

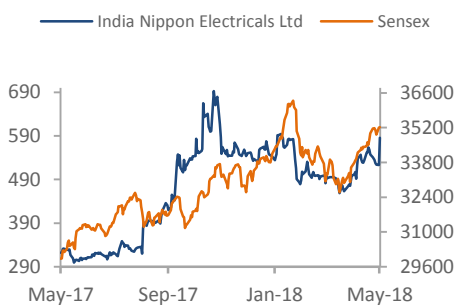
Sector	Auto Ancs
Recommendation	BUY
Upside	27%

Stock Data	
Sensex	35,319
52 Week h/l (₹)	712/298
Market cap (₹ Cr)	1,251
BSE code	532240
NSE code	INDNIPPON
FV (₹)	5
Div yield (%)	1

Shareholding Pattern			
	Sep-17	Dec-17	Mar-18
Promoters	66.39	66.39	66.39
DII+FII	2.01	0.42	2.62
Individuals	64.38	65.97	63.77

Source: ACE Equity

Share Price Trend



Prices as on 09/05/2018

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May 10, 2018

India Nippon Electricals (INEL) is among the leading manufacturers of electronic ignition systems for 2W, 3Ws and portable generator sets. We expect INEL's EBITDA margin to expand 93bps over FY18-20E owing to addition of higher margin products to its portfolio. Strong underlying demand for 2/3Ws and growing electronic content per vehicle will lead to 16% revenue CAGR over FY18-20E. INEL is debt free with RoE, RoCE and RoIC of 16%, 19% and 32% respectively (FY18). We forecast EBITDA and PAT CAGR of 20% each over FY18-20E. We recommend BUY with target price of ₹700 (22x FY20E EPS).

Growing proportion of vehicle electronics: INEL will benefit from rising proportion of electronics in automobiles (*from 23% of vehicle cost to 45% by FY30; Source: Govt data*). As per FY17 Annual Report of MeiTY, domestic production of automotive electronics will grow from ₹5,629cr in FY14 to ₹36,500cr in FY20, 31% CAGR (refer exhibit 2). Based on these projections, we expect INEL to see revenue CAGR of 16% over FY18-20E.

Superior product mix to aid margin expansion: Over past 2-3 years, INEL has invested in development of new 2W products to meet upcoming technology and emission demands. Exports and aftermarket sales (4% of revenue each), which enjoy superior margins, have grown at 25% and 35% CAGR respectively over FY14-17 (FY18 data not yet available). Consequently, EBITDA margin expanded ~500bps from 9% in FY14 to 14% in FY18. Over FY18-20E, we expect EBITDA margin expansion of 93bps to 15.1%.

Outlook & Valuation: We are positive on INEL due to (a) robust underlying sector (2/3W) demand, (b) growing vehicle electronics, (c) improving product mix and (d) strong balance sheet. INEL is debt free with cash / equivalents of ₹124cr (FY18), providing scope for investing in new products and technologies when required. Stock is currently trading at 34% discount to its peak PE of 28x and is in-line with the average 52 week PE. We believe that a stock with zero debt, high return ratios, improving financial metrics and credible management pedigree deserves premium valuation (refer exhibit 8).

Financial Summary

Consolidated ₹Cr.	FY17	FY18	FY19E	FY20E
Revenue	350	452	527	610
YoY growth (%)	4.2	29.3	16.4	15.8
EBITDA Margin (%)	10.7	14.2	14.8	15.1
PAT	30	50	61	72
EPS (₹) – post split	13.1	22.0	27.0	31.8
RoE (%)	11.1	16.1	16.8	17.5
RoIC (%)	21.1	31.5	33.1	37.8
P/E (x)	42.3	25.1	20.5	17.4

Source: IIFL Research

Company Overview

INEL is manufacturer of ignition systems for two wheelers, three wheelers and portable engines. The company’s core products include flywheel magneto, capacitor discharge engine (CDI), transistor controlled ignition (TCI), ignition coil, etc. Over past few years, INEL has added (or has plans to add) several new products such as immobilizers, electronic fuel injection (EFI), instrument clusters, electronic control units (ECU), integrated starter generator (ISG), electronic fuel injection system (IFES), brushless alternators, etc. (refer exhibit 1). This is in order to keep up with technological changes and stricter emission norms.

