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Suprajit Engineering Limited

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Company **Suprajit Engineering**			
CMP	317	P / E (FY23)	19.8
Market Cap (cr)	3,950	EV / EBITDA (FY23)	12.1
Promoter holding	44.60%	Div Yld (FY23)	1.3%

About the company: Suprajit Engineering Limited "SEL" was incorporated at Bengaluru in 1985, promoted by Mr Ajith Kumar Rai. The company manufactures mechanical control cables used in two- and four-wheelers and by non-automotive segments, and equipment such as speedometers, tachometers, and fuel and temperature gauges for the automotive sector. It acquired Phoenix lamps and has become dominant player in halogen lamps, catering to the two- and four-wheeler, passenger, commercial vehicle, and after-market segments.

Company has a competitive manufacturing base in India, UK, US, and Mexico, along with technical and logistical supports worldwide, the company provides optimal product development and manufacturing solutions to its domestic and international customers. Suprajit has one of the largest manufacturing capacities in the world with 300+ million cables per year and 110+ million bulbs per year.

What is the Company Strength: Suprajit is a well-diversified company deriving 40% of its revenue from global operations, while 60% of revenue is derived domestically. Product wise contribution: 2W - 37%, Automotive (4W) - 20%, Aftermarket - 23%, Non-automotive - 20%. Company's market share in 2W is 60%-65%, while that for automotive business at 30%-35%. Market share in the Indian market is 40%-45%.

Investment Thesis: We will seek answer to the following questions to understand investment attractiveness of Suprajit:

1. Is the market opportunity huge enough to provide long runway to growth
2. Is Suprajit capable to capture the market opportunity
3. Is shareholder major beneficiary of the growth in business
4. How is valuation stacked up in sector

1. Is the market opportunity huge enough: Suprajit carries very dominant market share in cable and lamp businesses in India. India has witnessed subdued market for 2W/4W/CV since 2018 and post Covid-19 sales have been further sluggish for past 12months.

Auto sector direct employment for close to 2cr people and total employment (direct+indirect) for close to 4cr people. Sector contributes ~8% of India's GDP and more than 45% of manufacturing GDP.

India remains a deeply underpenetrated market for automobiles. 4wheeler penetration stands at 22/1000 people 850-950vehilces per 1000 in US/UK. Similarly, India got decent runway for growth for 2wheeler as well. From 2012-21, 16.6cr 2wheeler has been sold in India, which makes a large inventory for replacement demand. Besides replacement demand, FY21 sales were 20% lower than highest sales achieved in India at 2.12cr vehicles, scaling back to previous peak would mean 40% growth from FY21 sales as FY21 year was impacted due to Covid led economic slowdown and lockdown restriction. This ensures long runway for growth for automobiles in India. Even China stands far ahead of India with 200vehicles per 1,000 persons.

Another kicker on demand for short term can be preference of personal mobility post Covid. As large section of society will try to avoid crowded public transport, there can be pent up demand in initial years for personal mobility, which can augur well for Suprajit.

Automobile sales are linked to household spend which is greatly influenced by wage commission. Last time, 7^{th} pay commission came in June 2016 which led to buoyant auto market for next 2yrs. However, once the loaded demand from wage commission wanes, auto sales plummeted. Which was further aggravated due to general economic slowdown and sharp increase in prices due to implementation of BS VI. Auto sales will again claw back to normalcy post subdued FY19-21.

CV demand has been subdued for past few years, as the economy is recovering from GST implementation, increase in axle load and implementation of BS VI norms which affected the diesel run CV more than other segment. However, CV demand is always linked to economic growth. CV demand will come back as the economy recovers from Covid, all OEMs within the segment and auto-anc will be benefitted from the same.

Cables market will further increase as the sophistication in vehicle goes up. Industry will switch focus from mechanical cables to electronic cables. Suprajit is consistently working in expanding its market. Company is moving from mechanical instrument clusters into electronics targeting EV vehicle. Suprajit cable business remain unaffected due to EV transition, as the cable company provides doesn't go inside the ICE engine.

