit Engineering (Suprajit) promoted by Ajith Kumar Rai is the largest automotive cable company in India with a capacity to manufacture 75mn units of cables. Suprajit has a 45% market share and derives more than 75% of its ₹2.5bn revenues from automotive OEMs of which 60% is from the three leading two wheeler manufacturers in India.

Market leadership position, scalable business model and capacity expansion by auto OEMs would in our view enable Suprajit to grow its net profits at a CAGR of 30% over the next 3 years on the back of an estimated 22% CAGR growth in revenues during the same period.

We expect Suprajit to leverage benefits of scale in raw material sourcing across its 10 facilities located in close proximity to its customers with no single customer accounting for more than 20% of its revenues. We believe that Suprajit could get a breakthrough with Maruti (not an existing customer) going forward which when happens could propel volumes.

Suprajit is expanding capacities by 47% at its facilities to cater to the growing needs of its customers and aims to grow its after market, export and non automotive business (which together accounts for 25% of its revenues) as part of a conscious strategy to de-risk its business model which is dependent on automotive OEMs.

Valuation

Suprajit with positive free cash generation trades at 5x FY'13E earnings and has a superior ROCE of 38% and is the only small cap auto component company which scored highly in our screener on companies with market capitalization above ₹2bn based on parameters like sales growth, profit growth and valuation ratios for the past 20 quarters. We rate Suprajit as a BUY and have assigned a multiple of 7.5x which is a 25% premium to its 3 year average trailing PE multiple of 6x, from which we derive our price target of ₹31 (₹1 F.V.), translating into an upside of 46%.

Risks and concerns

Higher than expected rise in input costs like steel and PVC components

Continued losses at Gills Cables UK may have a negative impact albeit low on net profits

Sharp slowdown in auto industry is a risk which the company can mitigate only partially through the non automotive business.

Stock Data

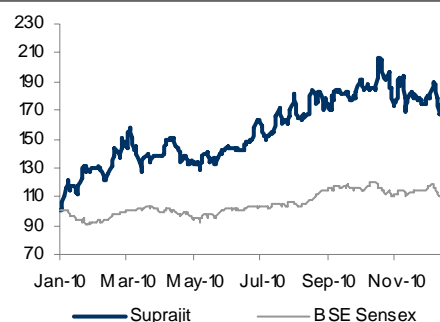
Current Market Price (₹)	21
12 Month Target Price (₹)	31
Potential upside (%)	46
Reuters	SUPE.BO
Bloomberg	SEL IN

Key Data

Market Cap (₹.bn)	2.49
52-Week Range(₹)	26 / 12
Avg. Daily Trading Value (₹mn)	2.83
Promoters (%)	51
FII Holding (%)	0
DII Holding (%)	4
Public & Others Holding (%)	45

YE Mar	FY 10	FY11E	FY 12E	FY13E
Revenues	2,485	3,293	3,947	4,480
EBITDA (%)	18.2	17.6	18.6	19.6
PAT(%)	8.9	8.8	9.9	10.9
EPS(₹s)	1.9	2.4	3.3	4.1
EPS growth (%)	146.4	30.5	35.7	24.5
P/E(x)	11.3	8.7	6.4	5.1
P/B(x)	3.4	2.7	2.1	1.6
EV/EBITDA(x)	6.6	5.4	4.3	3.5
ROCE(%)	39.7	38.4	38.6	38.0
ROE(%)	30.2	30.9	32.4	31.4
Dividend yield (%)	2.4	3.5	4.7	5.8

Relative price performance



One Year Indexed

(%)	1 Month	3 Months	12 Months
Absolute	(5.3)	(5.3)	70.5
BSE Relative	(2.7)	2.0	61.0

Ashwin Patil

ashwin_patil@lkpsec.com

+91 22 6635 1271

Disclaimer:

The information in this document has been printed on the basis of publicly available information, internal data and other reliable sources believed to be true and is for general guidance only. While every effort is made to ensure the accuracy and completeness of information contained, the company makes no guarantee and assumes no liability for any errors or omissions of the information. No one can use the information as the basis for any claim, demand or cause of action. LKP Securities Ltd., and affiliates, including the analyst who have issued this report, may, on the date of this report, and from time to time, have long or short positions in, and buy or sell the securities of the companies mentioned herein or engage in any other transaction involving such securities and earn brokerage or compensation or act as advisor or have other potential conflict of interest with respect to company/ies mentioned herein or inconsistent with any recommendation and related information and opinions. LKP Securities Ltd., and affiliates may seek to provide or have engaged in providing corporate finance, investment banking or other advisory services in a merger or specific transaction to the companies referred to in this report, as on the date of this report or in the past.

Investment Argument

Market leadership position and wide scale of operations is the USP

Suprajit is the market leader in control cables in India with a market share of 45% and is globally positioned within the Top 5 rank. The company sells its products to most of the domestic as well as global 2 wheeler and 4 wheeler companies. It is a single source supplier to companies like TVS Motor and Volkswagen India. Suprajit has 10 manufacturing facilities (which produce cables and speedometers) operating at 80-85% utilization, the latest one at Chakan has started full operations in CY 10. The company has a capacity of 75mn cable units which will be expanded to 110mn units by the end of FY 11. It also has a capacity of manufacturing 6 lakh speedometer units. By virtue of having its facilities in the vicinity of all the major auto hubs in India, Suprajit we believe has a clear logistic advantage.

