OBSC PERFECTION

Long Term Recommendation | BUY

CMP: INR 245 | TP: INR 360 | Upside: 53%

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The CUB series

Under the 'CUB' series, we cover smallcap companies with a robust long-term growth potential.

Our endeavour is to recommend smallcap companies that are not widely covered.

Despite low liquidity and small size of the business, these companies boast of strong long-term fundamentals and sustainable structural growth drivers.

In our view, investment themes in equity markets play out over the long-term with potential payoffs taking time to materialise.

By introducing the CUB series, our objective is to identify quality smallcap companies in the early stages of their growth cycle.

Company profile

A precision equipment manufacturing company

- It was set up in 2017 as JV of OBSCPL and Leekha family (see Slide 31).
- OBSCP is part of the machining industry, with a key focus on the auto sector.
- Its main products include piston rods, connecting rods, and steering knuckles (see Slide 29).
- It operates in four industries: auto (93%), defence and marine (7%), and telecom.
  - Recently, it ventured into the defence business. Segmental order book stands at INR50cr.
  - The management is looking to foray into aerospace and the wind segment.
- Its key customers include ZF India Pvt, Tenneco, Tata AutoComp Systems, Forurecia, Mahle, HL Mando (see Slide 30).
- It has four plants, three in Pune and one in Chennai. A plant is coming up in Gujarat.
- Recently, it raised INR66cr from an IPO. The issue proceeds will be used for capex (~INR30cr), working capital (~INR17cr), and general corporate purposes (~INR12cr).
- Financials (see Slide 16)
  - It expects to end FY25 with a revenue of ~INR145cr with exports of 25–27%.
  - It is targeting an EBITDA/PAT margin of 18%/11% in FY25.
  - Order book stands at INR380cr (INR360cr at the time of its IPO).
- Liquidity though is limited with average daily trading volumes of 4.5% of its free float.

INR cr, unless specified	FY25
Revenue	144
EBITDA	26
EBITDA margin (%)	*18*
PAT	15
PAT margin (%)	*11*
EPS (INR)	7.39
Share price (INR)	235
M-cap	575
P/E ratio (x)	30.6

Source: Company, Nuvama Wealth Research, Bloomberg

Investment rationale

Potential for exponential revenue and PAT growth

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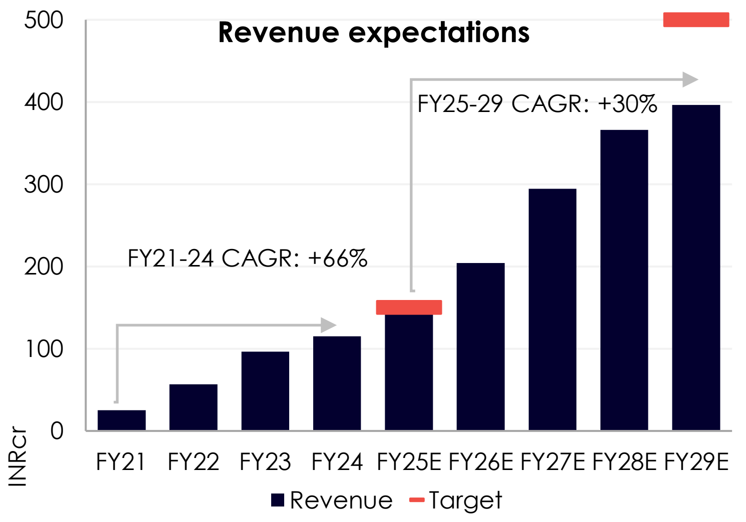
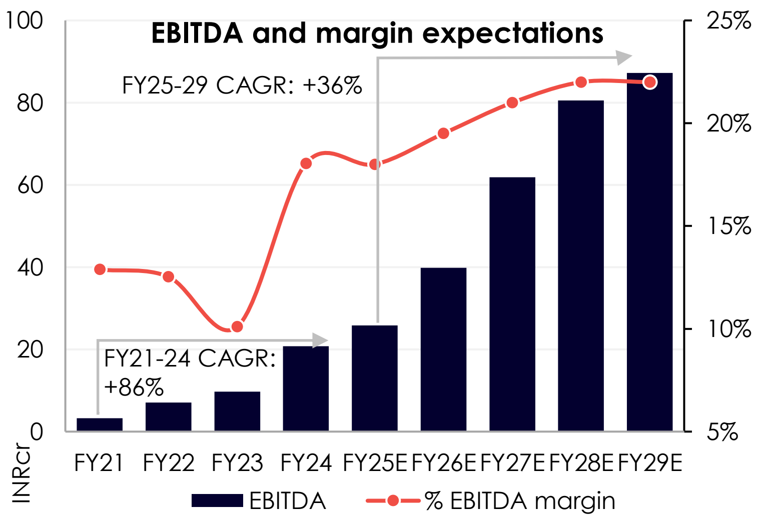
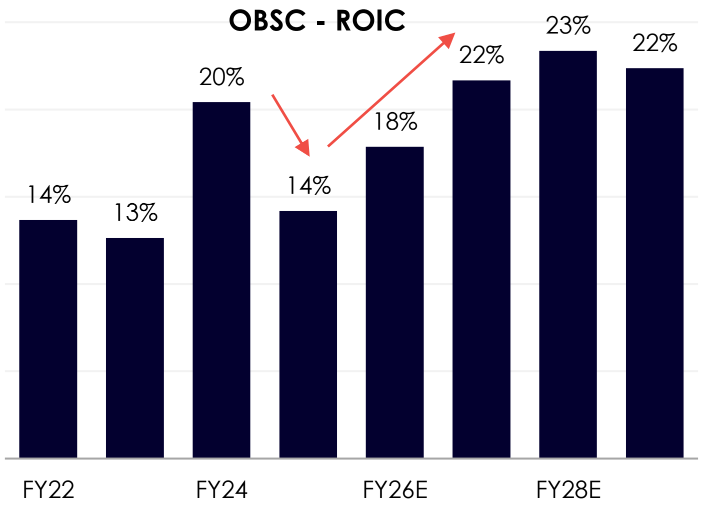
Investment rationale

