

Swaraj Engines Ltd.

Rural sentiments turning positive, Swaraj a value BUY!

Swaraj Engines Ltd (SWL) reported another good quarterly performance by posting its 2nd highest ever Q3 engine sales and profit. Looking at the demand scenario, the company plans to increase the capacity from 150K units annually to 180K units through internal accruals. On ground momentum is healthy with positive farmers/dealers sentiments (driven by good crop prices), expect double-digit growth in the FY23e tractor industry, and traction to remain good in FY24 as well. 'Quality' is what dealers across the zones calls Swaraj brand of tractors, which has led to outperformance in Q3FY23 volume sales (industry volumes grew by 10.5% YoY vs. Swaraj's volume growth of 13.0%). Its outperformance vs. the industry should continue going forward as there is an increase in the business anticipated from Kirloskar to Swaraj. Considering sound fundamentals, rural sentiments are turning positive, we see SWL as a strong beneficiary of the same. We maintain BUY rating on the stock with the target price of Rs 2,096 apiece (valued at 17x FY25e EPS of Rs 123.3).

A decent quarter, good feedback for 'CODE' & to maintain margins

- RMC remain the culprit that led to lower than expected EBITDA Margin. RMC as % of sales climbed higher by 139bps YoY to 79.8% in Q3FY23, while there is a clear operating leverage benefits visible in other line items. Despite lower margin, EBITDA per engine YoY remained flat possibly due to better mix & scale advantage. Overall, SWL reported a double-digit growth in the bottom line in Q3FY23 as well as 9MFY23. Performance should be healthy going ahead.
- Swaraj's 'CODE' product received positive feedback and has the potential to take some of the sales from power tillers market. This product could bring in additional revenues for the company.
- We have conservatively projected EBITDA Margin to remain in 13-13.4% range in the foreseeable future, despite softness in commodities.

Ongoing check giving an optimistic outlook with clear turnaround happening

- All India retail sales are higher by 9% YTD FY23, wholesales are up by 10.5% for the same period. Real on ground check reveals that tractor dealers' body language turned positive driven by good harvesting & farmers getting better crop prices, that we believe is the deciding factor for tractor purchase. A good rural spending on cards by GoI one year before national election.
- Peak season starts from March near Holi, and this time dealers look optimistic that tractor buying could slowly start from February onwards. There are many small festivals around Feb-May period that should further support volume uptick in the coming months.

Y/E Mar (Rs mn)	Q3 FY23	Q3 FY22	YoY (%)	Q2 FY23	QoQ (%)	Q3 FY23e	Var. (%)
Engine Sales (No)	26,944	23,836	13.0	36,792	(26.8)	29,556	(8.8)
Realisation (Rs)	103,522	99,639	3.9	104,574	(1.0)	101,005	2.5
EBITDA/Engine (Rs)	12,274	12,255	0.2	13,729	(10.6)	13,311	(7.8)
Net sales	2,789	2,375	17.4	3,848	(27.5)	2,985	(6.6)
Operating costs	2,459	2,083	18.0	3,342	(26.4)		
EBITDA	331	292	13.2	505	(34.5)	393	(15.9)
EBITDA Margin (%)	11.9	12.3	(44) bps	13.1	(127) bps	13.2	(132) bps
Depreciation and amortisation	46	44	5.5	47	(1.9)		
Interest	0	1	NA	0	NA		
Other income	28	24	14.5	25	10.8		
PBT	312	272	14.7	483	(35.4)		
Provision for tax	80	70	13.8	124	(35.6)		
Effective tax rate (%)	25.6	25.8	(21) bps	25.7	(11) bps		
PAT (Reported)	232	202	15.1	359	(35.3)	277	(16.0)
NPM (%)	8.3	8.5	(17) bps	9.3	(100) bps	9.3	(94) bps

Source: Company, SMIFS research

Y/E Mar (Rs Mn)	Revenue	YoY (%)	EBITDA	EBITDA (%)	PAT	YoY (%)	EPS	RoE (%)	RoCE (%)	P/E (x)	EV/EBITDA (x)
FY21	9,866	27.6	1,357	13.8	925	30.3	76.2	35.8	35.8	17.8	10.9
FY22	11,382	15.4	1,554	13.7	1,095	18.3	90.1	37.3	37.4	17.5	11.4
FY23e	13,503	18.6	1,762	13.0	1,244	13.6	102.4	38.9	38.9	15.4	9.8
FY24e	14,858	10.0	1,966	13.2	1,386	11.4	114.1	39.2	39.2	13.8	8.7
FY25e	15,852	6.7	2,117	13.4	1,497	8.1	123.3	37.7	37.7	12.8	7.8

