

**SELL**

TP: Rs 1,300 | ▼ 10%

**SWARAJ ENGINES**

Auto Components

25 September 2020

## Healthy prospects but valuations full – initiate with SELL

**Swaraj Engines (SWE) is the sole supplier of engines for M&M-owned Swaraj tractors which command ~12% market share in the 800,000-unit p.a. tractor industry. A successful rabi harvest, signs of healthy kharif cultivation and aggressive tractor financing bolster growth prospects. Given its strong support from M&M, debt-free status, government thrust on farm mechanisation and a growing rural economy, we value the stock at Rs 1,300, set at 18x Sep'22E EPS. However, the ~60% share price rally since Apr'20 prices in most positives; initiate with SELL.**

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**Rural recovery to catalyse growth:** After a successful rabi crop harvest, we are seeing early signs of stronger kharif cultivation as well. Mahindra & Mahindra-controlled Swaraj Division manufactures tractors and is a key player in the agriculture belts of Central and North India (~12% market share). SWE, being the sole engine supplier for M&M's Swaraj tractors, will be a direct beneficiary.

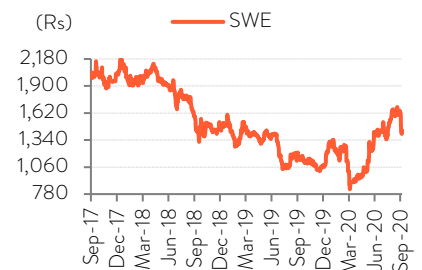
**Tractor industry expected to log 5% CAGR over FY20-FY23:** After declining in FY20, we expect a steady recovery in domestic tractor industry volumes, backed by a growing rural economy, favourable base, aggressive infrastructure spends and revival in the mining, aviation and agriculture sectors. We estimate a 5% CAGR in industry volumes during FY20-FY23, with SWE keeping pace, aiding a revenue/EBITDA/PAT CAGR of 8%/10%/9% for the company.

**Valuations full:** SWE has been a zero-debt company, clocking healthy ROE and ROCE of ~30% each for the last decade. Given steady growth prospects and a healthy balance sheet, we value the stock at 18x Sep'22E EPS, in line with its 10Y average P/E multiple. Strong demand visibility in the tractor space has led the stock to rally ~60% since Apr'20, taking valuations to 21x FY22E EPS. We believe most optimism is in the price – initiate with SELL and a Sep'21 TP of Rs 1,300.

Ticker/Price	SWE IN/Rs 1,441
Market cap	US\$ 237.3mn
Shares o/s	12mn
3M ADV	US\$ 0.2mn
52wk high/low	Rs 1,700/Rs 803
Promoter/FPI/DII	52%/1%/11%

Source: NSE

## STOCK PERFORMANCE



Source: NSE

## KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	8,717	7,733	8,161	8,764	9,749
EBITDA (Rs mn)	1,317	1,004	1,108	1,174	1,321
Adj. net profit (Rs mn)	824	711	770	826	928
Adj. EPS (Rs)	67.9	58.6	63.5	68.1	76.5
Adj. EPS growth (%)	2.9	(13.8)	8.4	7.2	12.4
Adj. ROAE (%)	34.6	30.1	27.9	28.9	31.9
Adj. P/E (x)	21.2	24.6	22.7	21.2	18.8
EV/EBITDA (x)	12.9	17.1	15.6	14.6	12.9

Source: Company, BOBCAPS Research

**BOB Capital Markets Ltd is a wholly owned subsidiary of Bank of Baroda**

Important disclosures, including any required research certifications, are provided at the end of this report.

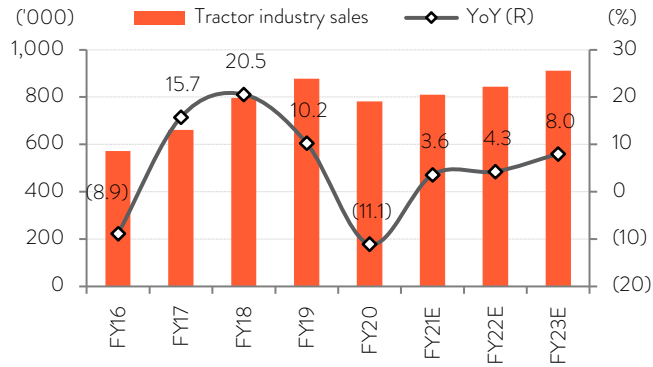


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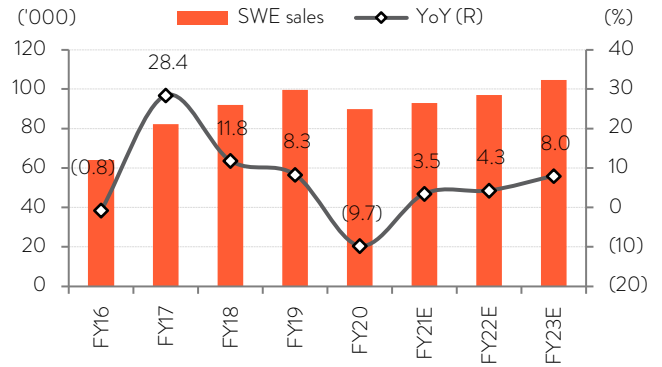
**Focus charts**