Plant locations adjoining the major auto hubs in India to save transportation costs

Suprajit has got 9 plants all over India. About 60% of Suprajit's capacity is contributed by Bommasandra unit 2 at Bangalore, Chakan and Manesar plants. The company has prudently laid its plants in vicinity to the various plants of OEMs, so as to deliver timely and earn goodwill from customers. Additionally it will enable Suprajit to save on transportation cost and hold a competitive edge.

Suprajit's plant location	OEM' s plant in vicinity
Bangalore - 4 units	TVS (Hosur, Mysore), Hyundai (Chennai) ,Toyota,Volvo (Bidadi)
Manesar	Maruti Suzuki , Swaraj Mazda (Punjab)
Chakan	M&M, Bajaj Auto, Volkswagen, Tata Motors, Piaggio (Baramati)
Vapi	Tata Motors ,GM (Halol)
Pantnagar	Tata Motors, Ashok Leyland, Bajaj Auto
Haridwar	Hero Honda

Capacity expansion plans to boost the topline

In order to cater to the rising demand from OEMs, Suprajit is expanding its cable capacity by 47% from 75 mn at the end of FY 10 to 110 mn at the end of FY 11E. As the company supplies cables to almost the entire auto industry, the growth in the company can easily be traced with the growth of the industry. For this capacity expansion, Suprajit has planned a capex of ₹250mn for FY 11E and a further capex of ₹100mn for FY 12E. The FY11E capex includes the capex to be incurred at Tata Motors' Nano plant at Sanand. However, given the low demand for Nano, Suprajit plans to curtail its FY 11E capex to ₹180-200 mn and may incur the rest in FY 12E if required. By virtue of this expansion, we estimate cable volumes to grow at 25% yoy and overall consolidated gross sales to grow at 33% yoy to ₹3,542 mn considering 8% growth in realization of cables.

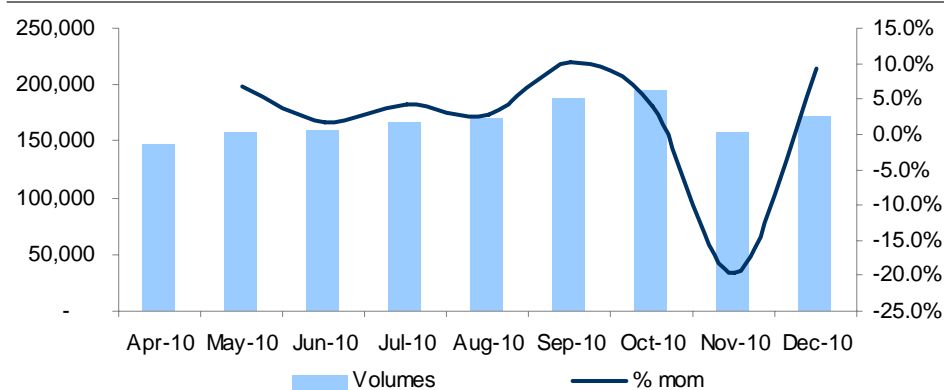
Growth in the Two wheeler industry to be the key growth driver

Suprajit derives ~ 77% of its revenues from OEMs out of which 60% is contributed by the three two wheelers - Hero Honda, Bajaj Auto and TVS each contributing 20%. 4 wheelers contribute 30% and the rest is contributed by exports and other two wheelers. This signifies Suprajit's considerable dependence on the two wheeler industry. With the split between Hero and Honda, competition in the two wheeler industry is expected to intensify. Although this may hamper growth prospects of individual companies within the sector, but for a supplier like Suprajit, this in fact entails more business as two wheeler companies launch more and more products to ward competition.

Honda also being one of the clients of Suprajit, aggressive slurry of solo launches from them will definitely lead to additional business for Suprajit. Suprajit is a single source supplier for TVS, who is in the process of expanding capacities from 2.4mn to 2.8mn which will only benefit Suprajit in the auto cable industry. Even companies like Hero Honda and Bajaj Auto have given strong volume guidance for the full year (5.5mn and 4 mn respectively), which will also benefit Suprajit. The macro drivers for the two wheeler industry like low penetration of two wheelers in India, strong rural demand, growing youth population, improving income levels and slew of new product launches are expected to remain intact in the medium to long term despite the short term worries like rising inflation and interest rates.

