



JOINDRE CAPITAL SERVICES LTD.

SEBI REGN NO. INH000002061 / INB 230766739 / INB 011107555

RESEARCH REPORT

3rd Dec 2018

SUBROS LTD

BSE : SUBROS

Sector: AUTO COMPONENTS

BSE: 517168

View - BUY

CMP : Rs. 275

Target Price: Rs 384 (In next 12 to 18 mths)

BUSINESS BACKGROUND

Subros Ltd is a joint venture with 40% ownership by Suri family and 13% each by Denso Corporation (Denso) and Suzuki Motor Corporation (SMC). Subros, is an integrated manufacturer and market leader for auto air-conditioning units and manufactures thermal products such as compressors, condensers, heat exchangers and all connecting elements required to complete AC loop for automotive applications. Subros caters to the Pvs, Buses, Trucks, Refrigeration Transport, off roaders, Railways & AC Manufacturers. SL has 4 plants located at Noida, 2 at Mannesar, 1 each at Pune, Chennai & Gujarat.

INVESTMENT HIGHLIGHTS

Strong Financial Performance in H1 FY19 –

SL reported a steady set of FY18 numbers with net sales at Rs 1912.89 crs as compared to a revenue of Rs 1534.92 crs last year, with EBIDTA placed at Rs 209.85 crs from Rs 1867.63 crs last year with the PAT placed at Rs 60.48 crs from Rs 12.72 crs. SL has declared a dividend of 55% for FY18.

For SL H1FY19 was noteworthy with Sales up by 20% at Rs 1095 crs with EBIDTA up by 18% at Rs 116.30 crs with PAT at Rs 42.72 crs up by 67% YoY. EBIDTA margins in H1FY19 stood at 10.62% from 10.82% in H1 last year.

SL is a well diversified player operating in the PV, CV, Railway and Consumer Durable segments –

SL caters to all major automotive segments like passenger vehicles (PV), commercial vehicles (CV; Trucks, Buses & Refrigerator transport), Off-roaders and Railways. It has also entered into Home AC segment in FY17. The PV segment is its primary segment, contributing 92% to the overall revenues while the non-PV segment contributes 8%. SL enjoys 42% market share in the PV segment, with Maruti Suzuki (MSIL) being its major customer.

Apart from AC solutions for passenger vehicles, Subros has evolved into supplying its products to AC railway cabins, Reefer Vans, Bus & trucks AC's etc. SL has a capacity of 1.5mn pieces p.a. & caters to Maruti Suzuki (MSIL), Mahindra & Mahindra (M&M), Tata motors (TTMT) and Renault Nissan in the passenger vehicle business. In CV segment, Subros tied up business with TTMT, Ashok Leyland (AL), Force Motors M&M and SML Isuzu (SML). SL also supplies to the Railways and AC Players like Whirlpool, LG, Haier and Voltas.

KEY DATA

FACE VALUE	Rs	2.00
DIVD YIELD %		0.40
52 WK HI/LOW		442/234
NSE CODE		SUBROS
BSE CODE		SUBROS
MARKET CAP	RS	1849 CRS

SHAREHOLDING PATTERN

PROMOTERS	-	73%
BANKS, MFs & DIIs	-	6%
FIIs	-	5%
PUBLIC	-	16%

KEY FUNDAMENTALS

YE	FY19	FY20	FY21
Rev Gr%	16	15	14
EBIDTA Gr%	16	17	15
PAT Gr%	40	32	24
EPS Gr%	28	32	24
EPS (Rs)	12.95	17.10	21.13
ROE %	15	15	16
ROCE %	16	17	18
P/E(x)		16	13



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Subros's key product range across all Industry Segments –

 Car Airccon System	 Engine Cooling Systems	 Commercial Vehicle	 Home AC
 Compressors	 Cooling Module	 Bus ACs	 Condenser
 HVACs & Evaporator	 Oil Coolers, CAC	 Rail ACs	 ODU
 Hose & Tubes		 Truck ACs Truck Blower	
 Condenser			

Subros Key Customers –

Passenger Car Segment			
			
			
Commercial Vehicle Segment			
			
			
Railways		Home AC	
			



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Subros Product Range for Automotive Customers –