Source: Company, SMIFS research estimates



Rating: **Buy** Upside/(Downside): **33.1%**
Current Price: **1,575** Target Price: **2,096**

Earlier recommendation

Previous Rating: Buy
Previous Target Price: 2,197

Market data

Bloomberg: SWE IN
52-week H/L (Rs): 1,960/1,293
Mcap (Rs bn/USD mn): 19.1/235
Shares outstanding (mn): 12.1
Free float: 47.0%
Avg. daily vol. 3mth ('000): 6.05
Face Value (Rs): 10

Source: Bloomberg, SMIFS research

Shareholding pattern (%)

	Dec-22	Sep-22	Jun-22	Mar-22
Promoter	52.1	52.1	52.1	52.1
FII	1.8	1.9	1.9	1.8
DII	9.7	9.9	8.9	8.9
Public/others	36.4	36.1	37.1	37.2

Source: BSE

Promoters Pledging (%)

	Dec-22	Sep-22	Jun-22	Mar-22
Promoters pledged shares	0.0	0.0	0.0	0.0

Source: BSE

Price performance (%)*

	1M	3M	12M	36M
Nifty 50	0.5	1.3	3.6	46.1
Nifty 500	0.8	0.1	2.3	50.5
Swaraj Engines	2.4	-1.0	-2.7	17.4

*as on 25th Jan, 2023; Source: AceEquity, SMIFS research

Amit Hiranandani

Sector Lead - Automobile

9619848422

amit.hiranandani@smifs.co.in

Awanish Chandra

Executive Director

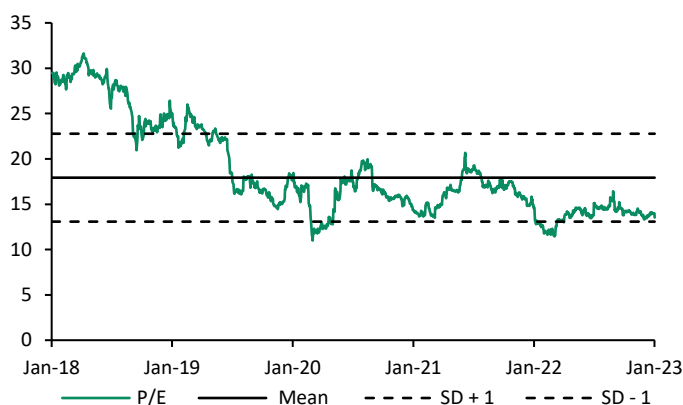
8693822293

awanish.chandra@smifs.com

Outlook and Valuations

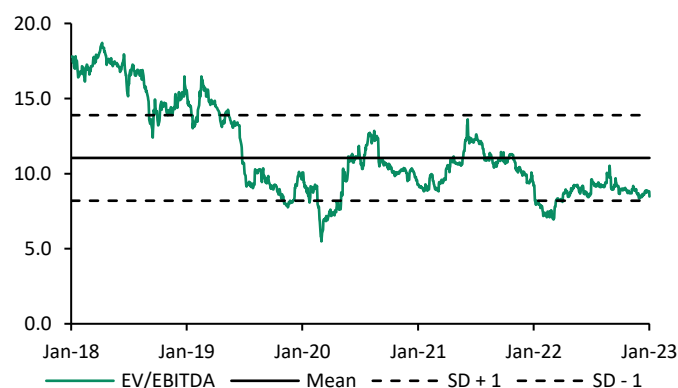
- Looking at the good future demand scenario, the company **will increase the engine capacity from 150K units annually to 180K units**, and this will be funded through internal accruals.
- Swaraj has been giving higher dividend, offering buyback schemes & has been generating strong FCF with a good amount of cash balance in the balance sheet.
- After projecting conservatively, Swaraj is attractively trading at P/E of 12.8x FY25e EPS of Rs 123.3. Owing to uncertainty w.r.t. the rural demand, we reduced multiple from 18x to 17x, rollover from Sep '24 to FY25 estimated EPS, after doing marginal tweaks.
- Arrived at a **target price of Rs 2,096 per share**, which offers an upside of ~33%. Considering sound fundamentals, rural sentiments turning positive, we see SWL as a strong beneficiary of this upturn and a clear value buy.
- Our EPS are lower by ~3%/3%/3% in FY23e/FY24e/FY25e respectively due to lower than anticipated margins in Q3FY23.