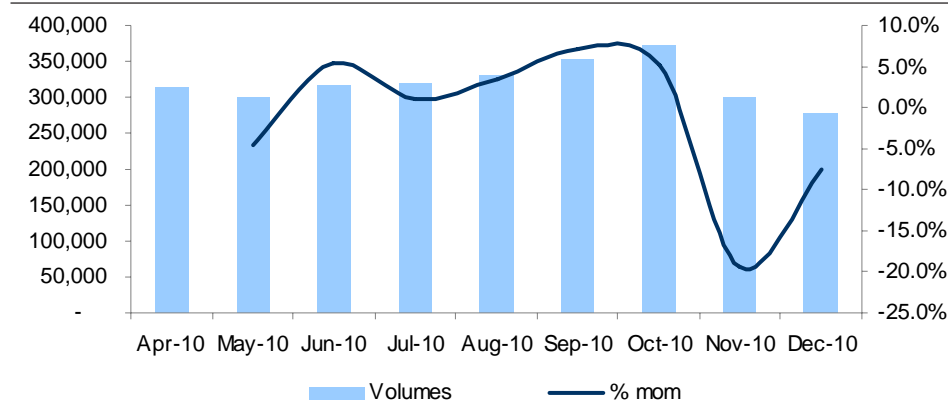
Monthly Volumes

TVS Motor



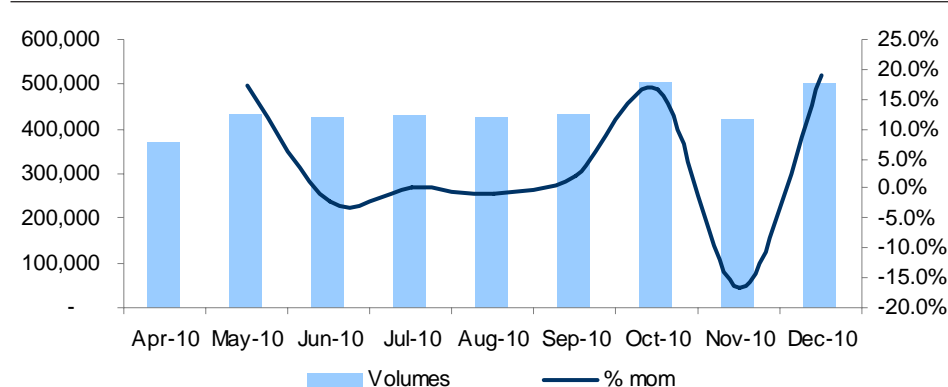
Source: SIAM, LKP Research

Bajaj Auto



Source: SIAM, LKP Research

Hero Honda

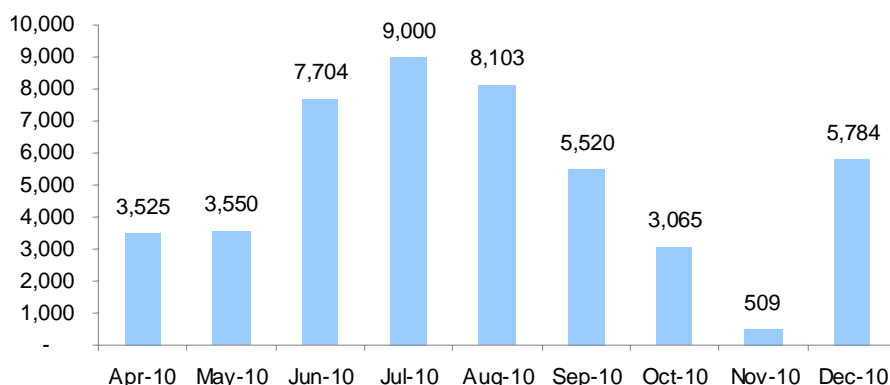


Source: SIAM, LKP Research

Turnaround in Nano sales may add to volume expansion for Suprajit

Suprajit is planning to set up a Greenfield plant at Sanand, next to Tata Motors' Nano plant. However, currently the plans are on hold as Nano sales are dwindling. In November, Nano sold just 500 units down from 9000 sold in July 2010. However, with renewed marketing efforts, in December ~5800 units of the model were sold. Suprajit will keep a close watch on the consistency of Nano sales in the coming months, based on which it will decide whether they will be setting up a plant at Sanand or not by April 2011. If they do so, it will call for an additional volume of 10-15 mn per annum for a capex of ~ ₹60mn. We have not factored in these volumes in our projections. Currently, Suprajits' Wapi and Uttaranchal plants are catering to the Nano demand.

Nano Volume trend



Source: SIAM, LKP Research

Fructification of deal discussion with Maruti Suzuki will be a boost for Suprajit

Suprajit supplies cables to all the four wheelers except Maruti Suzuki. With Maruti Suzuki expanding its capacity by ~5 lakh units in the next 1.5 years, it will require higher cable volumes. For this purpose Maruti Suzuki is in advanced talks with Suprajit. Suprajit has a plant location at Manesar, which is in vicinity of Maruti's plant, thus saving transportation cost for Suprajit and cutting any supply delay from Suprajit's end. We believe that winning Maruti Suzuki as a client would be a big boost for Suprajit.

Aftermarket, non-auto and export business is a new focus area for Suprajit

After market, exports and non-automotive businesses contributed 23% of total revenues of Suprajit in FY 10. Among non-auto segment (5% of revenues) Whirlpool, LG, JCB are some of the clients of Suprajit. It supplies non-auto cables mainly to washing machine manufacturers and construction companies. The company has won a contract for John Deere's non auto business in India and expects the non-auto business to grow at a good pace in the coming years. As far as the export market is concerned, Suprajit is getting good export orders from various foreign auto and construction companies like Ferrari, Volvo, Ford, Piaggio, Caterpillar, CLASS, Honda, New Holland Tractors etc. Management has projected revenues of ₹400 mn for exports in FY 11E and expects it to grow by 25% in FY 12E. Suprajit is also tapping the aftermarket demand aggressively. It has established a marketing set up in South India for after market, because of which it expects aftermarket business to double in FY 12 from the expected level of ₹250mn in FY 11E.

