

Portfolio traits unchanged; albeit client concentration risk, non-diversification efforts to limit upside...

About the stock: Swaraj Engines (SEL) is involved in manufacturing diesel engines (20-85 hp) for M&M's Swaraj brand of tractors. Installed capacity 1.5 lakh units (FY22).

- Steady ~10% compounding of revenues, EBITDA, PAT over past five years
- Net cash positive b/s; consistent cash flow generation; highly capital efficient player with history of >30% return ratios & high dividend payouts

Q4FY23 Results: Posted healthy numbers for Q4FY23.

- Net sales for the quarter came in at ₹ 360 crore, up 48.5% YoY
- Diesel engine volume was at 34,841, up 45.6% YoY. ASP remained flat sequentially at ~1.03 lakhs/unit and was up 2% YoY
- EBITDA margins came in at 13.3%, up 148 bps QoQ & up 50 bps YoY
- PAT came in at ₹ 35 crore, up 58% YoY
- SEL declared a dividend of ₹ 92/share for FY23 (payout at 83%)

What should investors do? The stock has de-grown ~4% (from ~₹ 2,086 levels in May 2018) over the past five years, underperforming the broader Nifty Auto index.

- We liked SEL in the past for its capital efficient business model with cash rich b/s and attractive dividend yield of ~5%. However, amid lack of diversification efforts and being a single product, single client company we believe it is trading near its fair value of ~15x PE (TTM) with limited upside potential. Henceforth, we **Suspend Coverage** on the stock and over the long term expect it to be subsumed under M&M given they now have the entire promoter stake and engine being core to the product

Key triggers for future price performance:

- Pure play on farm mechanisation with ~33% volume share of M&M's tractor sales via Swaraj brand and likely beneficiary of positive monsoons
- Debt free b/s & superlative return ratios (RoCE: ~50%, RoIC: ~100%) along with positive CFO, FCF generation & high dividend yield (~5%+)
- Incremental capex for capacity expansion from 1.8 lakh to 1.95 lakh units
- Uncertain tractor industry outlook for FY24E amid monsoon fears post four years of robust monsoons and high base of ~9.4 lakh units in FY23

Alternate Stock Idea: In our auto- ancillary coverage, we like Apollo Tyre.

- Walking the talk on b/s deleveraging, sweating of assets, capital efficiency.
- BUY with target price of ₹390

Key Financial Summary

| Key Financials | FY19 | FY20 | FY21 | FY22 | FY23P | FY24E | CAGR (FY22-24P) |
|--------------------|-------|-------|-------|---------|---------|---------|-----------------|
| Net Sales | 871.7 | 773.3 | 986.6 | 1,138.2 | 1,421.8 | 1,464.3 | 13.4% |
| EBITDA | 131.7 | 100.4 | 135.7 | 155.4 | 186.4 | 197.0 | 12.6% |
| EBITDA Margins (%) | 15.1 | 13.0 | 13.8 | 13.7 | 13.1 | 13.5 | |
| Net Profit | 82.4 | 71.0 | 92.6 | 109.5 | 133.6 | 143.0 | 14.3% |
| EPS (₹) | 67.9 | 58.6 | 76.2 | 90.2 | 110.0 | 117.7 | |
| P/E | 25.0 | 29.0 | 22.3 | 18.9 | 15.5 | 14.4 | |
| RoNW (%) | 34.6 | 30.1 | 33.0 | 35.8 | 39.0 | 39.3 | |
| RoCE (%) | 47.1 | 34.0 | 41.3 | 44.9 | 49.1 | 48.9 | |

Source: Company, ICICI Direct Research

SWARAJ

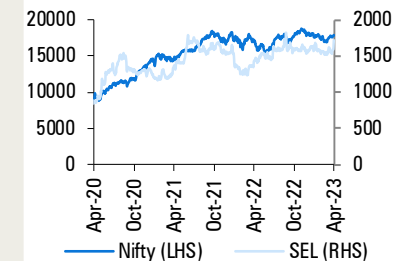
Particulars

| Particular | ₹ crore |
|-----------------------|---------------|
| Market Capitalization | 2,061.3 |
| Total Debt (FY23P) | 0.0 |
| Cash & Invs. (FY23P) | 185.1 |
| EV | 1,876.1 |
| 52 week H/L (₹) | 1,962 / 1,396 |
| Equity capital | 12.2 |
| Face value (₹) | 10.0 |

