

HOLD

TP: Rs 560 | ▲ 7%

SYRMA SGS

| Consumer Durables

| 02 November 2023

Miss on margins; downgrade to HOLD

- Q2 topline growth robust at 52% YoY but lower share of ODM business drove gross margin down 690bps
- Management expects ODM contribution to remain low in FY24, likely weighing on margins medium term
- We adjust FY24/FY25 EPS by -6%/+2% for a revised TP of Rs 560 (vs. Rs 600); downgrade from BUY to HOLD on limited upside

Vinod Chari | Arshia Khosla
Swati Jhunjhunwala
research@bobcaps.in

Topline robust but margins structurally lower: Syrma posted strong topline growth of 52% YoY but flattish EBITDA of Rs 490mn, with steep margin reduction to 6.9% vs. 10.1% last year. The lower margin can be attributed primarily to a larger revenue share of plain-vanilla electronics manufacturing services (EMS) as compared to original design manufacturing (ODM) in its consumer vertical.

Segment performance sound, consumer margin a drag: The auto, consumer, and industrials verticals clocked healthy YoY topline growth while healthcare and IT & railways floundered. Consumer margins halved from 32.5% in H1FY23 to 16.4% in H1FY24 due to the weaker ODM mix. Syrma has a Rs 3.8bn order book largely consisting of projects in the consumer segment.

Guidance tweaked: Management maintains its revenue guidance of Rs 30bn for FY24 and double-digit growth thereafter but expects EBITDA margin to be lower than previously anticipated due to the change in revenue composition. ODM contributed 22% of revenue in the year-ago quarter, which has reduced to 17%. Syrma expects a return to ~20% levels in FY25, but the margin differential of ~7% in the two businesses will likely result in a lower EBITDA margin for FY24.

Johari acquisition complete: During Q1, Syrma acquired a 51% stake in Johari Digital Healthcare (JDHL), a medical devices company, for Rs 2.6bn. The acquisition has now been completed and the company expects to see Rs 1bn in revenue from JDHL in H2FY24, followed by annualised revenue of ~Rs 2.5bn. Separately, Syrma indicated that it is merging with one subsidiary and one step-down subsidiary to simplify its structure.

Cut to HOLD: Syrma is facing margin headwinds due to the shift in product mix in its consumer vertical, with ODM share guided to remain low till FY25, raising concerns over margin revival. We adjust our FY24/FY25E EPS by -6%/+2% and trim our target P/E to 38x (from 40x) to build in lower margin accretion. On rolling valuations over to Sep'25E, we have a new TP of Rs 560 (vs. Rs 600). The stock has run up 116% since our initiation in Dec'22 and carries limited upside – cut from BUY to HOLD.

Key changes

| Target | Rating |
|--------|--------|
| ▼ | ▼ |

| | |
|------------------|-----------------|
| Ticker/Price | SYRMA IN/Rs 525 |
| Market cap | US\$ 1.1bn |
| Free float | 53% |
| 3M ADV | US\$ 7.0mn |
| 52wk high/low | Rs 665/Rs 248 |
| Promoter/FPI/DII | 47%/5%/9% |

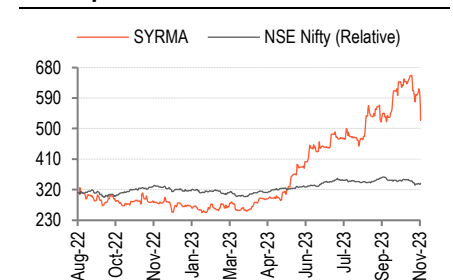
Source: NSE | Price as of 2 Nov 2023

Key financials

| Y/E 31 Mar | FY23A | FY24E | FY25E |
|-------------------------|--------|--------|--------|
| Total revenue (Rs mn) | 20,484 | 30,014 | 39,474 |
| EBITDA (Rs mn) | 1,878 | 2,404 | 3,730 |
| Adj. net profit (Rs mn) | 1,193 | 1,535 | 2,357 |
| Adj. EPS (Rs) | 6.7 | 8.7 | 13.3 |
| Consensus EPS (Rs) | 6.7 | 10.3 | 14.4 |
| Adj. ROAE (%) | 11.3 | 9.6 | 13.3 |
| Adj. P/E (x) | 77.7 | 60.4 | 39.3 |
| EV/EBITDA (x) | 49.4 | 38.6 | 24.9 |
| Adj. EPS growth (%) | 56.1 | 28.7 | 53.5 |