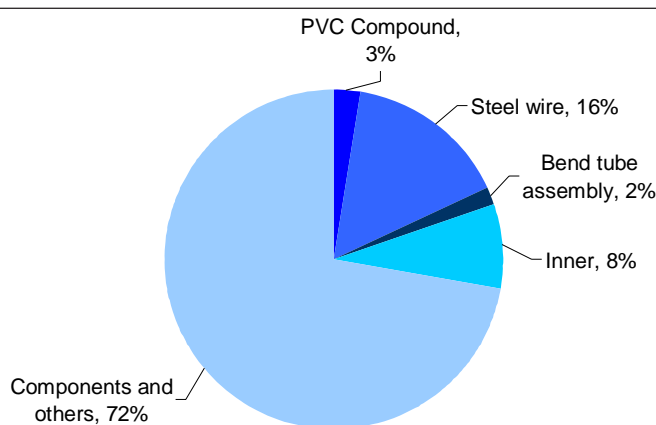
Haridwar plant to provide tax advantage

Suprajit also supplies products to Hero Honda from its Haridwar plant. Haridwar plant is in the tax exempted zone and hence is getting tax holiday on its production. Currently the company produces 7-8% from Haridwar, which is expected to move up to >10% in a couple of years. This will save tax for the company which is expected to come down to 28% in FY 12E from the current rate of 30%.

EBITDA margins to sustain at 18% on muted growth in RM costs

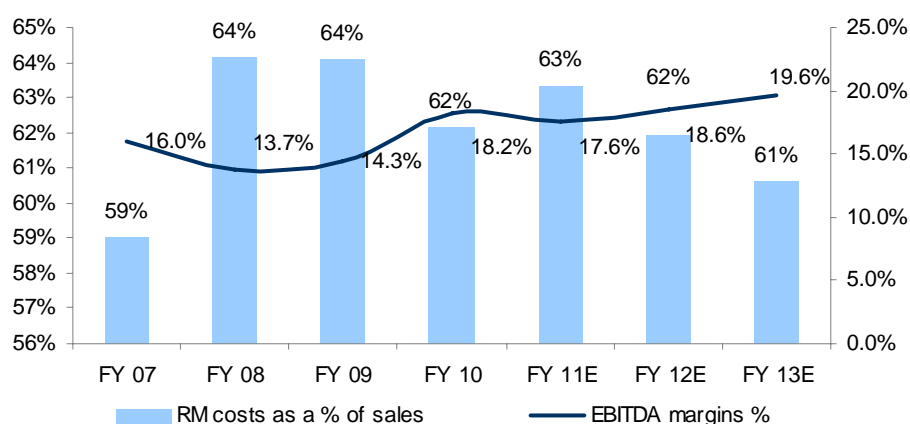
Suprajit has guided for its EBITDA margins to be at 18% in FY 11E as it does not expect raw material costs to increase significantly from present levels. In FY 12E, the company anticipates expansion in margins as demand increases and the company gains operating leverage from higher utilization rates (80% currently). Steel wires contributed 16% of total RM costs in FY10. Management expects steel prices to move up by ~5% in FY 12E which is lower compared to the hike witnessed this fiscal.

RM cost composition



Source: Company, LKP Research

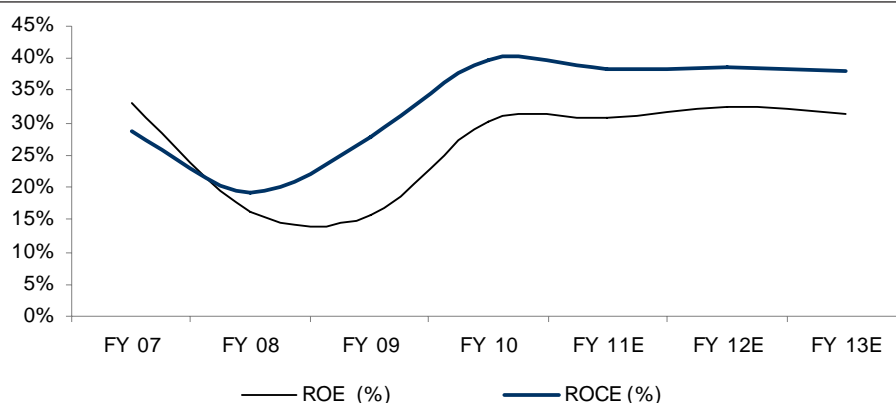
RM cost as a % of sales Vs EBITDA margins (%)



Source: Company, LKP Research

Robust Return Ratios and low leverage

Suprajit has high return ratios – 32.4% ROE and 38.6% ROCE and we believe the company will be able to maintain this on the back of expected strong profitability arising from growing volumes, growth in the auto industry and slower growth in raw material costs.