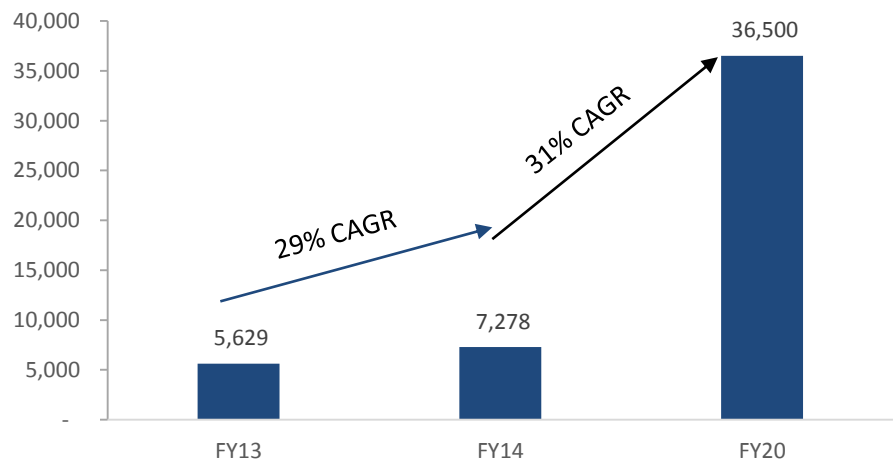
INEL is a Joint Venture between its promoters Lucas Indian Service Limited (Lucas) and Mahle Electric Drives Japan Corporation (MEDJC), formerly known as Kokusan Denki Company Limited, Japan (KDCL). As per BSE data as on March 31, 2018, Lucas and MEDJC own 45.87% and 20.52% stake in INEL respectively. Institutional ownership is low at 2.62%, of which Sundaram Alternative Opportunities Fund owns 1.61%. A sustained improvement in financial performance may lead to higher institutional ownership, boosting valuations for the stock.

Exhibit 1: INEL’s Product portfolio

Core Products	New Products (recently added or soon to be added)
Flywheel magneto, capacitor discharge ignition (CDI), transistor controlled ignition (TCI), capacitor discharge ignition (CDI), ignition coil	Immobilizers, electronic fuel injection (EFI), instrument clusters, electronic control units (ECU), integrated starter generator (ISG), electronic fuel injection system (IFES), brushless alternators,