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Fig 1 – Quarterly performance

| Particulars (Rs mn) | Q2FY24 | Q2FY23 | YoY (%) | Q1FY24 | QoQ (%) | H1FY24 | H1FY23 | YoY (%) |
|---------------------|--------|--------|----------|--------|---------|--------|--------|----------|
| Revenue | 7,117 | 4,669 | 52.4 | 6,013 | 18.4 | 13,130 | 8,562 | 53.3 |
| EBITDA | 490 | 472 | 3.9 | 369 | 32.7 | 859 | 807 | 6.4 |
| EBITDA Margin (%) | 6.9 | 10.1 | (320bps) | 6.1 | 70bps | 6.5 | 9.4 | (290bps) |
| Depreciation | 116 | 71 | | 101 | | 217 | 142 | |
| Interest | 80 | 63 | | 75 | | 155 | 113 | |
| Other Income | 89 | 79 | | 221 | | 310 | 104 | |
| PBT | 370 | 417 | (11.4) | 413 | (10.6) | 783 | 656 | 19.4 |
| Tax | 64 | 128 | | 130 | | 194 | 195 | |
| Adjusted PAT | 284 | 282 | 0.5 | 282 | 0.7 | 565 | 460 | 22.8 |
| Exceptional item | - | - | | - | | - | - | |
| Reported PAT | 284 | 282 | 0.5 | 282 | 0.7 | 565 | 438 | 29.0 |
| Adj. PAT Margin (%) | 4.0 | 6.0 | (210bps) | 4.7 | (70bps) | 4.3 | 5.4 | (110bps) |
| EPS (Rs) | 1.7 | 1.6 | 5.1 | 1.6 | 7.7 | 3.3 | 3.1 | 8.7 |

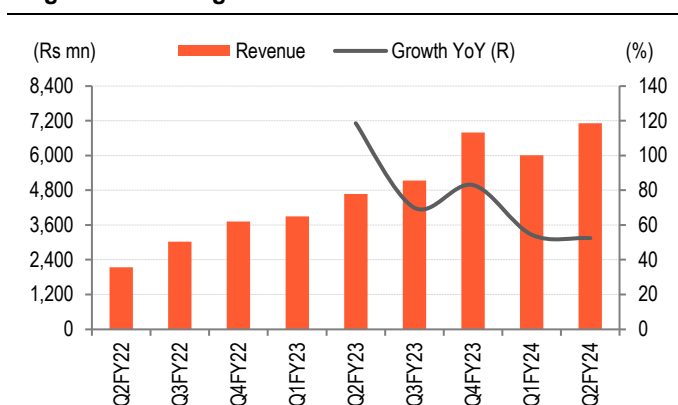
Source: Company, BOBCAPS Research

Fig 2 – Segment-wise revenue breakup

| Particulars (Rs mn) | Q2FY24 | Q2FY23 | YoY (%) | Q1FY24 | QoQ (%) | H1FY24 | H1FY23 | YoY (%) |
|---------------------|---------|---------|---------|---------|---------|--------|--------|---------|
| Auto | 1,725 | 903 | 91.0 | 1,451 | 18.9 | 3,176 | 1,735 | 83.1 |
| Consumer | 2,519.0 | 1,059.0 | 137.9 | 2,324.0 | 8.4 | 4,843 | 1,845 | 162.5 |
| Healthcare | 512 | 504 | 1.6 | 157 | 226.1 | 669 | 1,070 | (37.5) |
| Industrials | 1,984 | 1,770 | 12.1 | 1,775 | 11.8 | 3,759 | 2,962 | 26.9 |
| IT and Railways | 376 | 434 | (13.4) | 307 | 22.5 | 683 | 952 | (28.3) |