Cable business outlook remain strong for next years in India and outside. Company is on look out for opportunistic acquisition to expand their product or geographic footprint. Covid has stretched few companies balance sheet and they can be good acquisition target. Suprajit on the other hand maintain a strong balance sheet, they are currently doing a buyback of 48cr, reflecting strength of the balance sheet.

2. Is Suprajit capable to capture the market opportunity: Management has regularly conveyed that they will deliver growth higher than Industry growth. In last two concall management has reiterated to maintain 500bips higher growth than Industry.

In FY21, Auto Industry has degrown 14-15% while Suprajit has grown 5%, beating industry growth with wide margin of 18-19%.

Strong brand profile of Suprajit

Key Brands	Suprajit	PHOENIX TRIFA	WESCON CONTROLS
Segment	Automotive Cables	Halogen Lamps	Non-Automotive Cables
Manufacturing facilities	15 manufacturing cables in India	3 manufacturing facilities in India	Manufacturing facility in Kansas
Experience	35yr expertise in Cables	30yr expertise in halogen lamps	75yr expertise in Cables & Control

Capex plan: Boot strapped capacity expansion, where capacity is augmented ~20-25% at a time. Company has consistently increased capacity in cable business as they achieve near optimum capacity utilization.

Cable biz	2016	2017	2018	2019	2020
Capacity (mn)	200	250	250	250	300
Production (mn)	157	180	212	220	210
Capacity utilzation	79%	72%	85%	88%	70%

Expanding capacity for Honda at Narsapura is continuing till Mar'21. Naya Manesar facility has been upgraded and now being showcased to customers in North India.

In the phoenix lamp segment, company is operating near full capacity. Though in Q1'FY22 production might be hampered as the plant need oxygen for operations and during emergency government has restricted any non-medical usage of oxygen. However, as the situation comes under control from June'2021 onwards, we believe that production will start from full swing. Company remains market leader in halogen bulb and currently the market remain large from OEMs and after market.

Company also re-iterate they will have higher growth from exports as they are small players in export market and low cost production advantage will continue to accrue to Suprajit.

Inorganic Growth: Management has conveyed on call they are looking for acquisition. Target ideally would be dealing in complimentary products, market leader in their segment.

Company also started going inorganic route for expanding product portfolio and geographic footprints. They have done three acquisition in past three years:

i. Pricol's speedometer cables division in 2015
ii. Pheonix Lamps, leading player in automotive lamps category - 2016
iii. Wescon Controls (US), leading player in the outdoor power equipment business in non-automotive cables – 2016
iv. Osram halogen bulb manufacturing facility in Chennai, India - 2019

3. Is shareholder major beneficiary of the growth in business:

As the company maintained to continue on growth path higher than industry, it is expected to generate meaningfully higher EBITDA/cash flow which can be further utilized in expanding capacities or rewarding shareholder.

Company has always maintained that they will maintain 14-15% EBITDA margin. Though they are shifting some business from overseas to India and capacity expansion in India also lead to operational leverage but management has highlighted how OEMs is always on the push for better pricing from vendors and as a result, not entire benefit of higher margin will be retained by vendors, some portion of same will accrue back to OEMs.

Company has used higher wealth generated from cable business to expand other product line and geography. Halogen lamp business was acquired, plus Wescon which provides global footprint helps the company in this regard. Recently company has acquired manufacturing facility of Osram in Chennai.

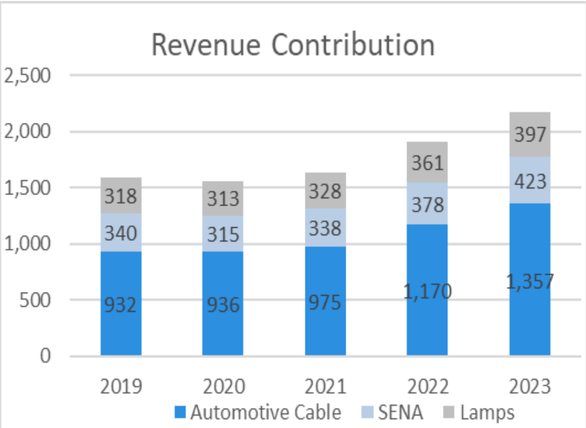
Key beneficiary of Suprajit Operational cash flow: We took a view on who gets a larger share of operational cash flow from Suprajit. Here are the key points from the study:

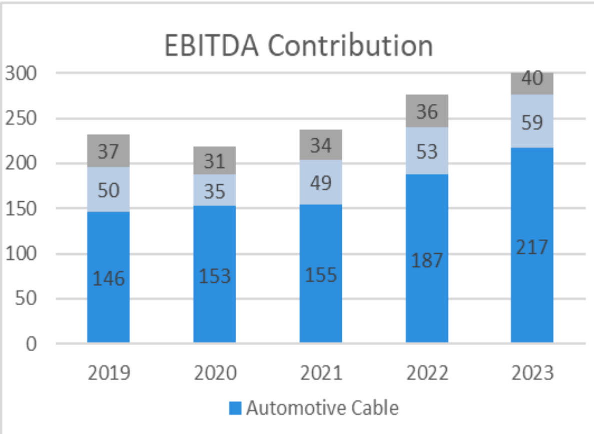
Suprajit (Fig in cr)	FY17	FY18	FY19	FY20	FY21	CAGR
Revenue	1,203	1,431	1,590	1,563	1,641	8%
EBITDA	198	237	233	219	237	5%
Tax	50	55	71	29	51	0%
Div inc DDT	23	23	26	30	24	1%
Fixed Assets	556	544	553	613	599	2%
Capex/Investment	40	25	50	118	43	2%
Working Cap						
Inventory	206	241	282	290	315	11%
Receivables	244	289	292	275	332	8%
Payables inc Customer Advances	105	182	175	214	248	24%
Working Cap	345	348	399	351	399	4%
Change in working Cap	30	3	51	-48	48	
PBT	164	193	205	133	194	4%
PAT	114	138	134	104	143	6%
Pay Out Ratio	17%	14%	16%	24%	17%	

- Suprajit made INR 1,124 EBITDA since FY17 of which 23% goes to government in the form of taxes. This is a good sign as the company is paying adequate taxes to the government is reflection of profit being really earned by the company.
- 25% of the operation EBITDA goes into expanding fixed assets/capex/inorganic growth in the company. This will help to grow profitability/maintain operations of the company.
- 12% has been paid to shareholder in the form of dividend. Shareholder has been reasonably benefitted from the profit of the company. In the recent call management has said they will have higher pay out to shareholder in the form of dividend and buyback. Currently, company is undergoing buyback, where 48cr will be returned to shareholder shrinking the outstanding equity shares by 1.1%
- Company maintain tight working capital as only 8% of the EBITDA got stuck in working capital despite revenue in FY21 being 36% higher than FY17. In contrast to revenue net working capital has gone up by much lower 16%.
- Remaining cash flow was used in further reducing debt and some of it will be used in July 2021 buyback.

Does wealth gets transferred to Shareholder:
Suprajit has articulated they will maintain dividend distribution of ~30% over a period of time. Currently company is also undergoing buyback program, where near 1% of the equity will be bought back by the company at the price of 320/share. We can rest assure that shareholder gets enough share of higher profitability generated by the company.

Growth & Profitability Outlook:
We believe the cable business will continue with highest growth and profitability, given the dominance and market leadership of Suprajit. We expect automotive cable business will grow at 12% revenue growth, despite other challenges in the economy for next two years with EBITDA margin of 16%. Lamps business, we have taken a conservative view on the growth and profitability as Suprajit has to compete with larger players in the industry, like Lumax, Fiem etc.





Shareholding pattern: Promoter has slightly increase its stake in the company, however increase in June'21 will be due to buyback where promoter acceptance ratio will be lower than other shareholders. FIIs made large exit in 1H CY20, however, now they hold very small stake in the company, and similar holding were lapped up by DIIs, hence institutional holding of the company remain intact.