Shareholding pattern

| | Jun-22 | Sep-22 | Dec-22 | Mar-23 |
|----------|--------|--------|--------|--------|
| Promoter | 52.1 | 52.1 | 52.1 | 52.1 |
| FII | 1.9 | 1.9 | 1.7 | 1.8 |
| DII | 8.9 | 9.1 | 8.9 | 9.2 |
| Other | 37.1 | 36.9 | 37.2 | 37.0 |

Price Chart



Recent event & key risks

- Posted healthy Q4FY23 results
- Key Risk:** (i) Higher than expected growth in tractor space in near term, (ii) Meaningful diversification efforts, enhanced play in farm mechanisation

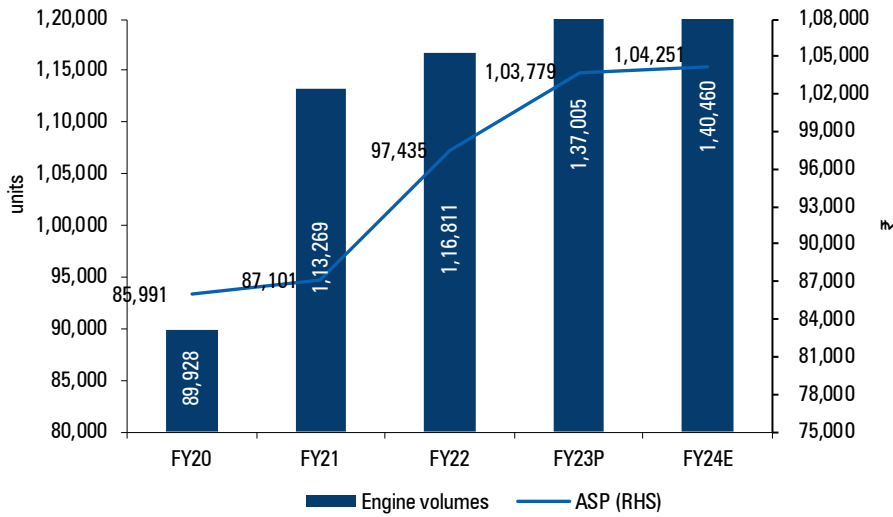
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Financial Story in charts

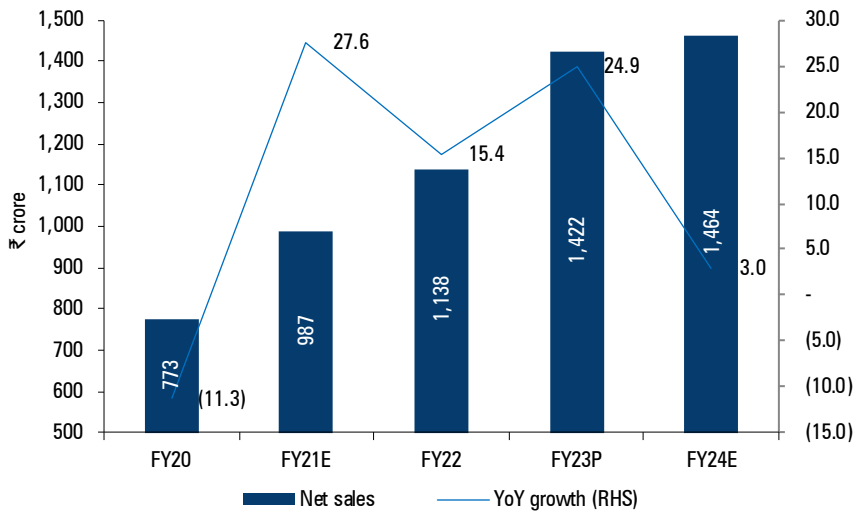
Exhibit 1: Trend in volume & ASP



We expect engine sales volume to increase by 2.5% to 1.4 lakh units in FY24E with ASP seen increasing to ₹ 1.04 lakh/unit