See exponential growth in revenue and EBITDA

- The Indian machining industry is poised for growth as European suppliers boost outsourcing to low-cost countries.
- Revenue/EBITDA is set to grow by ~3x/~4x by FY28, implying a CAGR of 36%/50% over FY25–28.
- The management expects margin tailwinds from growth in the ASP and change in the export mix. It is targeting a margin expansion of more than 400bp in the medium term.
- We see PAT increasing to ~INR60cr by FY28 (57% CAGR over FY25–28), with a PAT margin of ~15%.
- RoIC is likely to decline in FY25 as the full potential of increased capex is not realised. OBSCP expects RoIC to increase to 22%/23% by FY27/FY28 from 20%/14% in FY24/FY25.



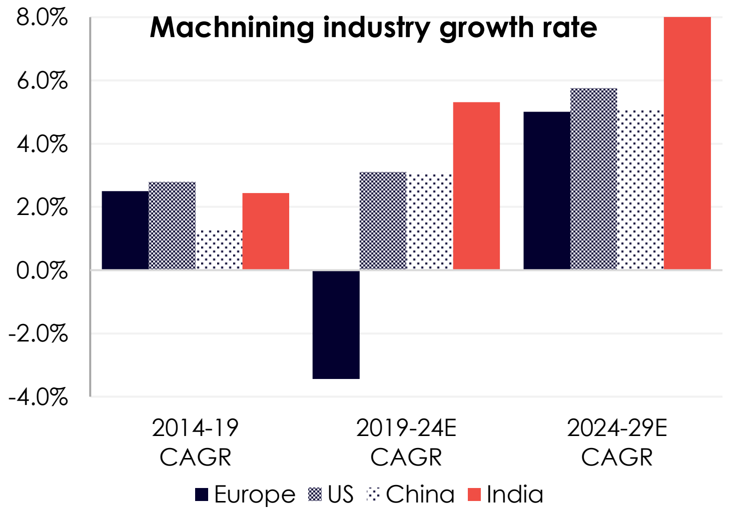


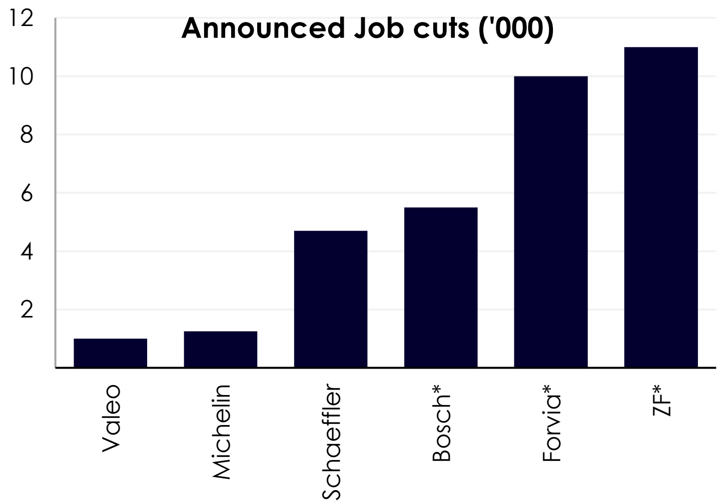


Source: Company, Nuvama Wealth Research

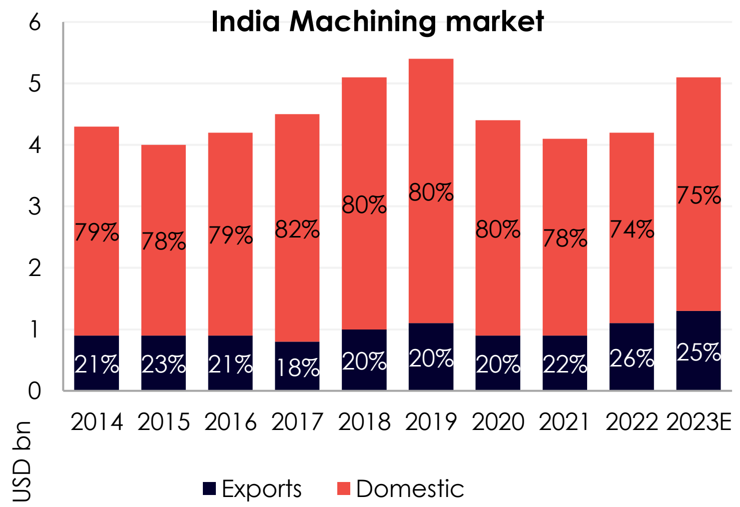
India's machining industry is poised for growth

- Globally, the machining industry is pegged ~USD53bn and is expected to grow at 5.4% CAGR over 2023–29. Automotive constitutes the biggest end user industry, accounting for ~85% of the total value.
- The Indian machining market is estimated at USD5.3bn (or ~10% of the global market). It is expected to clock 8% CAGR over 2023–29 as against a global growth of 5.4%.
- Exports from India gathered pace over the last two years (~20% CAGR over 2021–23). This growth rate is expected to continue as global suppliers are increasingly looking to cut costs.
- Both forging and machining are: i) energy intensive, and ii) have higher emissions and wastage. With an increase in emission regulations and energy prices, global suppliers are outsourcing to low-cost countries (refer Slide 33 for announced job cuts).