ROE & ROCE trend

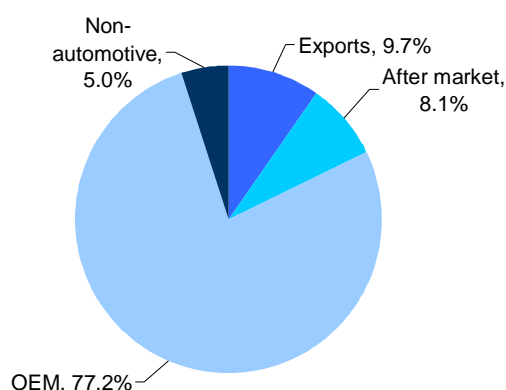
Source: Company, LKP Research

Subsidiary performance to remain muted at the bottomline

Suprajit has two subsidiaries – Suprajit Automotive and Gills Cables UK (the marketing, technological support and R&D set up for business in Europe). Suprajit Automotive is a profitable cable business, as it reported profits of ₹20mn in FY10, while Gills Cable is the acquired UK business which incurred loss of ₹13mn in FY 10. The losses can be mainly attributed to higher employee costs in UK and lower scale of business. At the top line, both the companies collectively had a turnover of ₹523mn which has fallen at a pace of 11%, due to a 28% fall in the revenues of Gills Cable. The fall was due to lower scale of operations and weaker European auto industry. Going forward, Suprajit expects Gills Cable to break even in FY 11E and collectively report a top line growth of 25-35% in FY 12E. Despite this at the bottom line it will contribute just 3-4% of the consolidated net profits due to the size of the subsidiaries, higher employee costs in the UK and the slow recovery in the European auto industry.

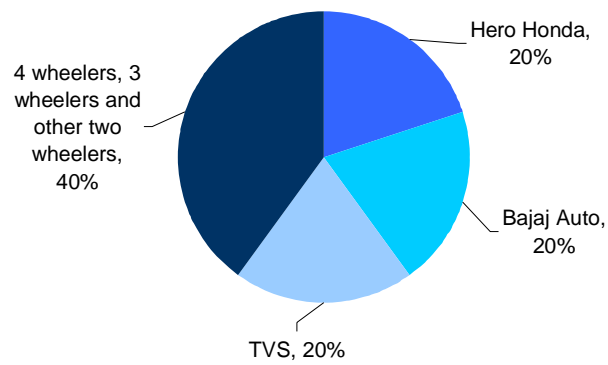
Company Background

Suprajit is a Bangalore based company manufacturing liner cables for automobile, construction, and white goods industry and is currently India's most preferred cable manufacturer with 45% market share supplying to all the leading vehicle manufacturers. The company has got 10 plant locations across India having a total capacity of 75mn cable units and 6 lakh speedometers. Suprajit has two subsidiaries namely Suprajit Automotive Ltd and Gills Cable UK which provides marketing, technology and R&D support to the export business. Approximately 77% of Suprajit's topline comes from OEMs, out of which 60% is contributed by the three two wheeler companies – TVS, Bajaj Auto and Hero Honda. The rest is contributed by 4 wheelers. Out of the remaining 23%, 10% is contributed by exports, while aftermarket and non-automotive business contributes 8% and 5% respectively. Remsons Cables and Hylax Cables are the closest competitors of Suprajit.

Revenue break-up

Source: Company, LKP Research

OEM Revenue break-up



Source: Company, LKP Research

Products

Automotive cables

Brake cables
Clutch cables
Throttle cables
Starting cables
Gear shift cables
Choke cables
Speedometer
Tachometer cables
Window regulator cables
Mirror cable assemblies
Seat recliner cables
Latch release cables etc.

Non-automotive cables for

Washing machines
Material Handling
Earth Moving Equipments
Marine applications etc.

Source: Company

Clientele

TVS Motor Ltd	LML	CLASS
Hero Honda	Lear Corporation	Kinetic Engineering
Bajaj Auto	Eicher Motors	Kinetic Motor Company
Tata Motors	General Motors	TAFE
Yamaha Motor	M&M	Whirlpool Washing Machines
Hyundai Motors	Swaraj Mazda	New Holland Tractors etc
Ford	Piaggio	
HMSI	JCB	