Source: FY17 Annual Report. This is not an exhaustive list

Exhibit 2: Domestic production of automotive electronics

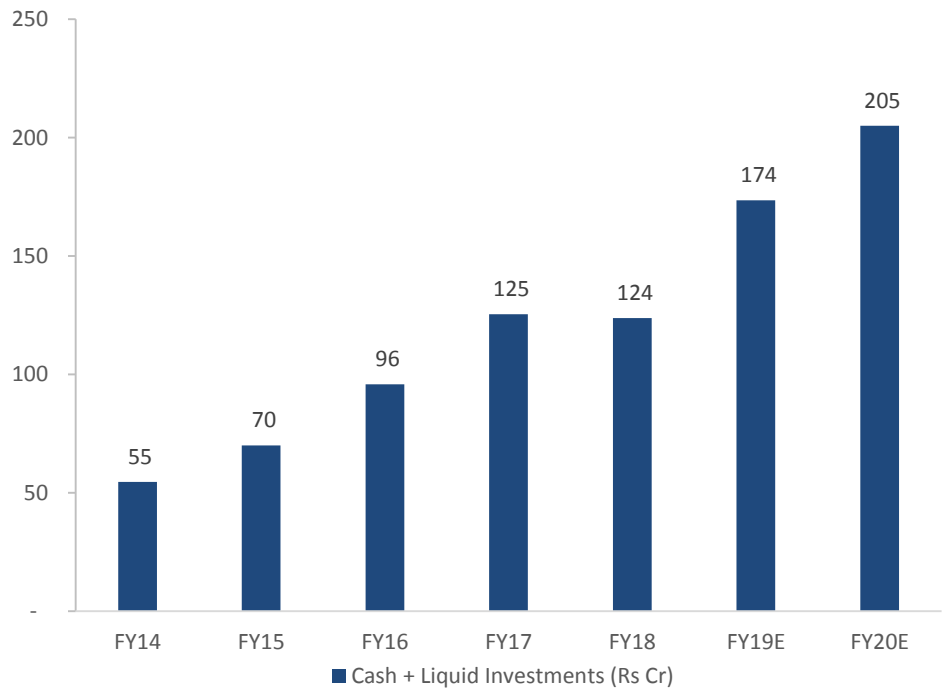


Production is expected to grow at 31% CAGR, as per Ministry data. Emphasis on domestic production goes in tandem with Government’s “Make-in-India” program

Source: FY17 and FY18 Annual report of Ministry of Electronics and Information Technology
Please note that there is no data provided for the interim years (FY15-FY19)

Sufficient gunpowder for growth: INEL has a zero-debt balance sheet and disciplined working capital cycle. This has led to steady increase in cash and liquid investments on books of the company. With debt free balance sheet and total cash and liquid investments worth ₹124cr as on March 31, 2018 (refer exhibit 3), we believe that INEL will be in a comfortable position to invest in new products or go in for related acquisitions. As things stand currently, we expect cash and liquid investments on books of the company to grow to ₹205cr by FY20E, given the debt free status and a disciplined working capital management. The company has highlighted in its FY17 Annual Report that it is exploring new opportunities in the Asia Pacific region. This will lead to geographic and client diversification for the company. We have not assumed any acquisition for INEL over the next 2-3 years, however, even if it happens, the company still has sufficient gunpowder for growth.

Exhibit 3: Cash rich position, debt free balance sheet

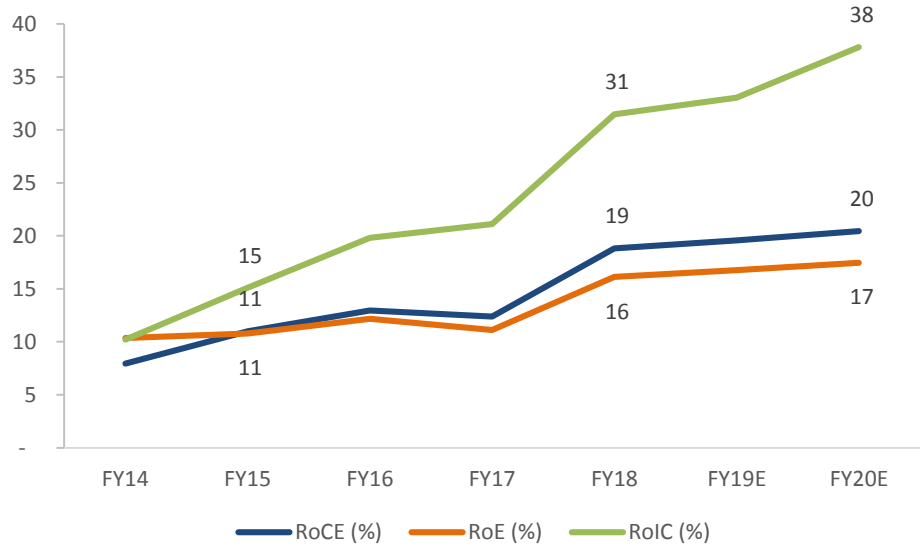


INEL is exploring new export opportunities in the Asia Pacific region. A strong balance sheet puts company in a sweet spot w.r.t. investing in geographical or product diversification

Source: Company Data, IIFL Research

Return ratios reflect robust profitability, balance sheet: INEL has strong return ratios owing to steady growth in profitability and strong balance sheet (refer exhibit 4). Due to a high proportion of cash and liquid investments, RoCE looks depressed. Hence, we have considered RoIC, given that it takes into account cash and liquid investments as well.