Note: Bosch job cuts is by 2032, Forvia and ZF is by 2028

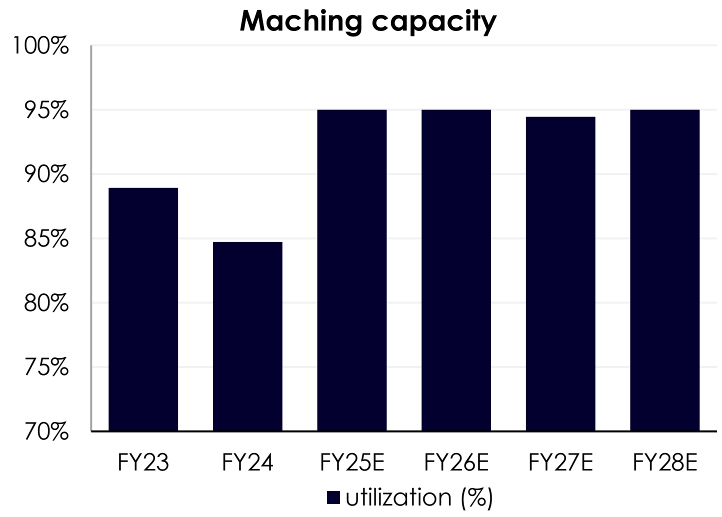


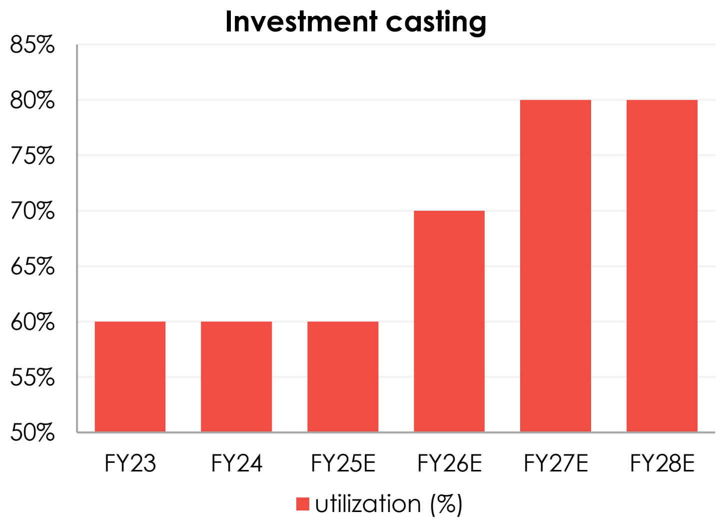
Source: Happy Forgings' prospectus, Ricardo report, Reuters for job cuts

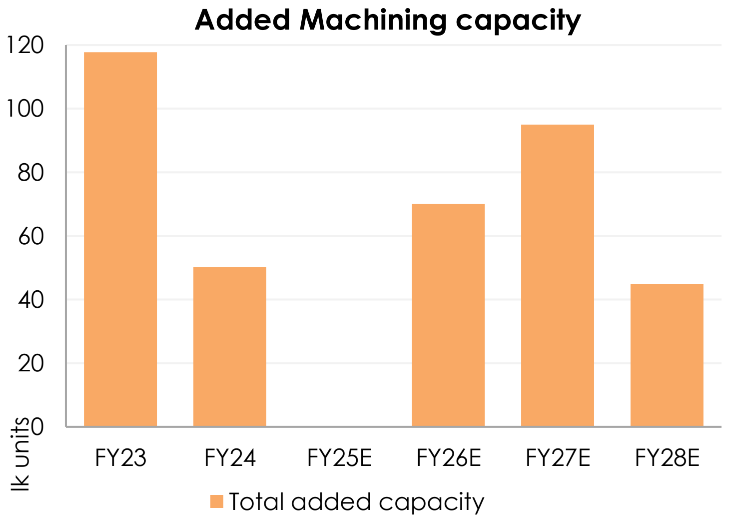
Incremental capacity to drive revenue growth

Adding new capacity of 60lk units over the next two years

- It has four plants, three in Pune and one in Chennai. A plant is coming up in Gujarat.
- Though machining capacity exists in all plants, is adding capacity of 25lk/35lk units at its Pune/Chennai plant to cater to growing demand.
- Investment casting (IC) is available only at the second unit in Pune as it is required for few components. IC is high energy and labor intensive, but capex requirement is much less.
- A further capacity addition is seen in 12–18 months.
- Not many details are available on its upcoming plant in Gujarat. We expect Start of operations in FY27.