**FIG 1 – TRACTOR INDUSTRY VOLUMES EXPECTED TO LOG 5% CAGR OVER FY20-FY23E**



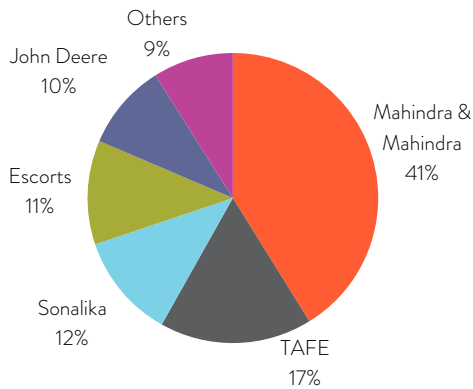
Source: Company, BOBCAPS Research, Tractor Manufacturers Association

**FIG 2 – SWE'S SALE VOLUMES TO TRACK INDUSTRY CAGR OF 5% THROUGH TO FY23E**



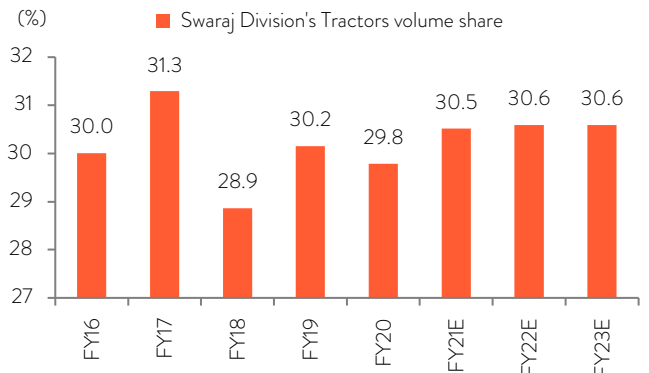
Source: Company, BOBCAPS Research

**FIG 3 – M&M (OWN BUSINESS + SWARAJ DIVISION) LEADS IN TRACTOR MARKET SHARE (FY20)**



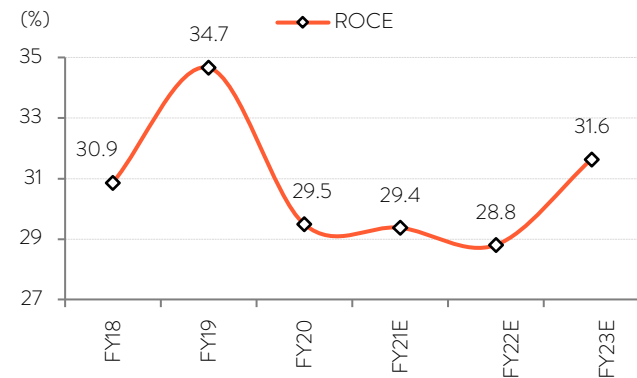
Source: Company, BOBCAPS Research, Tractor Manufacturers Association

**FIG 4 – SWARAJ DIVISION TRACTORS ACCOUNT FOR ~30% OF M&M'S TRACTOR SALES VOLUMES**



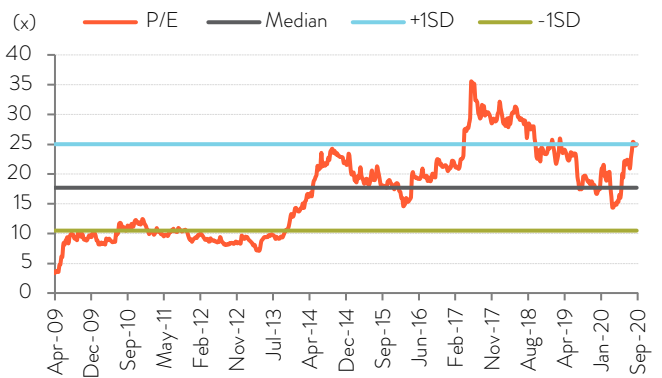
Source: Company, BOBCAPS Research, Tractor Manufacturers Association