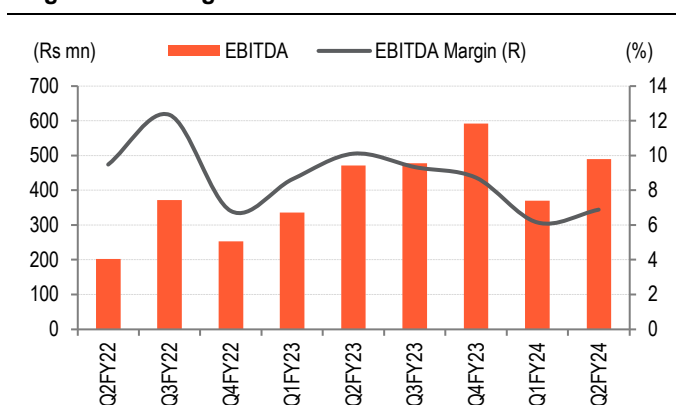
Source: Company, BOBCAPS Research

Fig 3 – Revenue growth



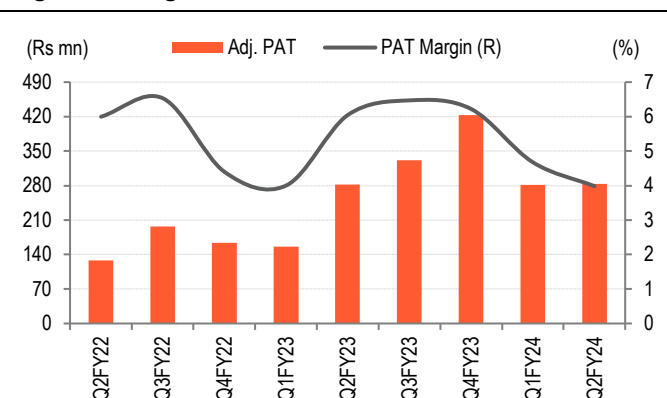
Source: Company, BOBCAPS Research

Fig 4 – EBITDA growth



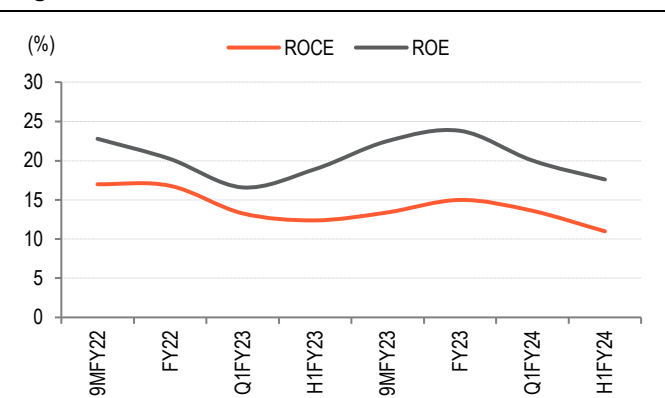
Source: Company, BOBCAPS Research

Fig 5 – Profit growth



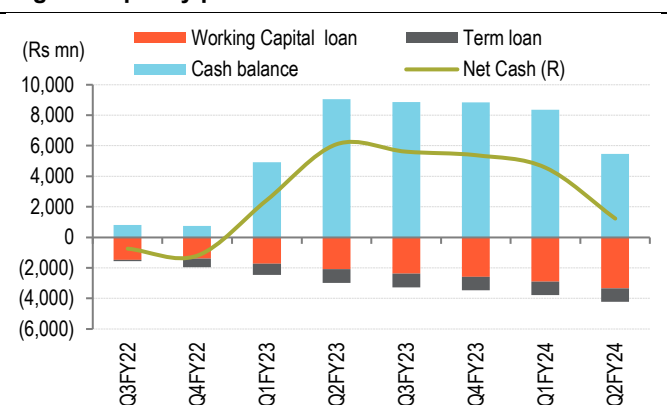
Source: Company, BOBCAPS Research

Fig 6 – Return ratios



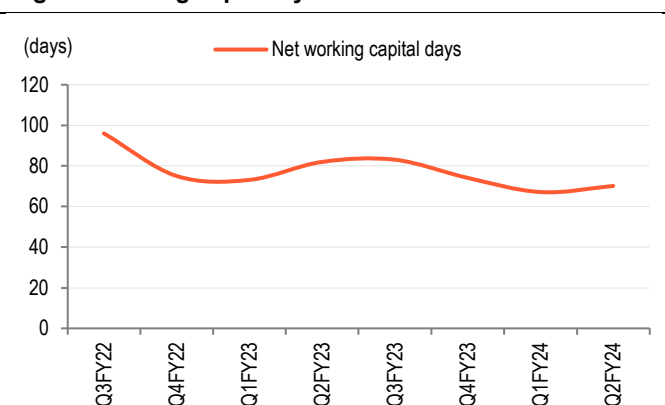
Source: Company, BOBCAPS Research

Fig 7 – Liquidity profile



Source: Company, BOBCAPS Research

Fig 8 – Working capital cycle



Source: Company, BOBCAPS Research

Earnings call highlights

- Order book:** Syрма has a Rs 3.8bn order book as of Q2FY24 and expects to fulfill Rs 3bn worth of orders over the next 12 months. The consumer segment forms the bulk of the order book, followed by automotive, industrials, healthcare and IT.
- Margins:** The Q2 EBITDA margin was lower at 6.9% compared to 10.1% in the year-ago period due to an unfavourable product mix coupled with one-time expenses of Rs 40mn-45mn related to the JDHL acquisition
- Guidance:** Management retained its ~35% revenue growth guidance for FY24 and FY25 and reiterated that H1 typically accounts for ~45% of the annual revenue. EBITDA margin is guided to be lower than earlier anticipated on account of a reduced share of ODM business in the consumer segment.
- Exports:** Export revenue stood at 27% of the topline and grew 9% YoY and 12% QoQ. Management expects exports to do well but to contribute only 25-30% of the topline in FY24 and FY25 given aggressive growth expectations for the domestic market.

- **Consumer:** Consumer business revenue surged 138% YoY, primarily due to high growth in plain-vanilla EMS business as compared to the previous year, when ODM commanded a higher share. Segmental EBIT margin halved from 32.5% in H1FY23 to 16.4% in H1FY24 as ODM is comparatively more margin accretive. Syrma has tied up with one of the largest IoT manufacturers in the world and foresees a variety of applications, including engineering, telecom and energy metering.