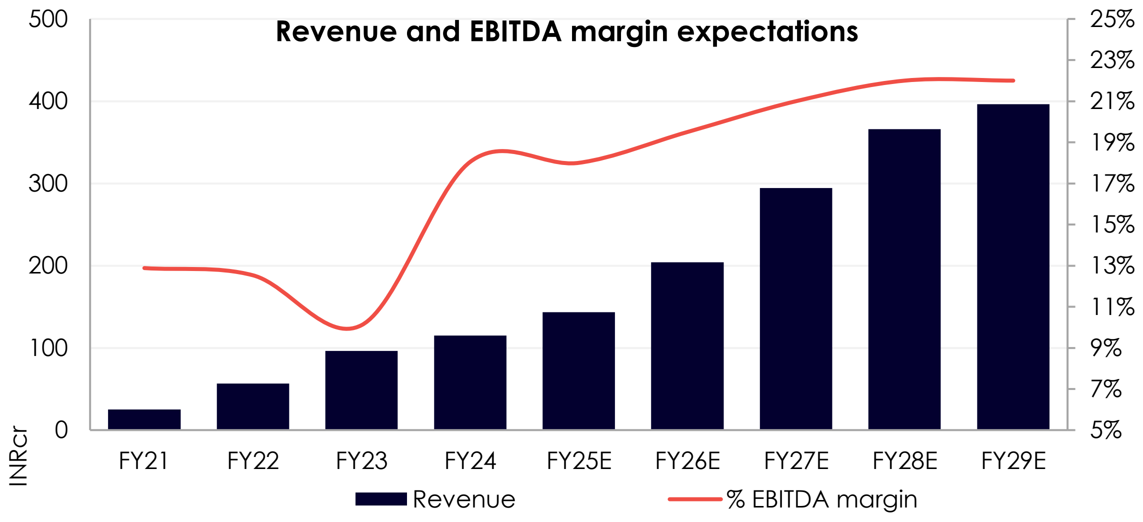


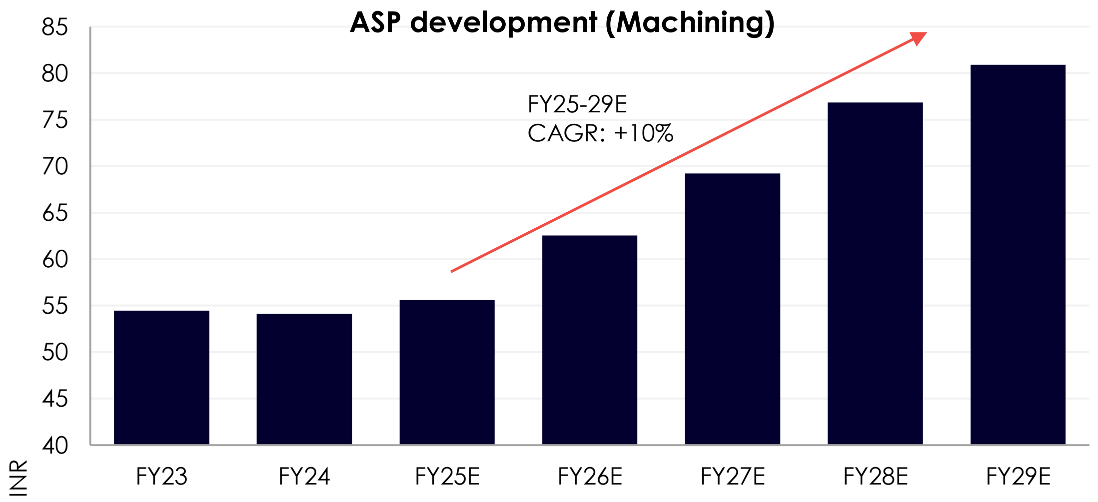


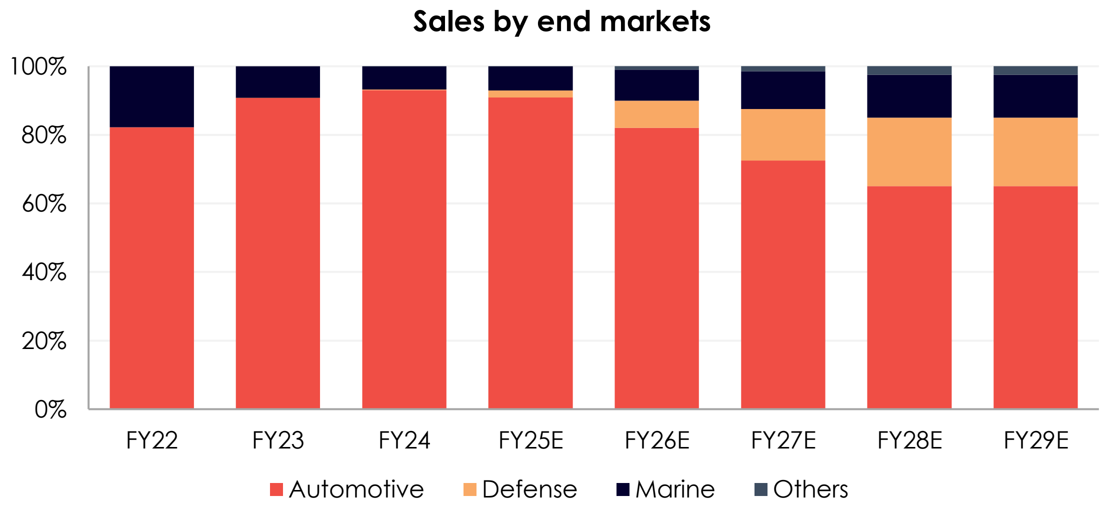
Source: Company, Nuvama Wealth Research

Revenue to grow 3x by FY28

- Growth in capacity will drive revenue to ~INR400cr by FY29. However, it is still below the management's target of INR500cr.
- It may need to add capacity to achieve its FY29 revenue guidance of INR500cr.
- There is strong scope of ASP development as sales in higher-priced segments like defence and marine grows.
- Revenue mix by segments: auto (65%), defence (20%), marine (~15%), and others (5%).