Fig 1: 1-year forward P/E



Source: AceEquity, SMIFS research

Fig 2: 1-year forward EV/EBITDA



Source: AceEquity, SMIFS research

Changes in estimates

Rs mn	New estimates			Old estimates			Change (%)		
	FY23e	FY24e	FY25e	FY23e	FY24e	FY25e	FY23e	FY24e	FY25e
Engines Sales (No)	130,839	146,748	156,275	132,210	146,484	157,671	-1.0%	0.2%	-0.9%
Revenue	13,503	14,858	15,852	13,642	14,832	15,990	-1.0%	0.2%	-0.9%
Gross profit	2,795	3,076	3,297	2,878	3,115	3,358	-2.9%	-1.3%	-1.8%
Gross margin (%)	20.7	20.7	20.8	21.1	21.0	21.0	(40) bps	(30) bps	(20) bps
EBITDA	1,762	1,966	2,117	1,842	2,006	2,175	-4.3%	-2.0%	-2.7%
EBITDA margin (%)	13.0	13.2	13.4	13.5	13.5	13.6	(45) bps	(29) bps	(25) bps
PAT	1,244	1,386	1,497	1,288	1,418	1,546	-3.5%	-2.3%	-3.1%
EPS (Rs)	102	114	123	106	117	127	-3.4%	-2.5%	-2.9%

Source: Company, SMIFS research estimates

Quarterly financials, operating metrics & key performance indicators

Fig 3: Quarterly Financials

Y/E March (Rs Mn)	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23
Net Sales	3,049	3,147	3,436	2,375	2,424	3,984	3,848	2,789
Raw Materials	2,354	2,438	2,707	1,861	1,897	3,170	3,077	2,225
Employee Costs	111	113	114	111	100	118	111	108
Other Expenditure	122	123	139	110	116	148	155	126
EBITDA	462	473	477	292	311	549	505	331
Depreciation	47	48	48	44	42	47	47	46
Interest	-	-	0	1	0	-	0	0
Other Income	22	26	23	24	23	30	25	28
PBT	437	452	453	272	292	531	483	312
Tax	111	115	115	70	73	136	124	80
Tax rate (%)	25.5	25.5	25.5	25.8	25.1	25.6	25.7	25.6
Reported PAT	326	337	338	202	219	395	359	232
Adjusted PAT	326	337	338	202	219	395	359	232
YoY Growth (%)								
Revenue	74.1	169.0	17.6	(12.8)	(20.5)	26.6	12.0	17.4
EBITDA	97.5	267.5	19.3	(20.2)	(32.7)	15.9	5.8	13.2
Adj. PAT	105.6	329.2	24.5	(19.3)	(32.9)	17.5	6.2	15.1
QoQ Growth (%)								
Revenue	11.9	3.2	9.2	(30.9)	2.0	64.4	(3.4)	(27.5)
EBITDA	26.2	2.5	0.9	(38.8)	6.5	76.4	(7.9)	(34.5)
Adj. PAT	30.1	3.3	0.4	(40.2)	8.3	80.9	(9.3)	(35.3)
Margin (%)								
RMC/revenue (%)	77.2	77.5	78.8	78.4	78.3	79.6	80.0	79.8
Gross margin (%)	22.8	22.5	21.2	21.6	21.7	20.4	20.0	20.2
Employee cost/revenue (%)	3.6	3.6	3.3	4.7	4.1	3.0	2.9	3.9
Other expenses/revenue (%)	4.0	3.9	4.0	4.6	4.8	3.7	4.0	4.5
EBITDA margin (%)	15.1	15.0	13.9	12.3	12.8	13.8	13.1	11.9
Adj. PAT margin (%)	10.7	10.7	9.8	8.5	9.0	9.9	9.3	8.3
Key Drivers								
Engine Sales (in Units)	33,831	33,747	35,291	23,836	23,937	38,428	36,792	26,944
Realization (Rs.)	90,127	93,256	97,359	99,639	101,245	103,661	104,574	103,522
EBITDA/Engine (Rs.)	13,650	14,025	13,528	12,255	12,992	14,273	13,729	12,274