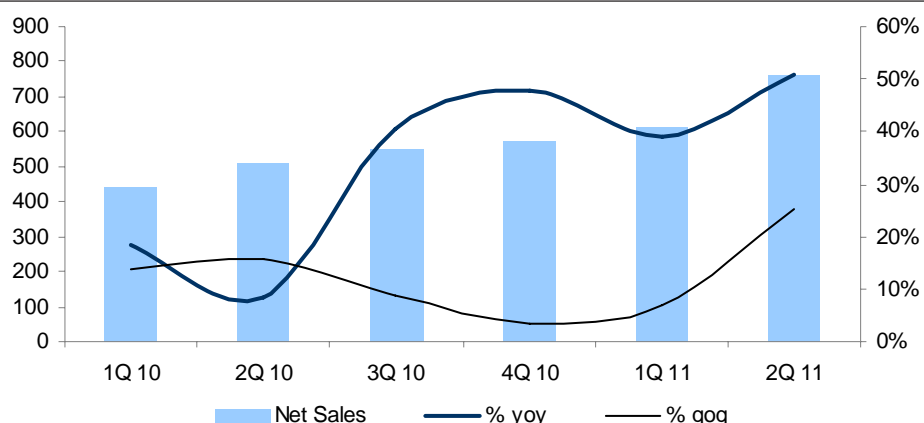
Source: Company

Financial performance

Revenues

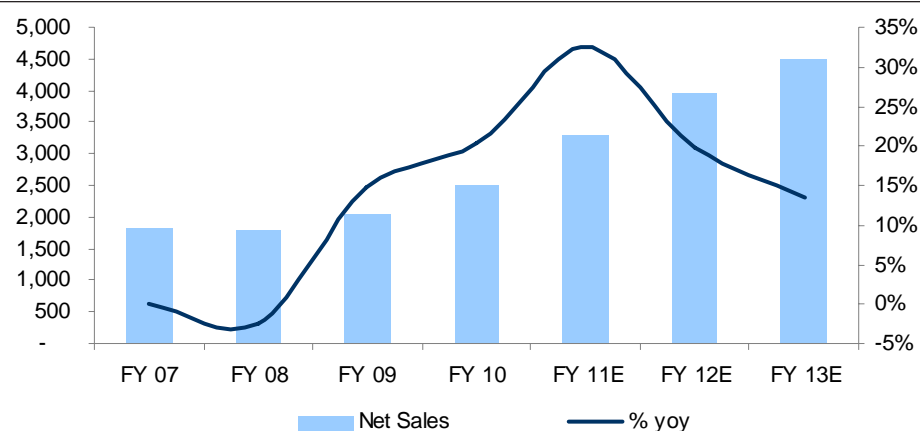
Suprajit's consolidated revenues have grown at a CAGR of 10% during FY 07 and FY 10, while it is expected to grow at a CAGR of 22% in FY 10-13E on account of capacity expansion, strong auto demand, traction from non-auto business, aftermarket sales and exports. In the first two quarters of the year, Suprajit has recorded sales of ₹1,505mn, a growth of 53% yoy and in the full year, we are expecting a growth of 36% to ₹3,542 mn in standalone sales and 33% to ₹3,293 in consolidated sales on higher base of FY 10.

Quarterly net sales (₹mn) Vs YoY & QoQ growth (%)



Source: Company, LKP Research

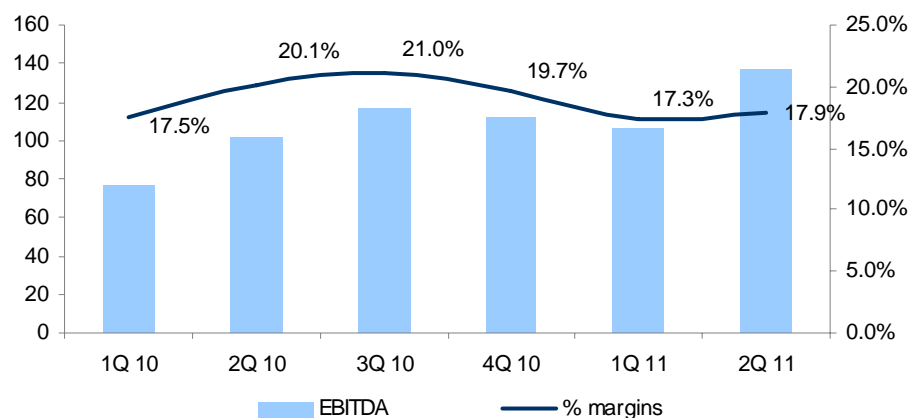
Yearly net sales (₹mn) Vs YoY growth (%)



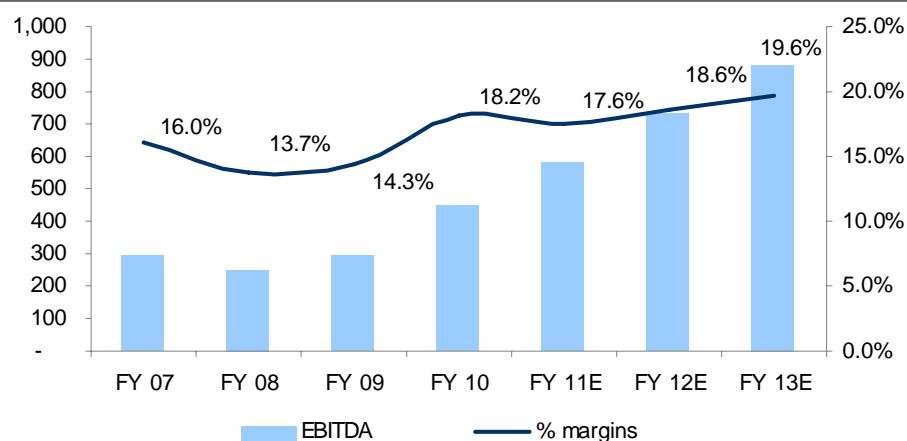
Source: Company, LKP Research

EBITDA

Suprajit's consolidated EBITDA has grown at a CAGR of 15% in the period between FY 07-10, which is expected to grow at a CAGR of 25% in the period between FY 10-13E as improving utilization rates and product realization provides a healthy margin growth. FY 10 saw margins peaking at 18%, from a 13.7% margins in FY 08. In FY 11E, margins are expected to remain flat and going forward we are expecting a 100 bps growth in margin every year.

Quarterly EBITDA (₹mn) Vs EBITDA margins (%)

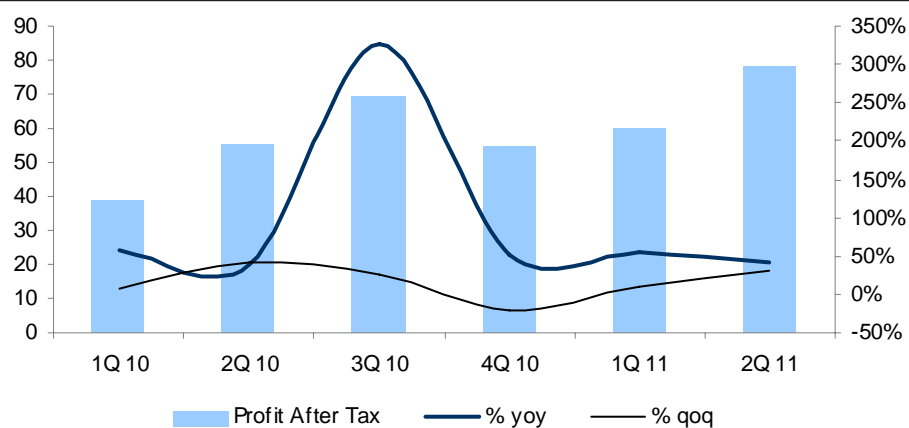
Source: Company, LKP Research

Yearly EBITDA (₹mn) Vs EBITDA margins (%)