- **Healthcare:** Healthcare segment revenue was largely flattish with a slight EBIT margin drop from 48% in H1FY23 to 46.7% in H1FY24. The company witnessed some demand revival in the sector after a muted Q1 performance. Management expects to double its revenue from the healthcare segment in the next two years.
- **Merger:** The board has approved the merger of wholly-owned subsidiaries SGS Teknis and SGS Infosystems with Syrma, which will be completed in phases.
- **Capex:** The company incurred capex of Rs 1.1bn during the quarter and expects to spend a total of Rs 2bn-2.5bn during FY24 (excluding the Rs 2.6bn JDHL acquisition). It has acquired land near Hosur, Tamil Nadu, and is also setting up a manufacturing plant in Chennai for its domestic business, for which it expects to incur Rs 1bn-1.1bn in the next few quarters. In addition, Syrma has leased a plant in Noida for its consumer electronics business, given the growing market.
- **Working capital:** Net working capital days stood at ~70 days as of Q2, slightly higher than the 67 days recorded in Q1, largely due to the increase in inventory days. Management expects working capital reduction to the tune of 5-7 days in the next 2-3 quarters.

Valuation methodology

Syrma is increasing its presence in the EMS space and expanding rapidly in both domestic and international markets. With the JDHL acquisition, the company has also entered the medical devices business and is open to further inorganic expansion where management sees fit.

However, the company is facing margin headwinds due to the shift in product mix in its consumer vertical, with ODM share guided to remain low till FY25, raising concerns over margin revival. We adjust our FY24/FY25E EPS by -6%/+2% and lower our target P/E multiple to 38x (from 40x) – a 30% discount to sector leader DIXON – to build in lower margin accretion. On rolling valuations over to Sep'25E, we have a revised TP of Rs 560 (vs. Rs 600). The stock has run up 116% since our initiation in Dec'22 and carries limited upside, leading us to downgrade our rating from BUY to HOLD as we await a better entry point.