Source: Company, SMIFS research

Fig 4: Key Assumptions

Operating Details	FY20	FY21	FY22	FY23e	FY24e	FY25e
Capacity (in units)	135,000	135,000	150,000	150,000	165,000	180,000
Engine Sales (in units)	89,928	113,269	116,811	130,839	146,748	156,275
Capacity Utilization (%)	66.6	83.9	77.9	87.2	88.9	86.8
Engine Realization (Rs)	83,449	84,975	95,149	100,857	98,840	98,840
EBITDA/unit (Rs)	11,169	11,977	13,302	13,467	13,400	13,547
Engine Revenues (Rs mn)	7,504	9,625	11,114	13,196	14,505	15,446
Component Revenues (Rs mn)	14	0	0	0	0	0
Total (Rs mn)	7,519	9,625	11,115	13,196	14,505	15,447
Other operating Income (Rs mn)	214	240	267	307	353	406
Total Operating income (Rs mn)	7,733	9,866	11,382	13,503	14,858	15,852

Source: Company, SMIFS research estimates

Financial Statements

Income Statement					
YE March (Rs mn)	FY21	FY22	FY23e	FY24e	FY25e
Net Sales	9,866	11,382	13,503	14,858	15,852
Raw Materials	7,657	8,902	10,708	11,782	12,555
% of sales	77.6	78.2	79.3	79.3	79.2
Personnel	429	439	469	502	537
% of sales	4.3	3.9	3.5	3.4	3.4
Manufact. & Other Exp.	423	487	564	607	643
% of sales	4.3	4.3	4.2	4.1	4.1
EBITDA	1,357	1,554	1,762	1,966	2,117
Other Income	86	97	102	118	140
Depreciation & Amortisation	198	181	202	233	256
EBIT	1,245	1,469	1,662	1,852	2,001
Interest Expenses	0	1	-	-	-
Core PBT	1,159	1,372	1,560	1,733	1,861
Extraord. items -Adj.	-	-	-	-	-
PBT	1,245	1,469	1,662	1,852	2,001
Tax-Total	319	374	418	466	504
Effective tax rate (%)	25.7	25.5	25.2	25.2	25.2
Reported PAT	925	1,095	1,244	1,386	1,497
Minority Interest	-	-	-	-	-
Adjusted PAT	925	1,095	1,244	1,386	1,497

Source: Company, SMIFS research estimates

Key Ratios					
YE March	FY21	FY22	FY23e	FY24e	FY25e
Growth ratios (%)					
Net sales	27.6	15.4	18.6	10.0	6.7
EBITDA	35.1	14.5	13.4	11.6	7.7
Adjusted PAT	30.3	18.3	13.6	11.4	8.1
Margin Ratio (%)					
Gross Margin	22.4	21.8	20.7	20.7	20.8
EBITDA Margin	13.8	13.7	13.0	13.2	13.4
EBIT Margin	12.6	12.9	12.3	12.5	12.6
Core PBT Margin	11.7	12.1	11.6	11.7	11.7
Adjusted PAT Margin	9.4	9.6	9.2	9.3	9.4
Return Ratio (%)					
ROE	35.8	37.3	38.9	39.2	37.7
ROCE	35.8	37.4	38.9	39.2	37.7
Turnover Ratio (days)					
Gross Block Turnover (x)	3.9	4.3	5.0	5.1	5.0
Adjusted OCF/PAT (in %)	30	94	115	95	113
Inventory Period	18	20	18	18	18
Debtors Period	22	35	32	31	31
Creditors	49	48	45	45	45
Cash Conversion Cycle	(9)	6	5	4	4
Solvency Ratio (x)					
Debt-equity	-	-	-	-	-
Net Debt-equity	(0.6)	(0.5)	(0.6)	(0.6)	(0.6)
Gross Debt/EBITDA	0	0	0	0	0
Liquidity ratio	2.0	2.1	2.0	2.2	2.1
Interest coverage ratio	42,926	1,923	NA	NA	NA
Dividend					
Dividend per share	40.1	69.1	80.0	80.0	85.0
Dividend Yield (%)	3.0	4.4	5.1	5.1	5.4
Dividend Payout (%)	52.7	76.7	78.1	70.1	68.9
Per share (Rs)					
Basic EPS (reported)	76.2	90.1	102.4	114.1	123.3
Adjusted EPS	76.2	90.1	102.4	114.1	123.3
CEPS	92.5	105.1	119.0	133.3	144.3
Book value	231.1	251.7	274.1	308.2	346.5
Valuation					
P/E	17.8	17.5	15.4	13.8	12.8
P/BV	5.9	6.3	5.7	5.1	4.5
EV/EBITDA	10.9	11.4	9.8	8.7	7.8
EV/Sales	1.5	1.6	1.3	1.1	1.0
Adj Mcap/Core PBT	12.8	12.9	11.1	9.8	8.9
Adj Mcap/Adj OCF	53.0	17.2	12.0	13.0	9.8