**FIG 5 – SWE'S ROCE EXPECTED TO RISE >200BPS TO ~32% BY FY23E**



Source: Company, BOBCAPS Research

**FIG 6 – SWE'S AVERAGE 10Y P/E STANDS AT 18X; CURRENT VALUATIONS OF 21X PRICE IN POSITIVES**



Source: Company, BOBCAPS Research

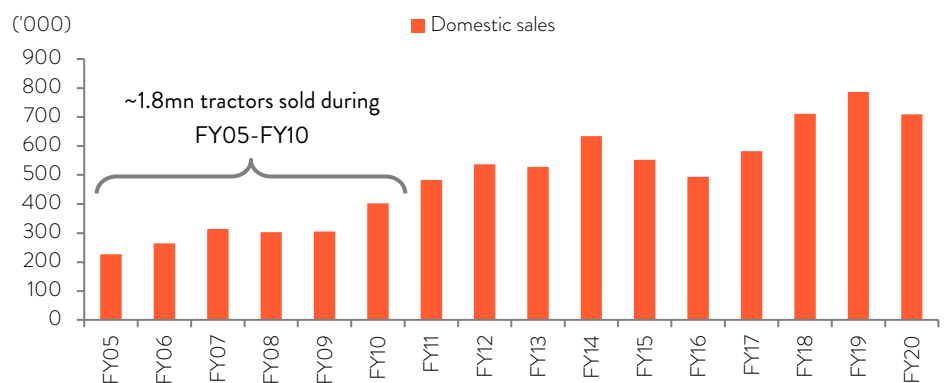
## Steady growth prospects

### Key tractor demand drivers in place

Swaraj Engines (SWE) is the sole supplier of engines for M&M-owned Swaraj tractors which command ~12% market share in India’s 800,000-unit p.a. tractor industry. A healthy outlook on agricultural output, an augmented product slate, aggressive tractor financing and geographic expansion are among the primary growth drivers for the company. We model for a 5% volume CAGR and 8% revenue CAGR in SWE’s tractor business over FY20-FY23.

- **Healthy agri output:** Sowing data released by India’s agriculture ministry shows that the area under rabi (winter) cultivation has risen 7% YoY from 53.5mn hectares sown last year to 57.1mn hectares. Water levels have remained adequate and this year’s normal monsoon should ensure robust kharif (summer) cultivation. SWE, a key player in the agricultural belts of Central and North India, will be a direct beneficiary.
- **High levels of vehicle financing:** Our channel checks in Rajasthan, Uttar Pradesh and Madhya Pradesh suggest that close to 95% of the on-road cost of tractors is financed if the buyer’s credit history is sound. On average, this number settles at ~85%.
- **Large discounts on offer:** Discounts, another crucial driver of sales, remain high – in the range of 6-7% of the tractor price. Our dealer interactions show that freebies range from a 100cc motorcycle offered on purchase of a 40hp tractor to cash discounts of Rs 30,000-35,000.
- **Robust replacement demand:** In mature markets, vehicle replacement begins in 5-6 years. In India, the life of a tractor is ~12 years. As per industry data, ~1.8mn tractors were sold in the domestic market during FY05-FY10, meaning most of these will now enter the replacement cycle.

**FIG 7 – ~1.8MN TRACTORS AVAILABLE FOR REPLACEMENT**



Source: Company, BOBCAPS Research, Tractor Manufacturer Association

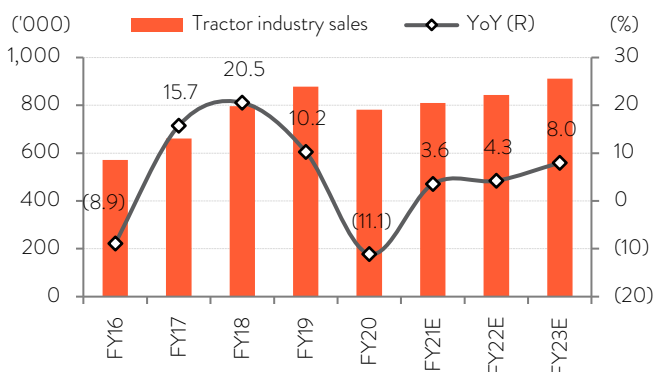
## Tractor industry to log 5% CAGR through to FY23E

Agriculture has always been a key sector of India’s economy (~17% of GDP, ~13% of exports), in turn fueling the largest tractor market in the world. The agriculture sector is growing at an average of 2.2%, with India ranking as the largest producer of pulses, second largest producer of rice, wheat, vegetables, groundnuts and fruits, and third largest producer of coarse grains in the world.