Exhibit 4: Return ratios



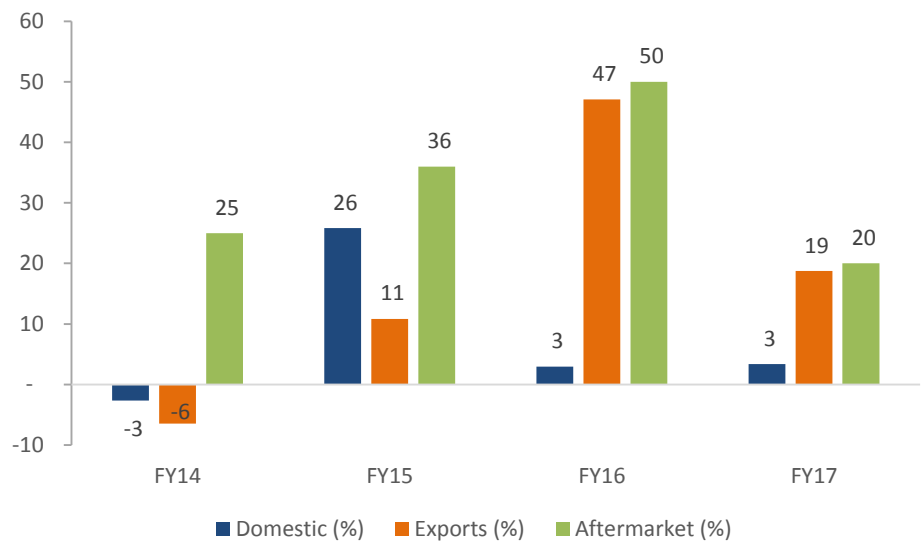
Source: Company Data, IIFL Research

RoCE = EBIT / Average capital employed

RoE = PAT / Average Net worth

RoIC = EBIT / (Average capital employed less cash and liquid investments)

Exhibit 5: Sales growth over the years



After a dip in FY14, domestic and export revenues have seen steady growth led by product diversification and strong underlying growth for the 2W industry. Aftermarket and export sales have grown at 35% and 25% CAGR respectively over FY14-17 (FY18 not yet available)

Source: Company data, IIFL Research

Note: Aftermarket sales are a part of domestic sales

Auto component sector poised for robust growth: The Indian auto component sector is set to grow at a swift pace over the next 2-3 years (refer exhibit 6) due to factors such as (a) strong underlying demand (volume growth), (b) demand arising from new emission norms (BS-VI), which come into effect from April 1, 2020 and (c) increasing trend of localization of automobile components, as OEMs prefer cheaper locally produced components vs. costlier imports.

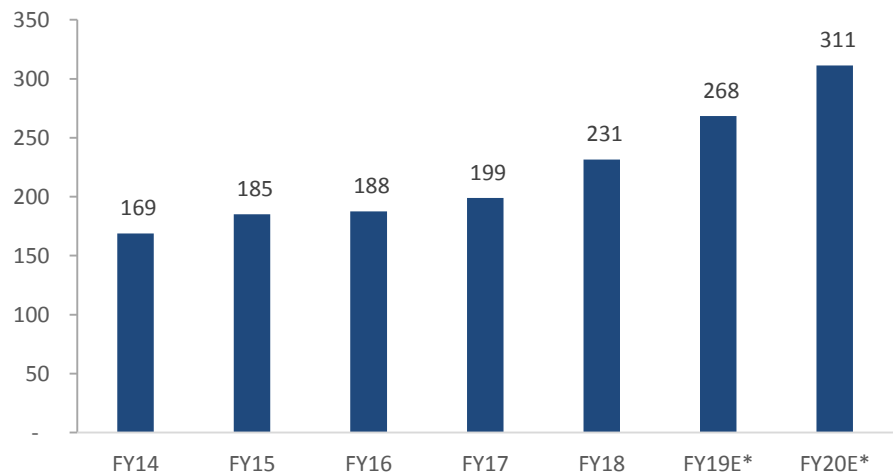
Exhibit 6: Auto Component industry projections