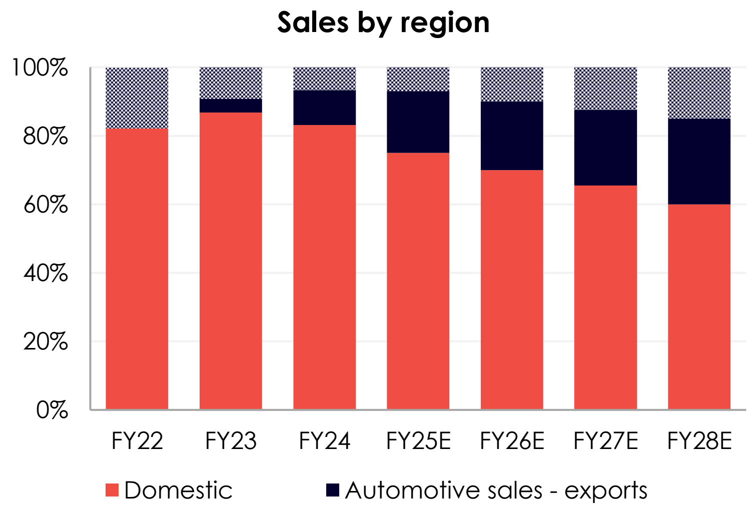


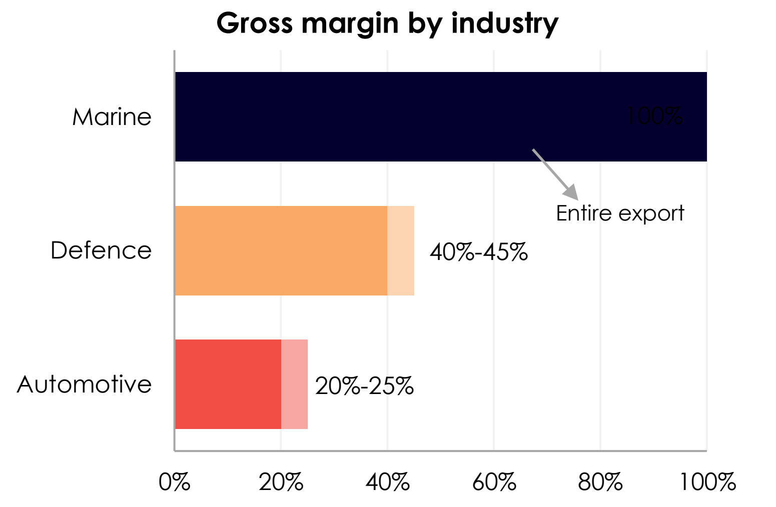


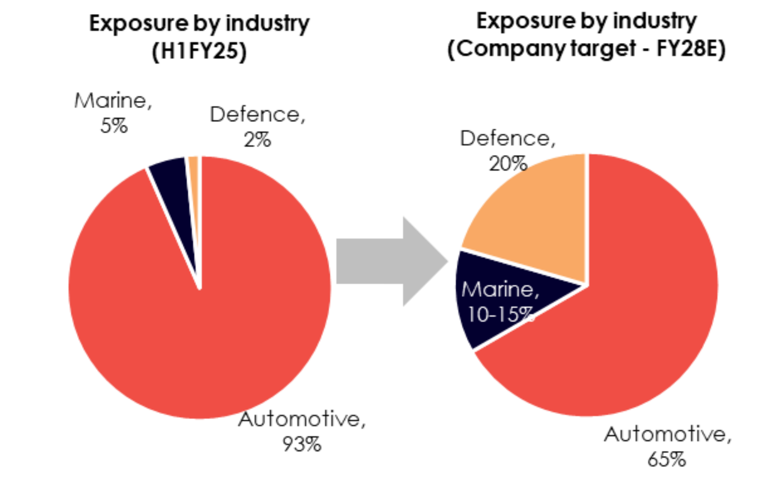
Source: Company, Nuvama Wealth Research

Segment and export mix to provide tailwinds of 8–9%

- The focus is on higher profitable sectors of defence and marine.
- Change in the export mix will provide a medium-term tailwind of 8–9%.
- Order book is supportive of growth expectations (defence/exports: ~INR150cr/~INR140cr).
- It caters to domestic clients in the marine segment.
- It aims to increase exports to 40% by FY29 from 23%/17% in H1FY25/FY24.
- The management is looking to foray into aerospace and the wind segment.