Increased use of tractors, not only for agriculture but also for haulage and non-agricultural applications, has seen India’s tractor industry grow from just ~50,000 units in the early eighties to over 800,000 units annually, overtaking global markets. The opportunities are still immense considering low farm mechanisation levels in the country when compared to other developed markets. Key industry players are M&M with ~41% market share (~29% under own brand and 12% under Swaraj tractors), TAFE (~17%), Escorts (~11%) and Sonalika (~12%).

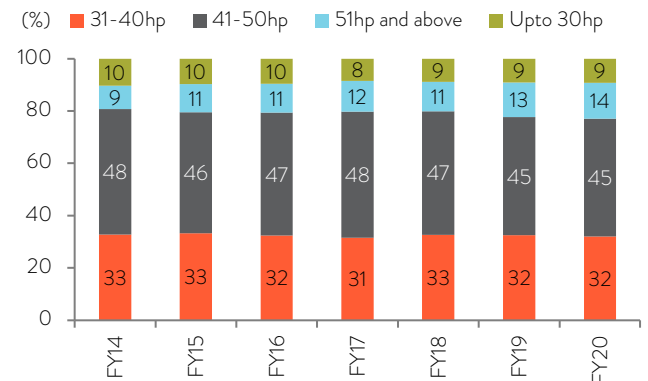
Domestic tractor industry volumes declined ~11% in FY20 to ~781,000 units against ~879,000 units in FY19. Key reasons for this underperformance were (1) the NBFC crisis that led to a pullback of aggressive financing, (2) a high base effect, and (3) slowdown in the economy due in part to Covid-19. We estimate an industry volume CAGR of 5% during FY20-FY23 steered by the government’s aggressive infrastructure spends and expected revival in the mining, aviation (where aircraft tractors are used for ground support equipment) and agri sectors.

**FIG 8 – TRACTOR INDUSTRY EXPECTED TO POST 5% CAGR OVER FY20-FY23E**



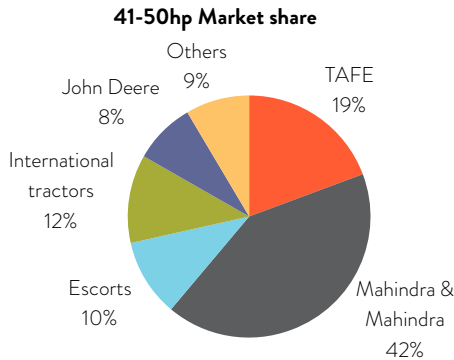
Source: Company, BOBCAPS Research, Tractors Manufacturers Association

**FIG 9 – INDUSTRY VOLUME MIX SUGGESTS GRADUAL SHIFT TOWARDS HIGH-POWERED TRACTORS**



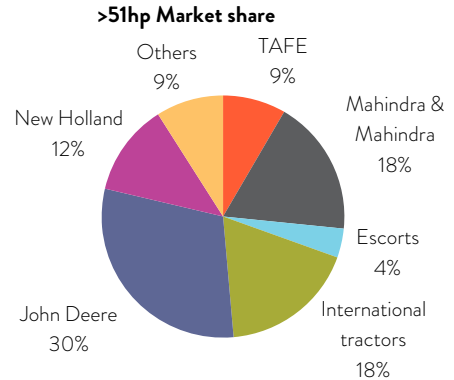
Source: Company, BOBCAPS Research, Tractors Manufacturers Association

**FIG 10 – M&M (OWN BUSINESS + SWARAJ DIVISION) DOMINATES 41-50HP MARKET...**



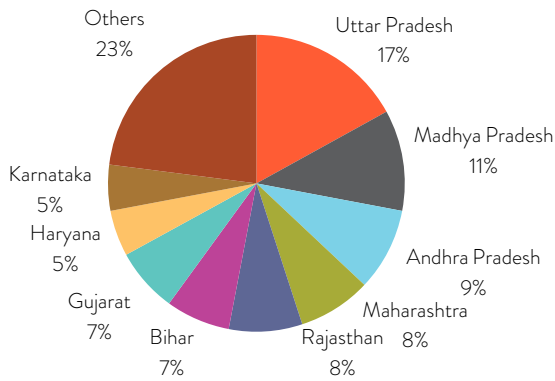
Source: Company, BOBCAPS Research, Tractors Manufacturers Association