Radiator



Blower

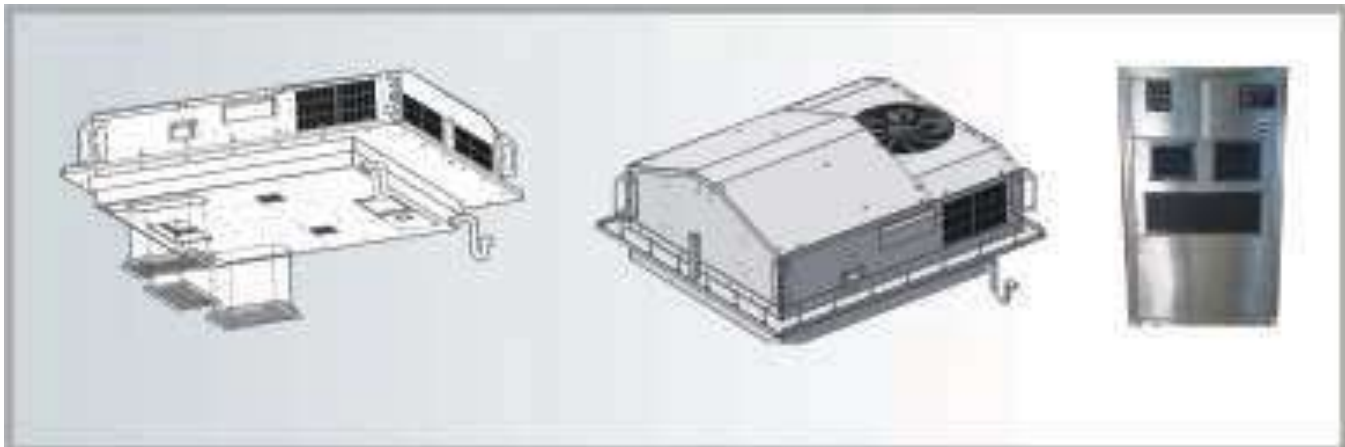


HVAC

Hoses & Tubes



Railway AC –





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Commercial Vehicle – BUS AC



Transport Refrigeration System –





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Home ACs Products –



Subros's Car AC Business continues to expand Footprint in H1 FY19 –

Subros continue to increase its reach in Indian Car AC market and increased its market share from 39% to 42% during H1FY19. During Q2FY19 SL has started supply to Marazzo (M&M's new launch) which is using Subros thermal product HVAC

Its business with Tata Motors for Tiago and Nexon is also picking up on the back of strong sales of Tata Motors. SL has also scaled up its supply to Suzuki Gujarat plant due to its two shift production schedule. SL continues to garner around 70% of Maruti's volume and remains a major supplier.

During Q2FY19 SL has also started its business association with Suzuki Motor Indonesia through Maruti Suzuki for supply of its Car AC Products.

Subros non Car AC & Non Maruti segment also growing rapidly –

Apart from its core business of Car AC, SL also supplies AC products to Buses, Trucks, Railway Cabins and Reefer Vans. SL also expects the radiators business to Maruti under contract manufacturing agreement with Denso to achieve Rs2.8bn to Rs 3 bn sales in FY19 and a steady traction ahead in this business segment.

SL has also scaled up its supply of Truck cabin AC system/ ventilation system (blower) in all new trucks above 3.5 tonne category in India. To further expand its product portfolio, SL has commenced the supply of condensers for Room AC's for Whirlpool and others OEM vendors.

Subros to give Preferential allotment of additional Equity to Denso Japan –

The Subros board has approved to issue 5,247,150 shares to Denso Japan at Rs Rs400 per share. With this, Denso's equity stake in SL will increase from 13% to 20%. SL will get additional Rs 209.88 crs for the 7% additional equity it will offer to Denso. After this allotment which has been finalized by CCI the post allotment equity capital will stand at Rs 13.04 crs in FY19 from Rs 12 crs earlier in FY18.

Denso is likely to help Subros in gaining new technologies to comply with Indian regulations related to fuel saving and emission related technological upgrade

Denso is also likely to share its expertise with Subros to realize the global quality level and improvement in manufacturing standards. We believe this as a big positive development for SL as this alliance can open-up further business opportunities in domestic and international markets.



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Subros lines up fresh Capex and Capacity Expansion ahead –

Subros is in a process to increase its Car AC kits capacity from 1.5mn to 2.5mn. It has set up a new plant in Gujarat to supply Maruti's production facility in Gujarat which has become partially operational.

Subros plans to incur a capex of Rs1.2bn wherein capacity expansion will be done in 3 phases over the next 3 years. First phase of the capacity will be through internal accruals and some part of debt.

Subros to be a big beneficiary of a steady PV industry growth ahead –

We expect the Passenger Vehicle industry volume to grow at an 8% CAGR over FY18-20E on the back of continued rural recovery, anticipated normal monsoon and pick-up in economic activity. We believe that MSIL would be the biggest beneficiary and grow faster than the industry at 13% CAGR.