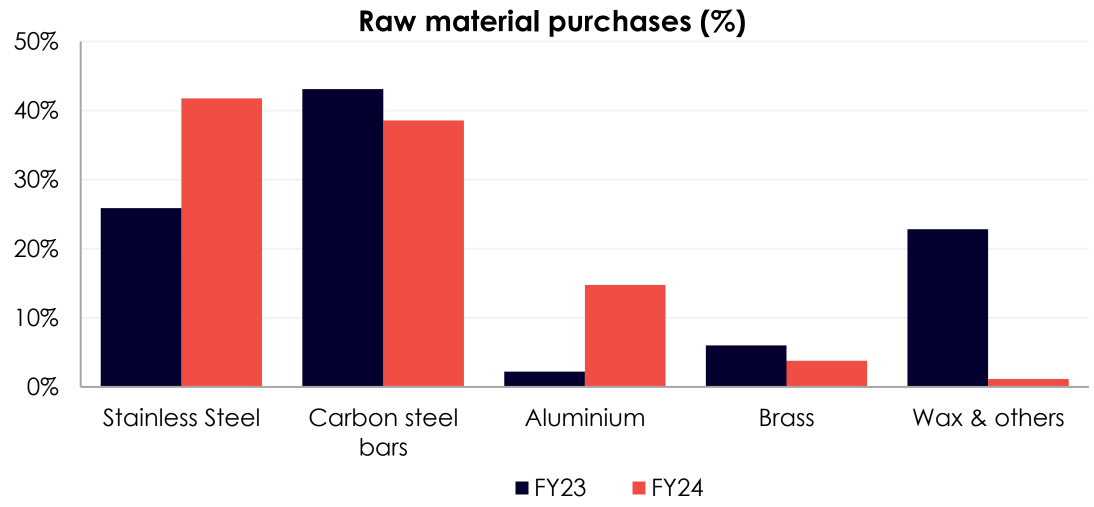


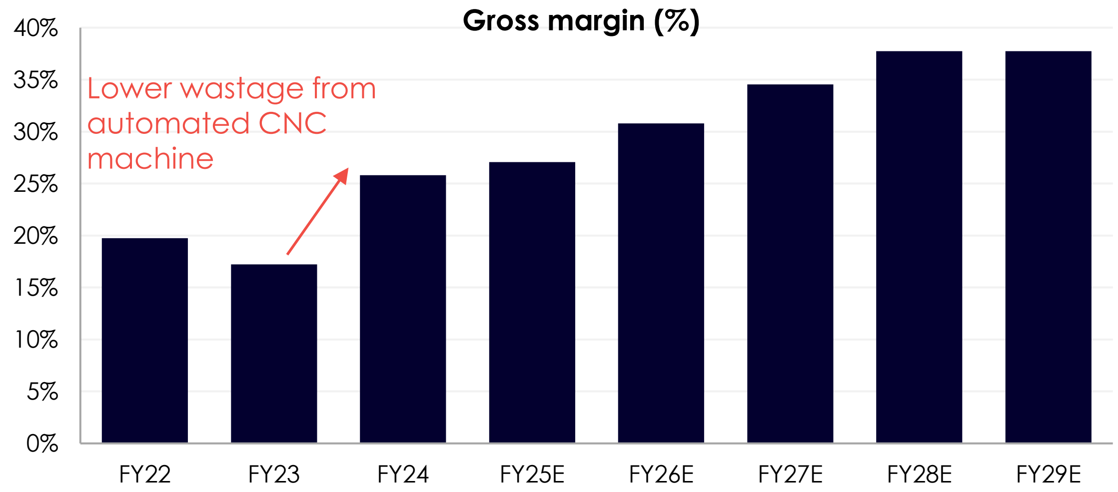


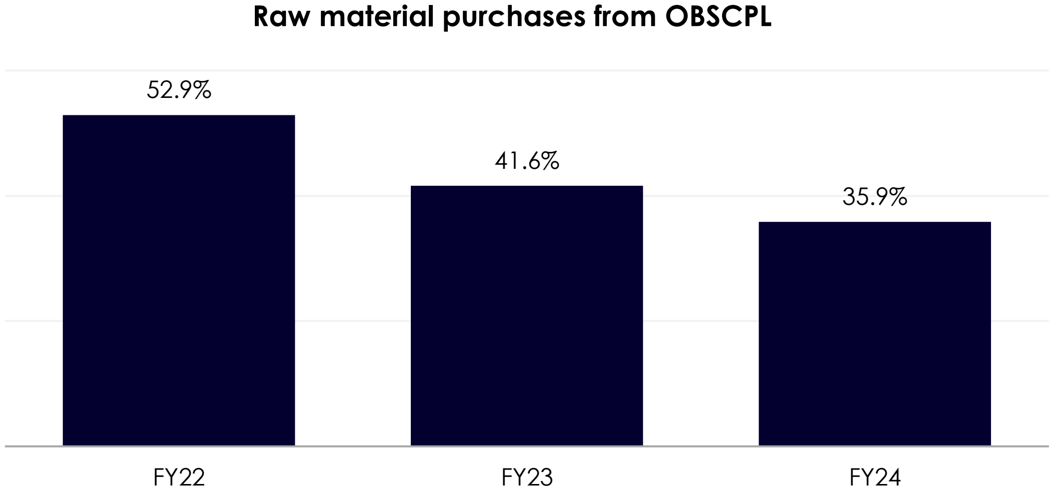
Source: Company, Nuvama Wealth Research

See 10% improvement in gross margin by FY28 and FY29

- We expect a medium-term tailwind of ~10% on account of: i) a better product mix, and ii) greater efficiency of an automated CNC machine.
- There is lower raw material wastage from an automated CNC machine vis-à-vis a domestic machine, thus reducing purchase cost as visible from the surge in gross margin to 25% in FY24 from 17% in FY23.
- There is inherent hedging in carbon steel bars as OBSCPL is the biggest raw material supplier.