**FIG 11 – ...BUT FACES RISK IF >51HP TRACTORS OUTPERFORM INDUSTRY**



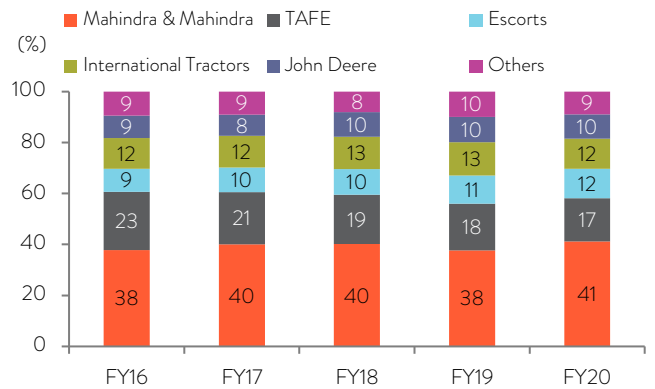
Source: Company, BOBCAPS Research, Tractors Manufacturers Association

**FIG 12 – REGION-WISE MIX OF TRACTORS SOLD**



Source: Company, BOBCAPS Research, Tractors Manufacturers Association

**FIG 13 – TRACTOR MARKET SHARE OF KEY PLAYERS**

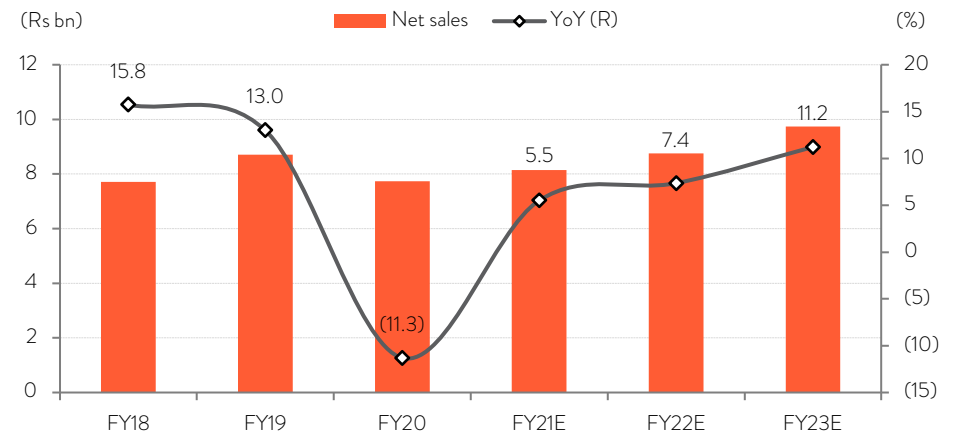


Source: Company, BOBCAPS Research, Tractors Manufacturers Association

### SWE set to grow in line with industry

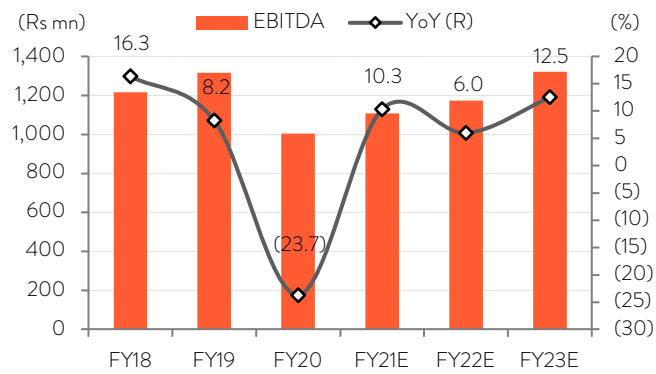
We believe SWE will perform in line with our industry volume growth estimate of 5% CAGR during FY20-FY23. Average realisation is projected to be muted in FY21 given that more tractors are likely to be sold for agricultural (lower-HP products) rather than construction purposes and the aviation industry is hard hit amid the ongoing Covid-19 crisis. Over the next three years, we model for an 8% revenue CAGR for SWE, accompanied by steady EBITDA margins of ~13%, aiding 10% EBITDA and PAT growth through to FY23.