Thus, with Subros supplying around 70% of the total AC requirement of MSIL, it is likely to benefit from the same. Further, improving share of business (SoB) with other OEMs (TAMO, Renault Nissan, M&M) and entry into radiators segment would provide aid to the revenue growth

MSIL is one of the largest PV manufacturers in India with market share of 50% in FY18. We believe it would continue to be the biggest beneficiary of this sturdy demand, given its stronghold in the entry-level segment. Further its new launches targeted toward filling gaps in its portfolio would improve the overall product mix and drive growth. We estimate 13% volume CAGR over FY18-21E for MSIL and expect market share to improve to 57% to 50% by FY21E

In FY18, Subros supplied around 70% of the total AC requirement of MSIL, catering to all the highest selling models which include Baleno, Brezza, Swift, etc. Besides petrol, it started providing ACs to diesel variants from FY16 onwards, which led to increase in SoB with MSIL from 65% in FY16 to 70% currently. Diesel cars account for nearly 30% of MSIL's total sales volume.

Also Subros supplies components to other Passenger Vehicle manufacturers like M&M (30% SoB), Renault-Nissan (20%) and TAMO (35%). Recently it tied up with Renault to supply condenser in Brazil, where Renault sells 0.3mn cars. Over the last 2 years, it has been able to increase its SoB with M&M and Renault as well besides MSIL

While, there is no doubt that MSIL would continue to contribute significantly to Subros revenue, the robust sale of existing and new models (Kwid, KUV 100, Tiago, Hexa, Nexon, etc.) by these other OEM's would drive growth for Subros.

Radiators Business to also contribute significantly to the Topline for Subros going ahead –

Subros entered into MoU with Denso to supply global standard cooling modules (radiators) to them, which they in turn supply to MSIL. Radiators are the heat exchangers used to transfer thermal energy from one medium to another for cooling and heating.

With the initial investment of Rs 25 crs in FY16, it installed 0.50mn capacity p.a. at its existing Manesar plant and further increased it to 0.75mn by FY17. The supply started from March 2016, but was halted due to a fire incident at the plant in May 2016. It resumed production from January 2017, post the repair work. For FY18 being its full year of production, SL generated revenue of Rs 2.2bn this year and expects a steady increase here over the next 2 years ahead.



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Non Auto Business to de risk the Company's Business Model –

Mandatory AC/ blower cabin for trucks – The next big opportunity for Subros

As per the notification from Ministry of Road Transport and Highway, ACs or blowers are mandatory in N2 and N3 category of trucks (3.5 tonnes and above) from January 2018 onwards. With this notification coming in, demand for AC/ blower in truck cabin will rise extensively. Currently, the majority of the customers have opted for blowers as it's one-fourth the cost of AC and only a few customers have chosen AC fitment as an optional action.

Post the notification, Subros has leveraged its existing strong relations with the OEMs and garnered around 70% market share in the truck cabin AC/ blower space.

It has received orders to supply 2.4 lakh units annual from the OEMs such as Ashok Leyland (supplying 90% of blower requirement), Tata Motors (75%), M&M (100%) & Swaraj Mazda Isuzu (100%) in the blower space and Daimler (30%) in the AC space. The above requirement will be catered through its existing Chennai and Pune plants where it has a capacity of 300,000 units p.a for adding the truck business. Here Subros key competitors include Sanden Bnternational and Mahle Bher.

Overall management expects CV business can turn into the revenue opportunity of Rs2.5-3bn for FY19 and Rs4bn for FY20 of revenues. Company expects Rs 30 crs sales in FY18 and expects major impact to come in FY19.

Railways is another big demand driver expected ahead –

Subros entered the Railway segment in FY14 by developing import substitute for driver cabin AC for diesel locomotives. Currently, it caters to only driver cabin AC with market share of 77%. Its key competitors are Cool Air Lloyd Electric & Engineering,

Recently, the company got shortlisted by two major Tier 1 suppliers of Indian Railways i.e. Bombardier India and Medha Servo Drives Pvt Ltd. They have engaged with Subros for future projects with Integral Coach Factory (ICF), Chennai. As part of this engagement, both the companies have awarded trial orders to Subros. This opportunity can provide strong business growth in this segment.

Apart from this, Subros also plans to enter railway coaches and evaluate opportunities in metro AC coach segment. Currently, majority of AC's are imported from China, Korea and Australia in this space. Subros targets to achieve 25% market share in railways and 10% market share in metros.

Home AC segment to also grow –

Subros forayed into the Home AC segment in FY17 by supplying 50k condensers to Whirlpool. It is looking to tie up with others players and currently added E-Durables as its client which is one of the largest and fully backward integrated OEM service provider in India, catering to clients like LG Electronics, Haier, Voltas etc



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Bus AC to also show strong growth –

Subros is a 100% supplier to Force Motors for its Traveller AC buses, ranging from 4kw to 8kw. It has also launched a 45kW AC for low floor city bus application. Though the demand for AC bus is at nascent stage currently, it is expected to grow at 20-25% p.a. over the next 3-4 years. Subros is keen to secure business from State Transport Undertakings (STUs) as most of them are expanding their AC bus fleet.