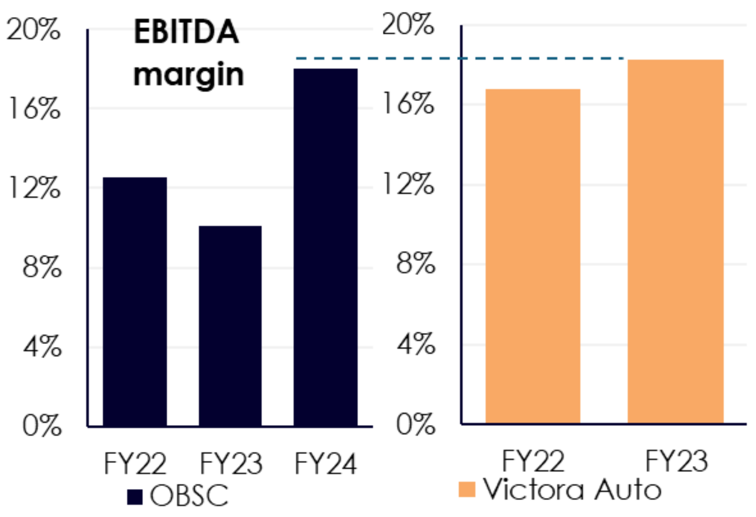


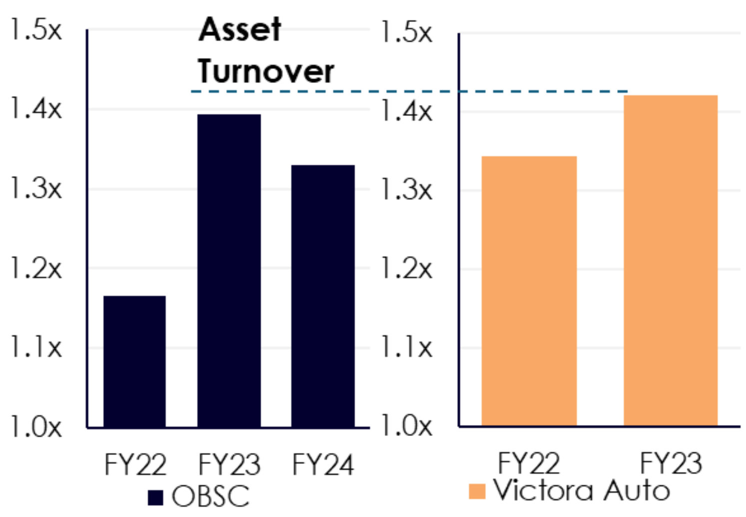
Source: Company, Nuvama Wealth Research

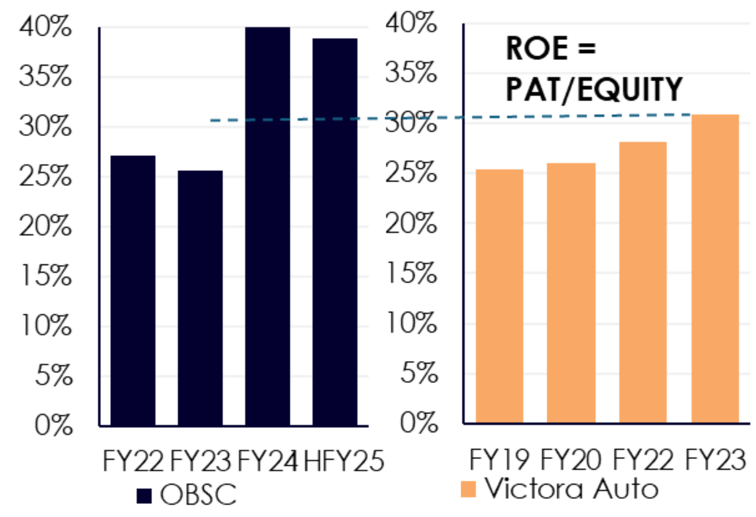
Victora Auto Pvt is its closest competitor

Peer margin and asset turnover provide confidence in OBSCP's growth forecast

- Started in 1991, Victora Auto Pvt (VAPL) shares the same top five customers with OBSCP.
- Like OBSCP (part of the Omega group), VAPL is part of the Victora group, which manufacturers metal sheet, metal components, seat frames, exhaust hangers, and forged auto components.
- VAPL has six manufacturing plants, all based in North India (two each in Faridabad and Haridwar, and one each in Mansear and Greater Noida).
- Exports constitute a major chunk of revenue (73% of FY23 sales).
- VAPL's scale advantage is visible with a consistent EBITDA margin of ~18% in FY23).
- This provides us confidence that OBSCP will be able to maintain EBITDA margin at 18%.
- *Note: Victora Auto is private company with limited public data. We don't have FY24 data for Victora Auto*







Valuation and risks

Initiate coverage with a ‘BUY’ rating and TP of INR360

Valuation and view

See bull case of INR450 and sales of INR500cr

- We have arrived at our TP using the blended average of FY27 and FY28 earnings and a 20% discount to its three-year forward peer multiples.
- We used a one-year forward multiple and discounted it at WACC for three years to arrive at our target multiple.
- As OBSCP has no direct peer in the listed auto space, we have used Happy Forgings and Bharat Forge to arrive at our target multiple.
- We initiate coverage with a 'BUY' rating and a TP of INR360, an upside of 53% from its CMP.
- Our bull case of INR450 is predicated on the company achieving sales of INR500cr.
- Our base case is driven by the management's guidance that its order book supports its capacity expansion plan. We did not consider a top-down approach in this report.

	EBITDA FY27/FY28	P/E ratio FY27/FY28
Target multiple (x)	**11.8**	**20**
Implied premium to industry average (%)	**-20**	**-19**
Peer multiple (current, x)	14.7	24.6
Fundamental value (from model)	7,118	19.3
Enterprise value	**83,993**	**1,232**
Net debt (FY25)	1,222	1,222
Minorities	0	0
Equity value	**82,771**	**9**
No. of shares (FY25)	245	245
Value per share	**338**	**386**
Weightage	*50%*	*50%*
SoTP-based TP	**360**	
Current price	235	
Upside (%)	**53**	

Source: Company, Nuvama Wealth Research. *Peer multiple is calculated by taking the 12-month forward multiples and then discounting it at WACC for three years