Source: Company, ICICI Direct Research

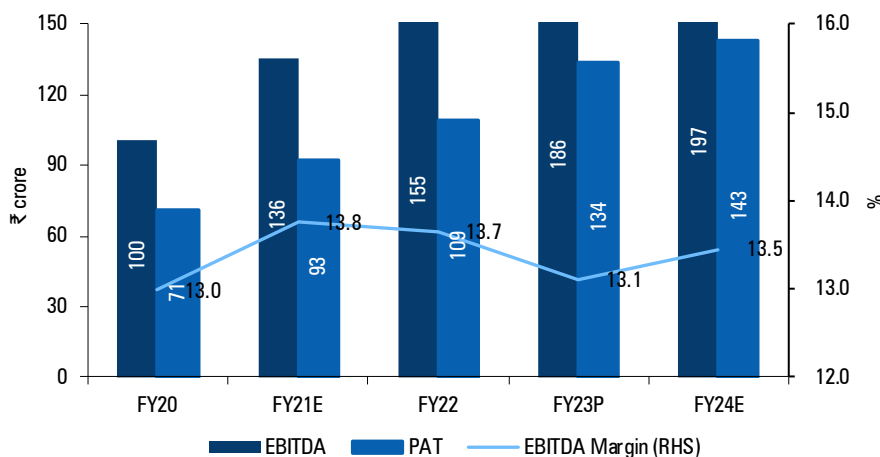
Exhibit 2: Trend in topline



Net sales are seen growing by 3% YoY in FY24E

Source: Company, ICICI Direct Research

Exhibit 3: Trend in margins & profitability



EBITDA margins are seen reaching 13.5% by FY24E

Source: Company, ICICI Direct Research

Financial Summary

| Exhibit 4: Profit and loss statement | | | | |
|--------------------------------------|--------------|----------------|----------------|----------------|
| | ₹ crore | | | |
| (Year-end March) | FY21 | FY22 | FY23P | FY24E |
| Net Sales | 986.6 | 1,138.2 | 1,421.8 | 1,464.3 |
| Other Operating Income | - | - | - | - |
| Total Operating Income | 986.6 | 1,138.2 | 1,421.8 | 1,464.3 |
| Growth (%) | 27.6 | 15.4 | 24.9 | 3.0 |
| Raw Material Expenses | 765.7 | 890.2 | 1,133.8 | 1,164.1 |
| Employee Expenses | 42.9 | 43.9 | 43.7 | 44.6 |
| Other Operating Expense | 42.3 | 48.7 | 57.9 | 58.6 |
| Total Operating Expenditure | 850.9 | 982.8 | 1,235.4 | 1,267.3 |
| EBITDA | 135.7 | 155.4 | 186.4 | 197.0 |
| Growth (%) | 35.1 | 14.5 | 20.0 | 5.7 |
| Depreciation | 19.8 | 18.1 | 18.5 | 19.0 |
| Interest | - | 0.1 | 0.1 | - |
| Other Income | 8.6 | 9.7 | 12.0 | 14.0 |
| PBT | 124.5 | 146.8 | 179.7 | 192.0 |
| Exceptional Item | - | - | - | - |
| Total Tax | 31.9 | 37.4 | 46.1 | 49.0 |
| PAT | 92.6 | 109.5 | 133.6 | 143.0 |
| Growth (%) | 30.3 | 18.3 | 22.1 | 7.0 |
| EPS (₹) | 76.2 | 90.2 | 110.0 | 117.7 |

Source: Company, ICICI Direct Research

| Exhibit 5: Cash flow statement | | | | |
|-------------------------------------|---------------|---------------|---------------|----------------|
| | ₹ crore | | | |
| (Year-end March) | FY21 | FY22 | FY23P | FY24E |
| Profit after Tax | 92.6 | 109.5 | 133.6 | 143.0 |
| Add: Depreciation | 19.8 | 18.1 | 18.5 | 19.0 |
| (Inc)/dec in Current Assets | (94.2) | 6.9 | (52.7) | (24.6) |
| Inc/(dec) in CL and Provisions | 62.6 | (21.5) | 37.4 | 15.8 |
| Others | - | 0.1 | 0.1 | - |
| CF from operating activities | 80.8 | 113.0 | 137.0 | 153.3 |
| (Inc)/dec in Investments | 76.9 | (2.1) | 10.1 | (5.0) |
| (Inc)/dec in Fixed Assets | (5.9) | (21.9) | (11.6) | (20.0) |
| Others | (4.8) | (31.0) | (20.2) | (2.0) |
| CF from investing activities | 66.3 | (55.0) | (21.7) | (27.0) |
| Issue/(Buy back) of Equity | 0.0 | 0.0 | 0.0 | - |
| Inc/(dec) in loan funds | - | - | - | - |
| Dividend paid & dividend tax | (48.5) | (97.1) | (111.8) | (121.5) |
| Inc/(dec) in Share Cap | - | - | - | - |
| Others | 0.5 | 12.7 | 14.6 | (0.0) |
| CF from financing activities | (48.0) | (84.4) | (97.2) | (121.5) |
| Net Cash flow | 99.0 | (26.4) | 18.1 | 4.8 |
| Opening Cash | 18.2 | 117.3 | 90.9 | 109.0 |
| Closing Cash | 117.3 | 90.9 | 109.0 | 113.8 |