**FIG 14 – EXPECT 8% REVENUE CAGR OVER FY20-FY23E**



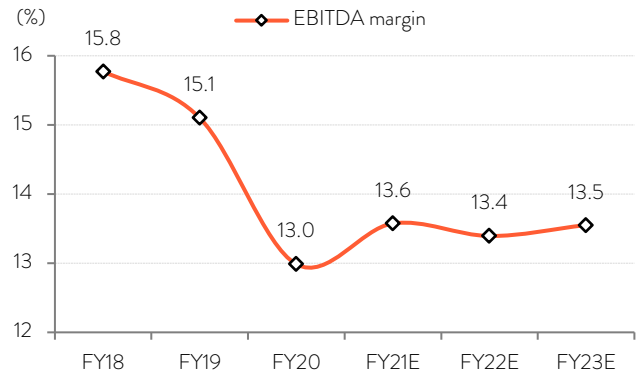
Source: Company, BOBCAPS Research

**FIG 15 – EBITDA TO CLOCK 10% CAGR...**



Source: Company, BOBCAPS Research

**FIG 16 – ...WITH MARGINS REMAINING STEADY**



Source: Company, BOBCAPS Research

**FIG 17 – ADJ. PAT TO LOG 9% CAGR OVER FY20-FY23E**



Source: Company, BOBCAPS Research

**FIG 18 – QUARTERLY PERFORMANCE**

(Rs mn)	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20	Q3FY20	Q4FY20	Q1FY21
<b>Volume (nos)</b>	<b>26,742</b>	<b>28,560</b>	<b>22,569</b>	<b>21,767</b>	<b>23,033</b>	<b>26,271</b>	<b>19,797</b>	<b>20,827</b>	<b>13,756</b>
YoY (%)	14.8	3.3	2.7	(0.1)	(13.9)	(8.0)	(12.3)	(4.3)	(40.3)
<b>Average Realization (Rs)</b>	<b>87,697</b>	<b>86,495</b>	<b>88,050</b>	<b>87,963</b>	<b>89,168</b>	<b>84,778</b>	<b>85,907</b>	<b>84,088</b>	<b>85,047</b>
YoY (%)	5.3	3.6	5.6	3.4	1.7	(2.0)	(2.4)	(4.4)	(4.6)
Net sales	2,345	2,470	1,987	1,915	2,054	2,227	1,701	1,751	1,170
YoY (%)	20.9	18.4	8.4	3.4	(12.4)	(9.8)	(14.4)	(8.5)	(43.0)
<b>Expenditure</b>									
(Inc)/dec in stock-in-trade	4	(32)	20	(79)	43	17	(13)	46	(56)
Raw Materials	1,762	1,886	1,490	1,515	1,533	1,696	1,322	1,280	936
% of sales	75.3	75.1	75.9	75.0	76.7	76.9	77.0	75.8	75.2
Staff cost	96	100	99	97	103	109	107	99	95
% of sales	4.1	4.1	5.0	5.1	5.0	4.9	6.3	5.7	8.1
Other expenditure	117	114	104	107	101	105	88	91	67
% of sales	5.0	4.6	5.2	5.6	4.9	4.7	5.2	5.2	5.7
<b>Total expenses</b>	<b>1,979</b>	<b>2,069</b>	<b>1,712</b>	<b>1,641</b>	<b>1,780</b>	<b>1,927</b>	<b>1,504</b>	<b>1,518</b>	<b>1,041</b>
<b>EBITDA</b>	<b>366</b>	<b>401</b>	<b>275</b>	<b>274</b>	<b>274</b>	<b>300</b>	<b>197</b>	<b>234</b>	<b>129</b>
YoY (%)	13.4	14.4	7.1	(4.0)	(25.3)	(25.2)	(28.4)	(14.7)	(52.9)
<b>OPM (%)</b>	<b>15.6</b>	<b>16.2</b>	<b>13.8</b>	<b>14.3</b>	<b>13.3</b>	<b>13.5</b>	<b>11.6</b>	<b>13.4</b>	<b>11.0</b>
Other income	39	39	40	36	36	34	28	30	21
Interest	1	-	-	-	-	-	-	-	-
Depreciation	47	48	47	53	48	53	51	49	42
Profit before tax	357	392	268	258	262	281	173	214	107
YoY (%)	8.5	9.1	1.7	(6.4)	(26.5)	(28.3)	(35.3)	(16.8)	(59.2)
Provision for taxation	126	138	95	91	93	27	44	56	29
Tax Rate (%)	35.3	35.3	35.3	35.4	35.5	9.6	25.6	26.1	26.8
<b>PAT</b>	<b>231</b>	<b>254</b>	<b>173</b>	<b>167</b>	<b>169</b>	<b>254</b>	<b>129</b>	<b>158</b>	<b>78</b>
<b>YoY (%)</b>	<b>7.4</b>	<b>8.1</b>	<b>0.8</b>	<b>(6.8)</b>	<b>(26.6)</b>	<b>0.1</b>	<b>(25.7)</b>	<b>(4.9)</b>	<b>(53.7)</b>
PAT Margin (%)	9.8	10.3	8.7	8.7	8.2	11.4	7.6	9.0	6.7
EPS (Rs)	18.6	20.4	14.0	13.4	13.6	20.5	10.4	12.8	6.3