Source: Company, LKP Research

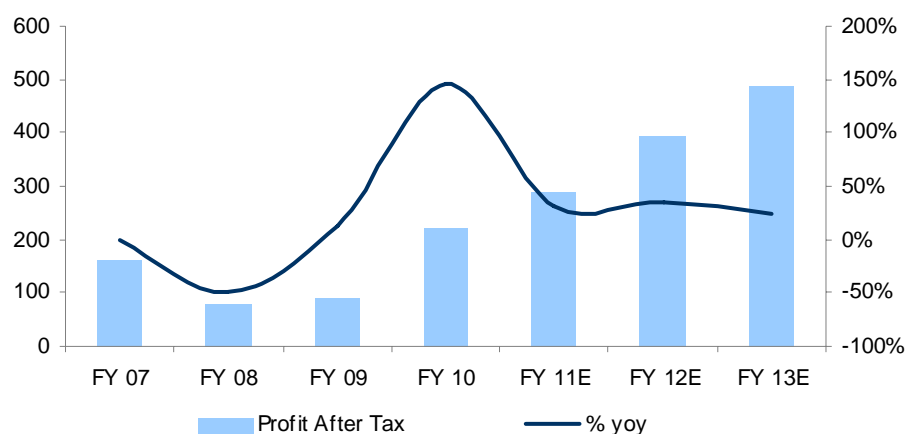
Net Profits

Suprajit's net profits grew at a 11% CAGR during FY 07-10 and is estimated to grow at a CAGR of 30% in FY10-13E. We expect 9-11% profit margins in FY11E-13E.

Quarterly net profits (₹mn) Vs YoY & QoQ growth (%)

Source: Company, LKP Research

Yearly net profits (₹mn) Vs YoY & QoQ growth (%)



Source: Company, LKP Research

Risks and concerns

Higher than expected rise in input costs such as steel and PVC components

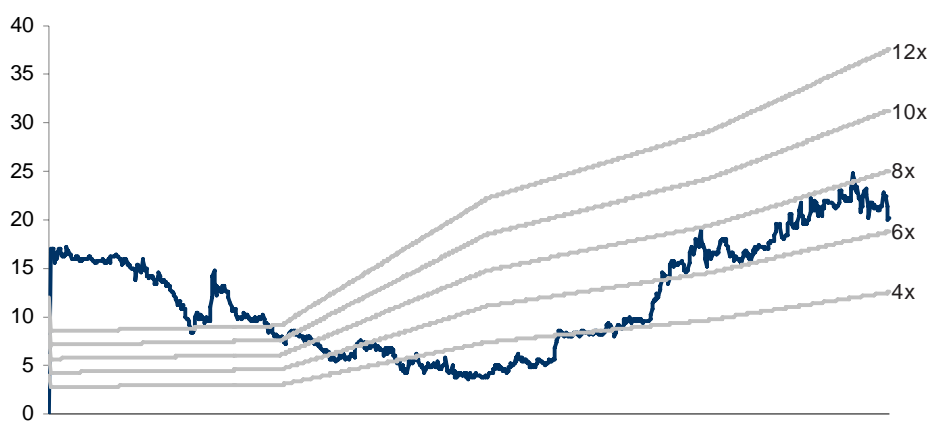
Continued losses at Gills Cables UK may have some negative impact albeit low on net profits

Sharp slowdown in auto industry is a risk which the company can mitigate only partially through the non automotive business.

Outlook and Valuation

We expect Suprajit to report strong growth in coming years as it is expanding capacities to cater to the robust demand from its customers and being a supplier to all leading auto companies, will benefit from growth in the industry irrespective of the competition within the sector. Furthermore, replacement, non-auto and export demand are also expected to pick up as company is putting added efforts in these businesses. Margin performance is expected to remain stable in FY 11E, and would improve in FY 12E and FY 13E. With market leadership in cables, location advantage and a wide product portfolio, we expect Suprajit to outperform its peers and improve its market share. At CMP of ₹21, the stock trades at a P/E of 5x FY 13E EPS of ₹4.09. We have assigned a multiple of 7.5x which is at a 25% premium to the 3 year average trailing P/E multiple of 6x, from which we derive a target price of ₹31, translating into an upside of 46%.