Source: Company, ICICI Direct Research

| Exhibit 6: Balance Sheet | | | | |
|---------------------------------|--------------|--------------|--------------|--------------|
| | ₹ crore | | | |
| (Year-end March) | FY21 | FY22 | FY23P | FY24E |
| Liabilities | | | | |
| Equity Capital | 12.1 | 12.1 | 12.2 | 12.2 |
| Reserve and Surplus | 268.4 | 293.5 | 330.0 | 351.6 |
| Total Shareholders funds | 280.5 | 305.7 | 342.2 | 363.7 |
| Total Debt | - | - | - | - |
| Deferred Tax Liability | 0.6 | 0.1 | - | - |
| Minority Interest / Others | - | - | 0.9 | 0.9 |
| Total Liabilities | 281.1 | 305.8 | 343.1 | 364.6 |
| Assets | | | | |
| Gross Block | 265.6 | 287.2 | 298.3 | 318.3 |
| Less: Acc Depreciation | 174.4 | 192.5 | 211.1 | 230.1 |
| Net Block | 91.1 | 94.7 | 87.2 | 88.2 |
| Capital WIP | 1.3 | 1.6 | 2.1 | 2.1 |
| Total Fixed Assets | 92.5 | 96.3 | 89.3 | 90.3 |
| Investments | 34.9 | 36.5 | 26.4 | 31.4 |
| Inventory | 61.7 | 62.1 | 69.6 | 80.2 |
| Debtors | 113.4 | 103.6 | 128.1 | 140.4 |
| Loans and Advances | 13.4 | 12.5 | 24.6 | 25.4 |
| Other Current Assets | 19.2 | 22.7 | 31.2 | 32.1 |
| Cash | 117.3 | 90.9 | 109.0 | 113.8 |
| Total Current Assets | 325.0 | 291.7 | 362.5 | 391.9 |
| Current Liabilities | 168.7 | 145.1 | 183.0 | 197.9 |
| Provisions | 8.5 | 10.6 | 10.1 | 11.0 |
| Current Liabilities & Prov | 177.2 | 155.6 | 193.0 | 208.9 |
| Net Current Assets | 147.8 | 136.1 | 169.5 | 183.0 |
| Others Assets | 5.9 | 36.9 | 57.8 | 59.8 |
| Application of Funds | 281.1 | 305.8 | 343.1 | 364.6 |

Source: Company, ICICI Direct Research

| Exhibit 7: Key ratios | | | | |
|-----------------------------|-------|-------|-------|-------|
| (Year-end March) | FY21 | FY22 | FY23P | FY24E |
| Per share data (₹) | | | | |
| EPS | 76.2 | 90.2 | 110.0 | 117.7 |
| Cash EPS | 92.5 | 105.1 | 125.2 | 133.4 |
| BV | 231.1 | 251.8 | 281.6 | 299.3 |
| DPS | 69.0 | 80.0 | 92.0 | 100.0 |
| Cash Per Share (Incl Invst) | 125.3 | 104.9 | 111.5 | 119.5 |
| Operating Ratios (%) | | | | |
| EBITDA Margin | 13.8 | 13.7 | 13.1 | 13.5 |
| PAT Margin | 9.4 | 9.6 | 9.4 | 9.8 |
| Inventory days | 22.8 | 19.9 | 17.9 | 20.0 |
| Debtor days | 41.9 | 33.2 | 32.9 | 35.0 |
| Creditor days | 62.4 | 46.5 | 42.6 | 45.0 |
| Return Ratios (%) | | | | |
| RoE | 33.0 | 35.8 | 39.0 | 39.3 |
| RoCE | 41.3 | 44.9 | 49.1 | 48.9 |
| RoIC | 94.7 | 98.0 | 101.8 | 101.6 |
| Valuation Ratios (x) | | | | |
| P/E | 22.3 | 18.9 | 15.5 | 14.4 |
| EV / EBITDA | 14.1 | 12.4 | 10.3 | 9.7 |
| EV / Net Sales | 1.9 | 1.7 | 1.4 | 1.3 |
| Market Cap / Sales | 2.1 | 1.8 | 1.4 | 1.4 |
| Price to Book Value | 7.4 | 6.8 | 6.0 | 5.7 |
| Solvency Ratios | | | | |
| Debt/EBITDA | - | - | - | - |
| Debt / Equity | - | - | - | - |
| Current Ratio | 1.2 | 1.3 | 1.4 | 1.5 |
| Quick Ratio | 0.8 | 0.9 | 1.0 | 1.0 |

Source: Company, ICICI Direct Research

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