Fig 9 – Revised estimates

| Particulars (Rs mn) | New | | Old | | Change (%) | |
|---------------------|--------|--------|--------|--------|------------|---------|
| | FY24E | FY25E | FY24E | FY25E | FY24E | FY25E |
| Sales | 30,014 | 39,474 | 26,682 | 36,371 | 12.5 | 8.5 |
| EBITDA | 2,404 | 3,730 | 2,510 | 3,634 | (4.2) | 2.6 |
| PAT | 1,535 | 2,357 | 1,634 | 2,303 | (6.0) | 2.3 |
| EPS | 8.7 | 13.3 | 9.2 | 13.0 | (6.0) | 2.3 |
| EBITDA Margin (%) | 8.0 | 9.4 | 9.4 | 10.0 | (140bps) | (50bps) |

Source: Company, BOBCAPS Research

Key risks

Key risks to our estimates are:

- **Upside risk:** Better traction in automotive and industrial segments, which are more margin-accretive
- **Downside risk:** Above-expected proportion of plain-vanilla EMS business which will likely weigh on margins

Sector recommendation snapshot

| Company | Ticker | Market Cap (US\$ bn) | Price (Rs) | Target (Rs) | Rating |
|--------------------|-------------|----------------------|------------|-------------|--------|
| Amber Enterprises | AMBER IN | 1.2 | 2,920 | 2,900 | HOLD |
| Blue Star | BLSTR IN | 2.2 | 927 | 1,100 | BUY |
| Crompton Greaves | CROMPTON IN | 2.2 | 283 | 360 | BUY |
| Dixon Technologies | DIXON IN | 3.9 | 5,330 | 6,300 | BUY |
| Havells India | HAVL IN | 9.7 | 1,266 | 1,600 | BUY |
| KEI Industries | KEII IN | 2.8 | 2,586 | 2,400 | HOLD |
| Orient Electric | ORIENTEL IN | 0.6 | 217 | 250 | HOLD |
| Polycab India | POLYCAB IN | 9.2 | 5,052 | 6,100 | BUY |
| Syrma SGS | SYRMA IN | 1.1 | 525 | 560 | HOLD |
| V-Guard Industries | VGRD IN | 1.6 | 295 | 300 | HOLD |
| Voltas | VOLT IN | 3.4 | 834 | 910 | HOLD |

Source: BOBCAPS Research, NSE | Price as of 2 Nov 2023

Financials

Income Statement

| Y/E 31 Mar (Rs mn) | FY22A | FY23A | FY24E | FY25E | FY26E |
|----------------------------|---------------|---------------|---------------|---------------|---------------|
| Total revenue | 12,666 | 20,484 | 30,014 | 39,474 | 50,237 |
| EBITDA | 1,260 | 1,878 | 2,404 | 3,730 | 4,541 |
| Depreciation | 249 | 312 | 506 | 666 | 802 |
| EBIT | 1,010 | 1,566 | 1,899 | 3,064 | 3,740 |
| Net interest inc./(exp.) | (80) | (216) | (306) | (397) | (480) |
| Other inc./(exp.) | 177 | 437 | 459 | 482 | 506 |
| Exceptional items | 0 | 0 | 0 | 0 | 0 |
| EBT | 1,108 | 1,787 | 2,052 | 3,149 | 3,766 |
| Income taxes | 343 | 556 | 516 | 793 | 948 |
| Extraordinary items | 0 | 0 | 0 | 0 | 0 |
| Min. int./Inc. from assoc. | 0 | 0 | 0 | 0 | 0 |
| Reported net profit | 765 | 1,193 | 1,535 | 2,357 | 2,818 |
| Adjustments | 0 | 0 | 0 | 0 | 0 |
| Adjusted net profit | 765 | 1,193 | 1,535 | 2,357 | 2,818 |

Balance Sheet

| Y/E 31 Mar (Rs mn) | FY22A | FY23A | FY24E | FY25E | FY26E |
|---------------------------------|---------------|---------------|---------------|---------------|---------------|
| Accounts payables | 2,405 | 4,881 | 7,401 | 9,733 | 12,387 |
| Other current liabilities | 921 | 1,088 | 2,467 | 3,461 | 4,404 |
| Provisions | 0 | 0 | 0 | 0 | 0 |
| Debt funds | 1,942 | 3,747 | 5,105 | 6,620 | 8,002 |
| Other liabilities | 554 | 293 | 417 | 540 | 680 |
| Equity capital | 1,376 | 1,768 | 1,768 | 1,768 | 1,768 |
| Reserves & surplus | 4,344 | 13,635 | 14,905 | 16,997 | 19,549 |
| Shareholders' fund | 5,721 | 15,403 | 16,673 | 18,764 | 21,317 |
| Total liab. and equities | 11,542 | 25,412 | 32,062 | 39,118 | 46,791 |
| Cash and cash eq. | 732 | 1,325 | (423) | (745) | (2,685) |
| Accounts receivables | 2,722 | 4,032 | 5,592 | 7,030 | 8,946 |
| Inventories | 2,913 | 5,874 | 7,401 | 8,652 | 11,011 |
| Other current assets | 645 | 1,032 | 1,233 | 1,298 | 1,652 |
| Investments | 47 | 7,535 | 11,041 | 14,520 | 18,479 |
| Net fixed assets | 3,793 | 5,373 | 6,868 | 7,902 | 8,800 |
| CWIP | 391 | 204 | 299 | 393 | 500 |
| Intangible assets | 0 | 0 | 0 | 0 | 0 |
| Deferred tax assets, net | 0 | 0 | 0 | 0 | 0 |
| Other assets | 299 | 36 | 52 | 69 | 87 |
| Total assets | 11,542 | 25,412 | 32,062 | 39,118 | 46,791 |