Refrigerated transport vehicles–

Cold storage coupled with last mile delivery of perishable items to the end point is also a future growth category for the chilling and refrigeration players and hence that is increasing demand for refrigerated CV's (both Light and Medium).

In 2014 Subros took up the task to meet the growing need in this segment launched its first transporter refrigeration system. Subros has set up a factory which can provide complete body with AC kits and thus provides great potential for growth.

Subros enjoys a strong balance sheet and both Topline and Bottomline growth is likely to remain strong going ahead –

SL has maintained a strong balance sheet over the years with reasonable debt of around Rs 315 crs as on FY18 on a consolidated basis on a consolidated networth of Rs 404 crs as on March 2018. The company has also enjoyed healthy operating cashflows. Operating cashflows between FY12-FY18 has grown at a CAGR of 15%, while a large part of the capex is complete which should enhance the free cash generation going ahead.

SL has also reported average RoE of 15-16% during the past 5 years, thus showing strong commitment on delivering shareholders return. Hence going ahead we expect that SL has the capability to sustain the robust financials performance given its strong business performance and entry in to the Non Automotive segments

We expect that going ahead overall bottomline growth in the next 3 years starting FY19 onwards should easily increase at a CAGR of 20-25% and going ahead also we believe that net cash flows generated will remain healthy going ahead.



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Business Outlook & Stock Valuation –

On a rough cut basis, in FY19, Topline will see a steady rise wherein Topline is expected to touch Rs 2218 crs in FY19E.

On the bottomline level we expect the company to record a PAT of Rs 84 crs in FY19E. Thus on a conservative basis, SL should record a EPS of Rs 12.95 for FY19E. For FY20E and FY21E our expectation is that earnings traction for SL would continue to be strong wherein we expect a EPS of Rs 17 and Rs 21 respectively.

We certainly believe that Subros strong relationship with its OEM's and technology support from Denso would help the company grow ahead. We believe positive signals of the rural markets and more disposable income in the hands of the rural populace raising the demand for 4Ws. Whereas CV would continue to do well on account of healthy replacement-led demand and pick-up in construction and mining activity.

We expect this to continue in FY20 as well. We expect subros would reap the benefits from the recent positive cycle of PV's and CV's over the next 2-3 years.

We believe that Subros enjoys a Unique Business Model where Business volume and technology is assured as Customer (Maruti) and Technology partner (Denso) are on the Company Board and shareholders.

We also believe that Subros entry into Commercial vehicle AC systems and Transport refrigeration (cold chain) to offer incremental business opportunities which will contribute meaningfully to its sales over the next 3-5 years

In conclusion we believe that Subros is supported by a competent management team and promoters, enjoys a strong brand equity and is well positioned to ride the next wave in the Automotive sector. With ready expansion, growing customer base, in house product development, and introduction of newer products for other Non Auto customers we believe Subros is well positioned for long term sustainable growth.

Hence we believe that the Subros stock should be purchased at the current price for a price target of around Rs 384 over the next 18 months.



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FINANCIALS

For the Year Ended March RsCr	FY17A	FY18A	FY19E	FY20E	FY21E
Net Sales	1534.92	1912.89	2218.95	2551.795	2909.047
EBIDTA	167.63	209.85	244.08	285.80	327.26
EBIDTA %	10.92	10.97	11.00	11.20	11.25
Interest	47.9	41.21	35.00	30.00	26.00
Depreciation	87.91	91.99	97.00	105.00	113.00
Non Operational Other Income	7.27	7.38	8.50	8.50	8.50
Profit Before Tax	39.11	84.14	120.58	159.30	196.77
Profit After Tax	12.72	60.48	84.41	111.51	137.74
Diluted EPS (Rs) FV Rs 2	2.12	10.08	12.95	17.10	21.13
Equity Capital	12.00	12.00	13.04	13.04	13.04
Reserves	335.48	392.44	677.68	779.19	906.93
Borrowings	326.89	315.83	280.83	230.83	200.83
GrossBlock	458	640.22	680.22	725.22	765.22
Investments	1.47	1.57	1.57	1.57	1.57

Source Company our Estimates

KEY CONCERNS

Subros is highly dependent on the growth of PV segment in India. Any slowdown in the economy would impact the growth of automobile industry, which could adversely affect Subros's revenue

Concentration risk due to high dependency on few customers (70% turnover comes from Maruti)

Future growth in the non-PV segment is highly dependent on the demand pickup in the truck, rail, bus and Home AC segments and any slowdown here can affect the profitability of the company

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