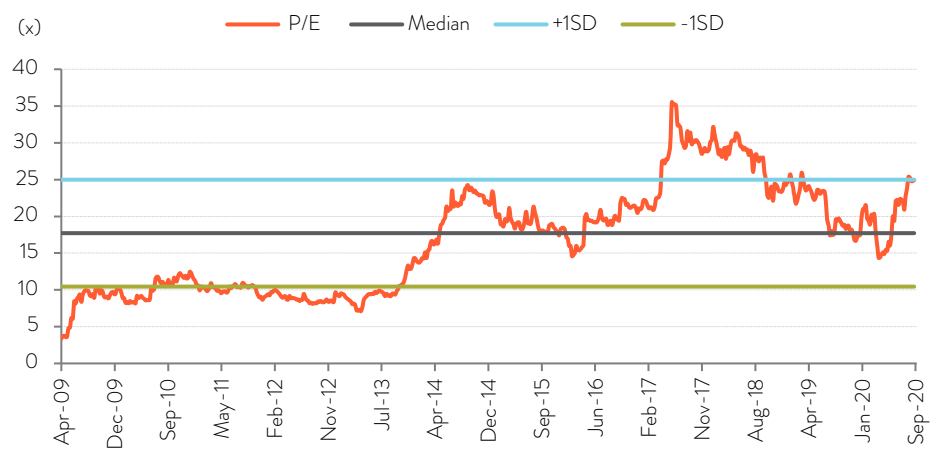
Source: Company, BOBCAPS Research



## Valuations price in positives – SELL

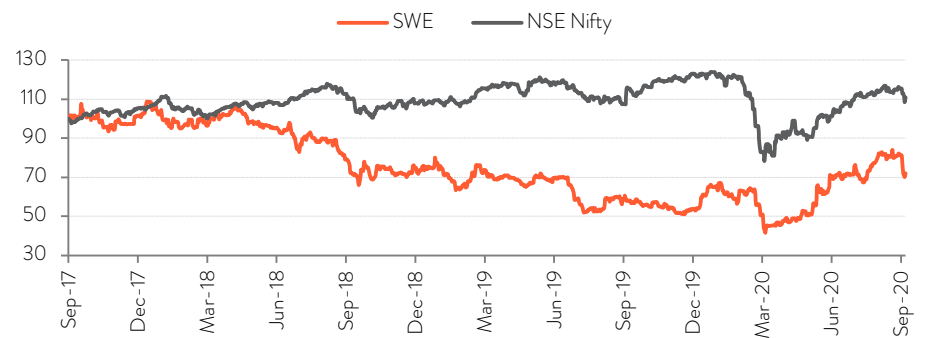
We pencil in a revenue/EBITDA/PAT CAGR of 8%/10%/9% for SWE over FY20–FY23, with ROCE/ROE estimated at ~32% each by end-FY23. Our Sep’21 target price of Rs 1,300 is set at 18x one-year forward EPS, in line with the stock’s 10-year average P/E multiple. The company has had a similar ROCE/ROE profile and a zero-debt balance sheet status since FY10. However, the ~60% rally in share price since Apr’20 has taken valuations to 21x FY22E EPS, which prices in most positives. Initiate with SELL.

**FIG 19 – P/E BAND – AVERAGE 1Y FWD P/E MULTIPLE FOR LAST 10Y AT 18X**



Source: Company, BOBCAPS Research

**FIG 20 – RELATIVE STOCK PERFORMANCE**



Source: NSE

## Key risks

- Above-estimated tractor growth
- Softening of raw material prices



## FINANCIALS

### Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Total revenue</b>	<b>8,717</b>	<b>7,733</b>	<b>8,161</b>	<b>8,764</b>	<b>9,749</b>
EBITDA	1,317	1,004	1,108	1,174	1,321
Depreciation	195	201	209	226	246
EBIT	1,275	931	1,030	1,104	1,241
Net interest income/(expenses)	(1)	0	0	0	0
Other income/(expenses)	154	128	131	156	166
Exceptional items	(9)	0	0	0	0
EBT	1,265	931	1,030	1,104	1,241
Income taxes	450	220	260	278	313
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	0	0	0	0	0
<b>Reported net profit</b>	<b>815</b>	<b>711</b>	<b>770</b>	<b>826</b>	<b>928</b>
Adjustments	9	0	0	0	0
<b>Adjusted net profit</b>	<b>824</b>	<b>711</b>	<b>770</b>	<b>826</b>	<b>928</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Accounts payables	1,092	992	1,163	1,185	1,261
Other current liabilities	38	20	147	124	82
Provisions	42	91	43	43	43
Debt funds	0	0	0	0	0
Other liabilities	40	43	43	43	43
Equity capital	121	121	121	121	121
Reserves & surplus	2,259	2,238	2,643	2,738	2,789
Shareholders' fund	2,380	2,360	2,764	2,859	2,910
<b>Total liabilities and equities</b>	<b>3,591</b>	<b>3,506</b>	<b>4,160</b>	<b>4,254</b>	<b>4,339</b>
Cash and cash eq.	186	182	416	397	378
Accounts receivables	187	41	112	120	134
Inventories	475	371	470	432	454
Other current assets	690	724	685	662	682
Investments	839	1,111	1,511	1,611	1,711
Net fixed assets	1,100	1,026	916	991	945
CWIP	20	40	40	30	25
Intangible assets	0	9	9	9	9
Deferred tax assets, net	(72)	(46)	(46)	(46)	(46)
Other assets	166	47	47	47	47
<b>Total assets</b>	<b>3,591</b>	<b>3,506</b>	<b>4,160</b>	<b>4,254</b>	<b>4,339</b>