Cash Flows

| Y/E 31 Mar (Rs mn) | FY22A | FY23A | FY24E | FY25E | FY26E |
|------------------------------------|--------------|----------------|----------------|----------------|----------------|
| Cash flow from operations | (126) | (703) | 2,653 | 3,595 | 2,588 |
| Capital expenditures | (901) | (1,893) | (2,000) | (1,700) | (1,700) |
| Change in investments | 43 | (7,488) | (3,506) | (3,480) | (3,959) |
| Other investing cash flows | 4,849 | 236 | 13 | 13 | 14 |
| Cash flow from investing | 3,992 | (9,145) | (5,493) | (5,167) | (5,645) |
| Equities issued/Others | 2,715 | 392 | 0 | 0 | 0 |
| Debt raised/repaid | 1,021 | 1,805 | 1,357 | 1,515 | 1,382 |
| Interest expenses | 0 | 0 | 0 | 0 | 0 |
| Dividends paid | 85 | 7,771 | (265) | (265) | (265) |
| Other financing cash flows | 0 | 0 | 0 | 0 | 0 |
| Cash flow from financing | 3,821 | 9,968 | 1,092 | 1,250 | 1,117 |
| Chg in cash & cash eq. | 7,687 | 120 | (1,748) | (322) | (1,940) |
| Closing cash & cash eq. | 732 | 1,325 | (423) | (745) | (2,685) |

Per Share

| Y/E 31 Mar (Rs) | FY22A | FY23A | FY24E | FY25E | FY26E |
|----------------------|-------|-------|-------|-------|-------|
| Reported EPS | 4.3 | 6.7 | 8.7 | 13.3 | 15.9 |
| Adjusted EPS | 4.3 | 6.7 | 8.7 | 13.3 | 15.9 |
| Dividend per share | 0.0 | 1.5 | 1.5 | 1.5 | 1.5 |
| Book value per share | 32.4 | 87.1 | 94.3 | 106.1 | 120.6 |

Valuations Ratios

| Y/E 31 Mar (x) | FY22A | FY23A | FY24E | FY25E | FY26E |
|----------------|-------|-------|-------|-------|-------|
| EV/Sales | 7.3 | 4.5 | 3.1 | 2.3 | 1.8 |
| EV/EBITDA | 73.6 | 49.4 | 38.6 | 24.9 | 20.4 |
| Adjusted P/E | 121.3 | 77.7 | 60.4 | 39.3 | 32.9 |
| P/BV | 16.2 | 6.0 | 5.6 | 4.9 | 4.3 |

DuPont Analysis

| Y/E 31 Mar (%) | FY22A | FY23A | FY24E | FY25E | FY26E |
|------------------------------|-------|-------|-------|-------|-------|
| Tax burden (Net profit/PBT) | 69.0 | 66.8 | 74.8 | 74.8 | 74.8 |
| Interest burden (PBT/EBIT) | 109.6 | 114.2 | 108.1 | 102.8 | 100.7 |
| EBIT margin (EBIT/Revenue) | 8.0 | 7.6 | 6.3 | 7.8 | 7.4 |
| Asset turnover (Rev./Avg TA) | 3.3 | 3.8 | 4.4 | 5.0 | 5.7 |
| Leverage (Avg TA/Avg Equity) | 0.7 | 0.5 | 0.4 | 0.4 | 0.4 |
| Adjusted ROAE | 13.8 | 11.3 | 9.6 | 13.3 | 14.1 |