P/E band



Source: Bloomberg, LKP Research

Financial Summary (Consolidated)

Income statement

YE Mar (₹mn)	FY 10	FY11E	FY12E	FY13E
Total Revenues	2,485	3,293	3,947	4,480
Raw Material Cost	1,544	2,086	2,445	2,716
Employee Cost	274	338	422	491
Other Exp	215	291	348	394
EBITDA	452	578	733	879
EBITDA Margin(%)	18.2	17.6	18.6	19.6
Depreciation	69	83	95	102
Other income	8	8	8	8
EBIT	392	503	646	785
EBIT Margin(%)	15.8	15.3	16.4	17.5
Interest	62	90	100	106
PBT	329	413	545	679
PBT Margin(%)	13.3	12.5	13.8	15.2
Tax	222	289	392	488
PAT	222	289	392	488
PAT Margins (%)	8.9	8.8	9.9	10.9

Key Ratios

YE Mar	FY 10	FY 11E	FY 12E	FY 13E
Per Share Data (₹)				
Adj. EPS	1.9	2.4	3.3	4.1
CEPS	2.4	3.1	4.1	4.9
BVPS	6.1	7.8	10.1	13.0
DPS	0.5	0.7	1.0	1.2
Growth Ratios(%)				
Total revenues	17.2	33.4	19.8	13.5
EBITDA	52.7	27.9	26.7	19.9
PAT	146.4	30.5	35.7	24.5
EPS Growth	146.4	30.5	35.7	24.5
Valuation Ratios (X)				
PE	11.3	8.7	6.4	5.1
PCEPS	2.4	3.1	4.1	4.9
P/BV	3.4	2.7	2.1	1.6
EV/Sales	1.2	0.9	0.8	0.7
EV/EBITDA	6.6	5.4	4.3	3.5
Operating Ratios (Days)				
Inventory days	21.5	25.0	26.5	29.0
Receivable Days	59.2	65.0	71.0	76.0
Payables day	37.4	32.0	28.0	25.0
Net Debt/Equity (x)	0.7	0.6	0.5	0.4
Profitability Ratios (%)				
ROCE	39.7	38.4	38.6	38.0
ROE	30.2	30.9	32.4	31.4
Dividend payout	26.9	30.0	30.0	30.0
Dividend yield	2.4	3.5	4.7	5.8

Source: Company, LKP Research

Balance sheet

YE Mar (₹mn)	FY 10	FY 11E	FY 12E	FY 13E
SOURCES OF FUNDS				
Equity Share Capital	120	120	120	120
Reserves & Surplus	615	817	1,092	1,434
Total Networth	735	937	1,212	1,554
Total debt	506	706	806	856
Total Liabilities	1,241	1,644	2,019	2,410
APPLICATION OF FUNDS				
Net block	561	678	753	751
Capital WIP	19	30	40	50
Investments	292	292	292	292
Current Assets				
Cash and Bank	10	118	164	299
Inventories	156	226	287	356
Sundry Debtors	430	586	768	933
Loans & Advances	62	83	98	109
Current Liab & Prov				
Current liabilities	213	289	303	307
Provisions	41	45	43	37
Net Current Assets	404	680	970	1,353
Deferred tax liabilities	-33	-33	-33	-33
Total Assets	1,241	1,644	2,019	2,410

Cash Flow

YE Mar (₹mn)	FY 10	FY 11E	FY 12E	FY 13E
PBT	329	413	545	679
Depreciation	69	83	95	102
Interest	62	90	100	106
Chng in working capital	(157)	(167)	(244)	(249)
Tax paid	(109)	(124)	(153)	(191)
Other operating activities	(5)	(2)	(0)	0
CF from operations (a)	190	293	343	447
Capital expenditure	(88)	(211)	(180)	(110)
Chng in investments	(57)	0	0	0
Other investing activities	5	0	0	0
CF from investing (b)	(140)	(211)	(180)	(110)
Free cash flow (a+b)	50	82	164	337
Inc/dec in borrowings	67	200	100	50
Dividend paid (incl. tax)	(49)	(87)	(118)	(147)
Interest paid	(65)	(90)	(100)	(106)
Other financial activities	(2)	0	0	0
CF from financing (c)	(49)	24	(118)	(203)
Net chng in cash (a+b+c)	1	106	46	134
Closing cash & cash equiv.12	118	164	164	299

Research Team

S. Ranganathan	Head of Research	Pharmaceuticals , Agriculture	6635 1270	s_ranganathan@lkpsec.com
Ashwin Patil	Research Analyst	Automobiles & Telecom	6635 1271	ashwin_patil@lkpsec.com
Chaitra Bhat	Research Analyst	Banking & Financial Services	6635 1211	chaitra_bhat@lkpsec.com
Ami Shah	Research Analyst	Cement & Sugar	6635 1247	ami@lkpsec.com
Deepak Darisi	Research Analyst	Energy	6635 1220	deepak_darisi@lkpsec.com
Dwaipayan Poddar	Technical Analyst		6635 1272	dwaipayan_poddar@lkpsec.com

Institutional Equities

Pratik Doshi	Director	98210 47676	-	pratik_doshi@lkpsec.com
Hardik Mehta	Sales	98190 66569	6635 1246	hardik_mehta@lkpsec.com
Varsha Jhaveri	Sales	93241 47566	6635 1296	varsha_jhaveri@lkpsec.com
Hitesh Doshi	Sales	93222 45130	6635 1281	hitesh_doshi72@lkpsec.com
Sunil Shah	Sales	98211 50270	6635 1310	sunil_shah@lkpsec.com
Kalpesh Vakharia	Dealing	98193 08082	6635 1267	kalpesh_vakharia@lkpsec.com
Gurdarshan Singh	Dealing	93228 61461	6635 1246	gurdarshan_singh@lkpsec.com