Source: Company, SMIFS research estimates

Balance Sheet					
YE March (Rs mn)	FY21	FY22	FY23e	FY24e	FY25e
Sources of funds					
Capital	121	121	121	121	121
Reserves & Surplus	2,684	2,935	3,207	3,621	4,086
Shareholders' Funds	2,806	3,057	3,329	3,743	4,208
Total Debt	-	-	-	-	-
Deferred Tax Liabilities	6	1	1	1	1
Total Liabilities	2,812	3,058	3,330	3,744	4,209
Application of funds					
Gross Block	2,594	2,678	2,774	3,054	3,334
Net Block	918	949	844	891	915
Capital WIP	13	16	0	0	0
Investments	342	362	402	442	482
Non-current Asset	59	369	437	481	514
Inventories	617	621	711	754	809
Sundry Debtors	1,134	1,036	1,332	1,192	1,501
Cash & Bank Balances	1,309	1,034	1,478	1,623	2,105
Other Current Assets	192	227	269	296	316
Total Current Assets	3,252	2,918	3,790	3,865	4,730
Creditors	1,639	1,381	1,949	1,715	2,194
Other Current Liabilities	134	175	195	221	238
Total Current Liabilities	1,772	1,556	2,144	1,936	2,432
Net Current Assets	1,480	1,361	1,646	1,930	2,298
Total assets	2,812	3,058	3,330	3,744	4,209

Source: Company, SMIFS research estimates

Cash Flow					
YE March (Rs mn)	FY21	FY22	FY23e	FY24e	FY25e
Operating profit before WC changes	1,005	1,179	1,344	1,500	1,613
Net change in working capital	(725)	(145)	90	(183)	81
Income tax paid (net)	(359)	(379)	(418)	(466)	(504)
Cash flow from operating activities (a)	280	1,034	1,434	1,318	1,695
Adjusted Operating Cash flow	280	1,033	1,434	1,318	1,695
Capital Expenditure	(56)	(222)	(80)	(280)	(280)
Adjusted FCF	224	811	1,354	1,038	1,415
Cash flow from investing activities (b)	563	(514)	(18)	(202)	(180)
Debt	-	-	-	-	-
Dividend Paid	(487)	(839)	(972)	(972)	(1,032)
Interest and Lease Expenses	(0)	(1)	-	-	-
Cash flow from financing activities (c)	(487)	(840)	(929)	(945)	(1,012)
Net change in cash (a+b+c)	355	(320)	487	171	502

Source: Company, SMIFS research estimates

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Analyst holding in stock: **NO**

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Contact us:

SMIFS Limited. (<https://www.smifs.com/>)

Compliance Officer:

Sudipto Datta,

5F Vaibhav, 4 Lee Road, Kolkata 700020, West Bengal, India.

Contact No.: +91 33 4011 5401 / +91 33 6634 5401

Email Id.: compliance@smifs.com

Mumbai Office:

206/207, Trade Centre, Bandra Kurla Complex (BKC), Bandra East, Mumbai – 400051, India

Contact No.: (D) +91 22 4200 5508, (B) +91 22 4200 5500

Email Id: institutional.equities@smifs.com

Kolkata Office:

Vaibhav, 4 Lee Road, Kolkata 700020, West Bengal, India.

Contact No.: (D) +91 33 6634 5408, (B) +91 33 4011 5400

Email Id: smifs.institutional@smifs.com