Particulars	Unit	FY2017	FY2020E	CaGR
Domestic auto component industry size	\$ bn	43.52	100.00	32.0%
Auto component exports from India	\$ bn	11.20	40.00	52.9%
Domestic component after-market	\$ bn	8.44	11.39	10.5%

Source: Indian Brand Equity Foundation (IBEF under the Ministry of Commerce and Industry), Automotive Component Manufacturers' Association of India (ACMA)

Two wheeler production is expected to grow at 16% CAGR until FY2020E, as per data from IBEF (refer Exhibit 7). This will be led by strong domestic demand, increasing trend of “scooterization” and growing emphasis on exports. This augurs well for INEL, which derives majority of its revenues from two wheelers.

Exhibit 7: Two Wheeler production (Lakh units)

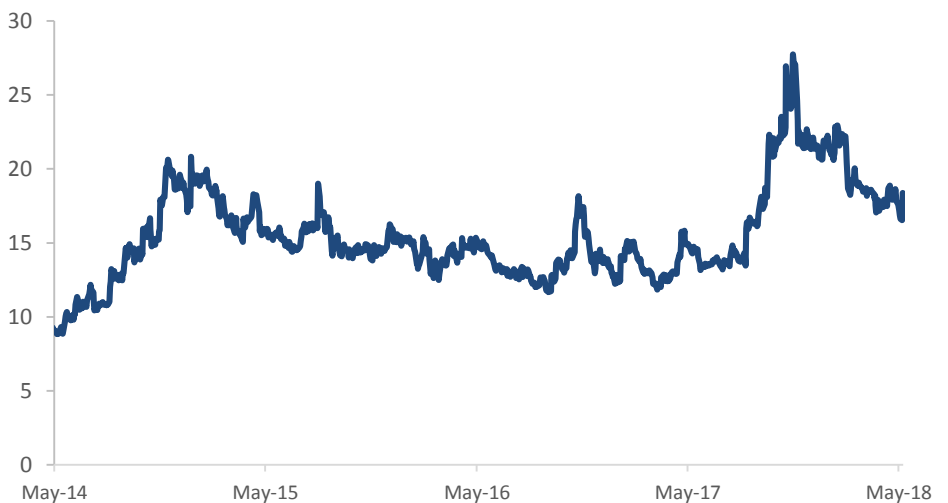


Two wheeler production is set to grow at 16% CAGR over FY18-20E against growth of 8% CAGR over FY14-18

Source: Historical data from SIAM
 *Projections from IBEF

Rationale for the PE multiple: In our opinion, a company like INEL, which has zero debt on books, high return ratios, improving financial performance and a credible management pedigree deserves premium valuation. The stock is currently trading at a forward PE of 17x (refer exhibit 8), which is at a 34% discount to its peak PE multiple of 28x. Currently, the stock is trading at the average of its 52 week forward PE multiple.

Exhibit 8: One year Forward PE chart



Source: ACE Equity, IIFL Research

Key Risks:

- ✧ Cyclical in automobile sector, especially 2Ws.
- ✧ Input cost inflation, namely steel, aluminum, copper, etc.
- ✧ Increasing competitive intensity, aggressive pricing strategy by competitors.

Recommendation Parameters for Fundamental/Technical Reports:

Buy – Absolute return of over +10%

Accumulate – Absolute return between 0% to +10%

Reduce – Absolute return between 0% to -10%

Sell – Absolute return below -10%

Please refer to <http://www.indiainfoline.com/research/disclaimer> for recommendation parameter, analyst disclaimer and other disclosures.

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