Ratio Analysis

| Y/E 31 Mar | FY22A | FY23A | FY24E | FY25E | FY26E |
|--|-------|-------|-------|-------|-------|
| YoY growth (%) | | | | | |
| Revenue | 42.7 | 61.7 | 46.5 | 31.5 | 27.3 |
| EBITDA | 26.1 | 49.0 | 28.0 | 55.1 | 21.8 |
| Adjusted EPS | 16.7 | 56.1 | 28.7 | 53.5 | 19.6 |
| Profitability & Return ratios (%) | | | | | |
| EBITDA margin | 9.9 | 9.2 | 8.0 | 9.4 | 9.0 |
| EBIT margin | 8.0 | 7.6 | 6.3 | 7.8 | 7.4 |
| Adjusted profit margin | 6.0 | 5.8 | 5.1 | 6.0 | 5.6 |
| Adjusted ROAE | 13.8 | 11.3 | 9.6 | 13.3 | 14.1 |
| ROCE | 13.4 | 10.0 | 8.6 | 11.2 | 11.6 |
| Working capital days (days) | | | | | |
| Receivables | 78 | 72 | 68 | 65 | 65 |
| Inventory | 84 | 105 | 90 | 80 | 80 |
| Payables | 69 | 87 | 90 | 90 | 90 |
| Ratios (x) | | | | | |
| Gross asset turnover | 3.1 | 3.8 | 4.1 | 4.3 | 4.6 |
| Current ratio | 1.3 | 1.4 | 1.0 | 0.9 | 0.8 |
| Net interest coverage ratio | 12.7 | 7.3 | 6.2 | 7.7 | 7.8 |
| Adjusted debt/equity | 0.3 | 0.2 | 0.3 | 0.4 | 0.4 |

Source: Company, BOBCAPS Research | Note: TA = Total Assets

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Registered office Address: **1704, B Wing, Parinee Crescenzo, G Block, BKC, Bandra East, Mumbai 400051**

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BUY – Expected return >+15%

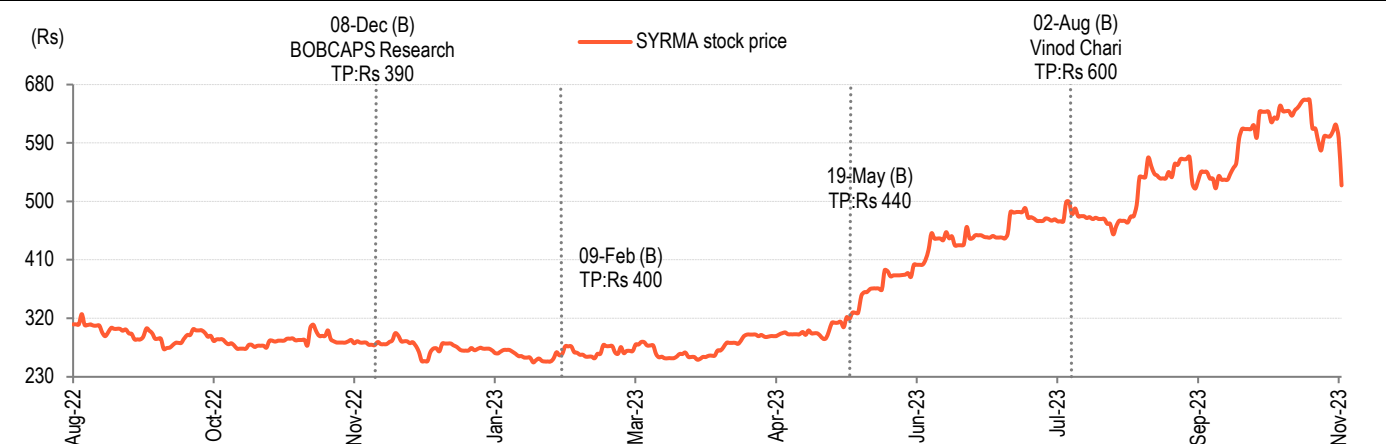
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

Ratings and Target Price (3-year history): SYRMA SGS (SYRMA IN)



B – Buy, H – Hold, S – Sell, A – Add, R – Reduce

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