Source: Company, BOBCAPS Research

### Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	1,010	912	980	1,052	1,174
Interest expenses	1	0	0	0	0
Non-cash adjustments	(154)	(128)	(131)	(156)	(166)
Changes in working capital	(178)	269	120	51	(21)
Other operating cash flows	(125)	0	0	0	0
<b>Cash flow from operations</b>	<b>555</b>	<b>1,053</b>	<b>969</b>	<b>946</b>	<b>987</b>
Capital expenditures	(336)	(156)	(100)	(290)	(195)
Change in investments	(78)	(272)	(400)	(100)	(100)
Other investing cash flows	154	128	131	156	166
<b>Cash flow from investing</b>	<b>(260)</b>	<b>(300)</b>	<b>(369)</b>	<b>(234)</b>	<b>(129)</b>
Equities issued/Others	2	0	0	0	0
Debt raised/repaid	0	0	0	0	0
Interest expenses	(1)	0	0	0	0
Dividends paid	(606)	(731)	(366)	(731)	(877)
Other financing cash flows	13	(26)	0	0	0
<b>Cash flow from financing</b>	<b>(592)</b>	<b>(758)</b>	<b>(366)</b>	<b>(731)</b>	<b>(877)</b>
<b>Changes in cash and cash eq.</b>	<b>(297)</b>	<b>(5)</b>	<b>234</b>	<b>(19)</b>	<b>(19)</b>
<b>Closing cash and cash eq.</b>	<b>186</b>	<b>182</b>	<b>416</b>	<b>397</b>	<b>378</b>

### Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	67.9	58.6	63.5	68.1	76.5
Adjusted EPS	67.9	58.6	63.5	68.1	76.5
Dividend per share	50.0	60.3	30.1	60.3	72.3
Book value per share	196.2	194.5	227.9	235.7	239.9

### Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	2.0	2.2	2.1	2.0	1.8
EV/EBITDA	12.9	17.1	15.6	14.6	12.9
Adjusted P/E	21.2	24.6	22.7	21.2	18.8
P/BV	7.3	7.4	6.3	6.1	6.0

### DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	65.2	76.3	74.8	74.8	74.8
Interest burden (PBT/EBIT)	99.2	100.0	100.0	100.0	100.0
EBIT margin (EBIT/Revenue)	14.6	12.0	12.6	12.6	12.7
Asset turnover (Revenue/Avg TA)	367.8	320.7	313.3	307.0	333.0
Leverage (Avg TA/Avg Equity)	1.0	1.0	1.0	1.0	1.0
Adjusted ROAE	35.3	30.0	30.1	29.4	32.2

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

**Ratio Analysis**

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
<b>YoY growth (%)</b>					
Revenue	13.0	(11.3)	5.5	7.4	11.2
EBITDA	8.2	(23.7)	10.3	6.0	12.5
Adjusted EPS	2.9	(13.8)	8.4	7.2	12.4
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	15.1	13.0	13.6	13.4	13.5
EBIT margin	14.6	12.0	12.6	12.6	12.7
Adjusted profit margin	9.5	9.2	9.4	9.4	9.5
Adjusted ROAE	34.6	30.1	27.9	28.9	31.9
ROCE	34.7	29.5	29.6	28.9	31.7
<b>Working capital days (days)</b>					
Receivables	7	5	3	5	5
Inventory	17	20	19	19	17
Payables	59	64	63	64	60
<b>Ratios (x)</b>					
Gross asset turnover	0.3	0.3	0.3	0.3	0.3
Current ratio	1.3	1.2	1.2	1.2	1.2
Net interest coverage ratio	0.0	0.0	0.0	0.0	0.0
Adjusted debt/equity	0.0	0.0	0.0	0.0	0.0

Source: Company, BOBCAPS Research

## Disclaimer

### Recommendations and Absolute returns (%) over 12 months

**BUY** – Expected return >+15%

**ADD** – Expected return from >+5% to +15%

**REDUCE** – Expected return from -5% to +5%

**SELL** – Expected return <-5%

**Note:** Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

### RATINGS AND TARGET PRICE (3-YEAR HISTORY): SWARAJ ENGINES (SWE IN)



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

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