Among others, TVS group held 6.2% stake, which they sold off recently. TVS group was the 1st customer of Suprajit and has been holding shares for a very long time. TVS group has been undergoing restructuring where they are simplifying holding structure within the group and outside as well. Majority of shares from TVS group was absorbed by Unifi Capital.
Link here https://www.thehindubusinessline.com/companies/sundaram-clayton-tvs-motor-sell-stake-in-suprajit-engineering/article34836711.ece

	Mar-19	Sep-19	Mar-20	Sep-20	Mar-21	Jun-21
Promoter	44.5	44.56	44.57	44.57	44.57	44.62
FII	11.41	13.04	8.14	2.82	4.33	4.4
DII	5.56	5.53	9.16	13.22	12.26	13.12
Others	38.53	36.87	38.14	39.39	38.85	37.86

Valuation:
Suprajit is consistently delivering strong return on capital employed in the range of 18-20%. Even during the FY21, which was impacted due to Covid and Q1'FY21 sales were lower due to lockdown restriction, company has been able to deliver highest revenue/EBITDA ever, besides maintaining RoCE of ~20%.
Company has maintained EBITDA margin guidance of 14-15% which remain healthy for Auto Ancillary company, it is even higher than OEMs like Hero Motor/TVS motors. Auto ancillary, which have dominant market share in their product offering can claim such high EBITDA margin.

We believe the company will continue to grow at 15% which will be its annual return on consistent basis.

Consolidated	2018	2019	2020	2021	2022	2023
Revenue	1431	1590	1563	1641	1909	2178
Rev Growth		*11%*	*-2%*	*5%*	*16%*	*14%*
EBITDA	237	233	219	237	276	316
EBITDA margin	16.5%	14.6%	14.0%	14.5%	14.5%	14.5%
Depreciation	37	41	58	57	59	61
EBIT	200	192	161	180	218	255
Net Interest Exp	6	-13	28	-15	-11	-8
PBT	194	205	133	195	229	263
PAT	138	134	104	143	171	196
No. of shares	13.99	13.99	13.99	13.99	13.84	13.84
EPS	9.9	9.6	7.4	10.2	12.4	14.2
DPS			1.8	0.8	3.1	3.5

Suprajit maintained a very healthy balance sheet, with cash balance growing despite distributing strong dividend. Company has healthy asset turnover, as net fixed asset remains low at 380-390cr. Balance sheet expansion is due to goodwill and intangible assets, which has come recently due to acquisition. Company is taking write down on intangible asset and taking tax credit on the same.

Company is generating strong free cash flow after spending ~110-120cr annually on capex and working capital requirement.

Balance Sheet	2018	2019	2020	2021	2022	2023
Shareholder Fund	701	775	854	990	1,070	1,220
Borrowings	362	390	401	289	289	289
Payables	182	175	214	248	289	329
Other liabilities	57	107	111	186	195	205
Total Liabilities	**1302**	**1,447**	**1,581**	**1,713**	**1,843**	**2,043**
Fixed Assets (inc WIP)	305	332	391	385	383	392
Goodwill (intangibles assets)	242	248	238	219	208	197
Receivables	289	292	275	332	386	441
Inventories	236	282	290	315	367	418
Cash and Equivalent	162	219	340	414	446	542
Other Assets	68	74	47	48	56	64
Total Assets	**1,302**	**1,447**	**1,581**	**1,713**	**1,845**	**2,054**

Cash Flow	2018	2019	2020	2021	2022	2023
EBITDA	237	233	219	237	276	316
EBITDA Post Tax	181	162	190	185	219	249
Capex	25	50	118	43	50	60
Working Cap	3	51	-48	48	59	57
Free Cash flow	153	61	120	94	111	134

Besides a strong investment case, we study corporate governance, management pedigree and risk to investment in greater detail for better gauge on our investment.

Management Pedigree:
Ajith Kumar Rai (Executive Chairman) set up Suprajit Engineering Ltd. after completing Master of Science in Industrial Engineering from Canada. He has done his BE. in Mechanical Engineering from Mysore and is the member of HE, CII, ACMA, IGCC and RCBI. SEL started as an auto-ancillary, manufacturing high quality liner cables as per Japanese standards for the automotive industry in 1987 with a single customer TVS Motors and graduated into supplying cables for requirements for all two-wheeler players and eventually entered into four-wheeler market.

Promoter appetite / vision for growth: Management hunger for growth is visible from its track record. It started with single customer (TVS group) and now become market leader with dominant market share. Recently the company has become active in acquisition, extended product lines, further augmenting geographic footprint. Management has consistently maintained their growth will be 500bips higher than Auto sector growth and as many global players are stretched financially due to Covid, it throws opportunity for Suprajit which has maintained strong balance sheet even during tough times.

Among promoter family, Ajit Kumar Rai draw remuneration of ~5cr since past three years, which is near 0.3% of revenue and 3% of PBT. As company regularly pay healthy dividend (pay out ratio of ~20%), he draw more cash from dividend than salary/remuneration. **This reflects promoter interest is well aligned with minority shareholder interests.**

	2018	2019	2020
Promoter Family Remuneration	4.65	5.28	4.91
Revenue	1431	1590	1563
PBT	194	205	133
Remuneration as % of Revenue	0.32%	0.33%	0.31%
Remuneration as % of PBT	2.4%	2.6%	3.7%
Promoter share in Dividend Income	7.48	9.35	10.91

Suprajit bargaining power among its customers and vendors: One of the key concerns for any B2B players is they get squeezed by their customers and hence return ratios remain sub-par. We see working capital requirement and EBITDA margin for any company to see how strong company will be able to maintain its profitability and return ratios.

Segment wise EBITDA margin	FY18	FY19	FY20	FY21
Cable division	16.9%	15.7%	16.3%	15.9%
SENA	18.6%	14.6%	11.1%	14.4%
Lamps	13.7%	11.6%	9.8%	10.2%
Overall EBITDA margin	16.5%	14.6%	14.0%	14.5%

	FY18	FY19	FY20	FY21	CAGR
Revenue	1,431	1,590	1,563	1,641	5%
Working Cap (In Cr)					
Inventory	241	282	290	315	9%
Receivables	289	292	275	332	5%
Payables inc Customer Adv	182	175	214	248	11%
Working Cap	348	399	351	399	5%
Change in working Cap	3	51	-48	48	

Suprajit was able to maintain its EBITDA margin in the current cycle when even the OEMs has struggled to maintain earlier margin reflects the strong positioning of the company. Besides, that company was able to maintain tight working capital cycle to maintain high return ratios.

Suprajit auditor and legal expenses:
We need to keep gauge on auditor and legal expense of Suprajit as they have grown substantially in the past few years. This may be due to growing complexity in the company with the acquisition done in the recent past. Also the expenses has come from a low base, hence high growth rate can be ignored. However, we need to gauge the growth in legal and auditor expense from here.

	2017	2018	2019	2020	CAGR
Auditor Exp	0.60	0.48	1.74	2.17	53%
As a % of Revenue	0.05%	0.03%	0.11%	0.14%	
Legal & Professional Exp	4.11	3.94	7.78	12.01	43%
As a % of Revenue	0.34%	0.28%	0.49%	0.77%	

Key risks to the recommendation:

Few of the key risk to our investment thesis is from the followings: 1. Suprajit loosing market share in Electric Vehicle; 2. Market shifting to led lamps. However, we believe that Suprajit is well placed to make better use of the threat mentioned above.

1. Suprajit doesn't provide cables to the engine and hence remain unaffected from transition from internal combustion to electric vehicle. As the consolidation goes higher in the industry, OEMs will find it better to manage few vendors and hence there will consolidation among vendors, giving larger market share to stronger players.

2. Halogen lamp contribution to Suprajit overall EBITDA is very small, hence cannot be larger impact on the overall profitability profile. Besides, company has regularly mentioned in their concall that overall market will move from halogen to LED lights but larger overseas players will find it expensive to produce halogen lamps in their expensive locations and hence Suprajit market share in global halogen market will increase. This was proven with Osram manufacturing facility acquisition by Suprajit.

EBITDA contribution	2018	2019	2020	2021
Cable division	63.3%	68.1%	71.4%	72.3%
SENA	26.4%	23.1%	16.3%	22.6%
Lamps	20.6%	17.3%	14.3%	15.7%

Besides this, Suprajit is working towards expanding its product reach and geographical footprint to augment its business worldwide. This approach of Suprajit will continue to safeguard company interest in current dynamic and uncertain environment.

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