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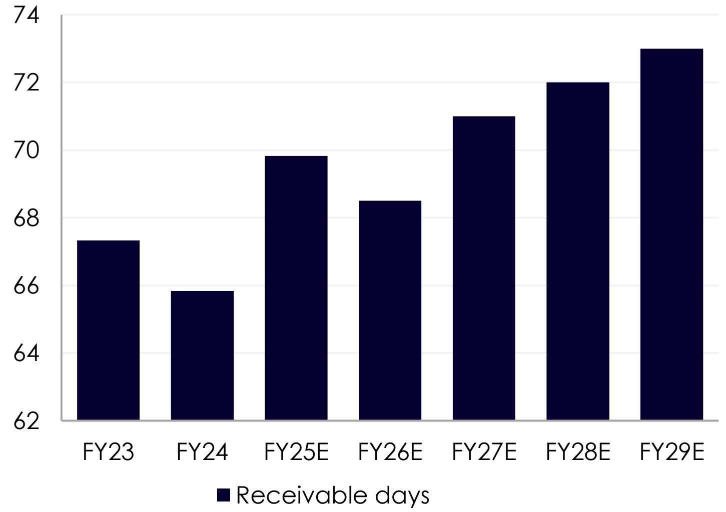
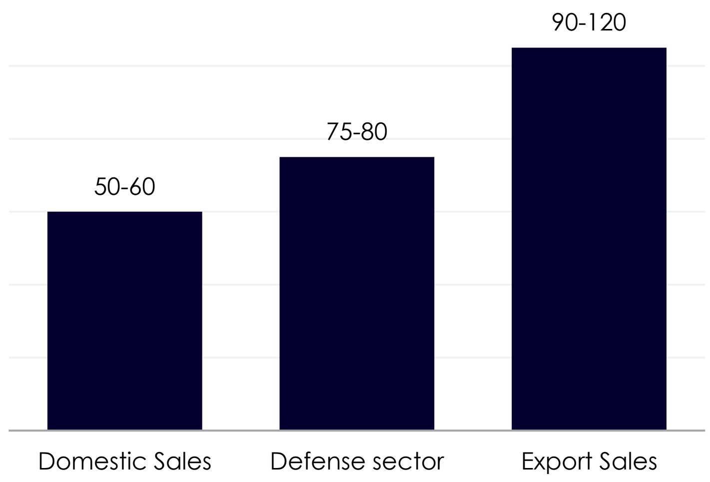
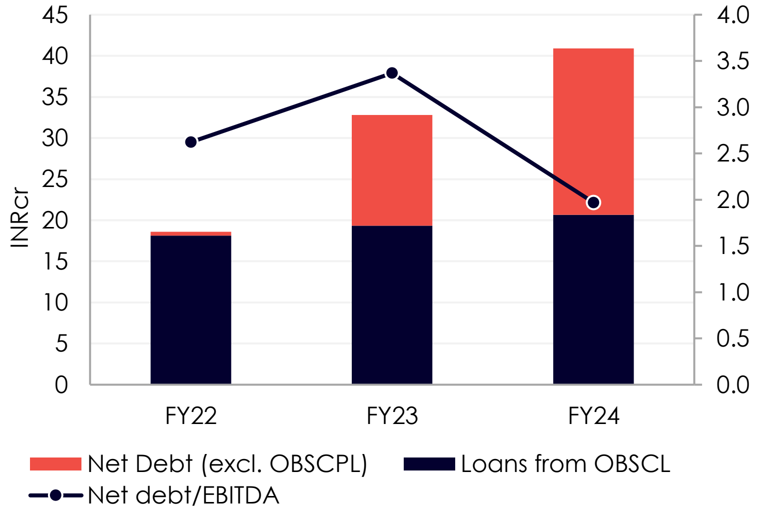
Risks

Cash conversion cycle a key risk; revenue target may need extra fund raising

- As marine sales are completely US driven, any adverse impact in the US market will lead to lower marine sales.
- Cash conversion cycle is a key risk as the contribution from exports is set to increase.
- Its current capacity expansion plans may not be sufficient to achieve its revenue target of INR500cr by FY29.
- Debt levels are higher, but this is primarily due to loans of ~INR20cr from OBSCPL.
- Increased weightage of Aluminum as a production metal will lead to greater supply chain risks since the Omega group doesn't supply this product.







Source: Company, Nuvama Wealth Research

Financials

OBSCP

Financial summary

Income Statement (INR cr, unless specified)

Year to March	FY22	FY23	FY24	FY25	FY26	FY27	FY28	FY29
Income from operations	57	96	115	144	204	295	366	396
Direct costs	43	72	66	80	106	142	165	179
Employee benefits expenses	2	3	4	6	8	12	13	14
Other Expenses	3	4	5	7	15	28	45	49
Operating exepenses	49	87	94	118	164	233	285	309
EBITDA	**7**	**10**	**21**	**26**	**40**	**62**	**81**	**87**
Depreciation and Amortisation Expense	1	2	3	4	5	7	9	10
EBIT	**6**	**8**	**18**	**22**	**35**	**54**	**71**	**77**
Finance Costs	1	2	3	3	4	4	4	4
Other Income	0	1	1	2	3	5	6	7
Profit before Tax (PBT)	4	6	16	21	34	55	74	80
Tax Expense	1	2	4	6	9	15	20	22
Net profit for the year	4	5	12	15	25	40	54	59
EPS, Diluted	**2.02**	**2.56**	**6.84**	**7.39**	**10.16**	**16.52**	**22.05**	**24.02**

Common size metrics - as % of revenues

Year to March	FY22	FY23	FY24	FY25	FY26	FY27	FY28	FY29
Operating expenses	87.5%	89.9%	82.0%	82.0%	80.5%	79.0%	78.0%	78.0%
Depreciation	2.6%	2.2%	2.4%	2.5%	2.5%	2.5%	2.5%	2.5%
Interest expense	2.6%	1.9%	2.3%	2.0%	1.8%	1.3%	1.0%	0.9%
EBITDA margin	**12.5%**	**10.1%**	**18.0%**	**18.0%**	**19.5%**	**21.0%**	**22.0%**	**22.0%**
EBIT margin	9.9%	7.9%	15.7%	15.5%	17.0%	18.5%	19.5%	19.5%
Net profit margin	6.4%	4.7%	10.6%	10.6%	12.2%	13.7%	14.7%	14.8%

Growth Metrics

Year to March	FY22	FY23	FY24	FY25	FY26	FY27	FY28	FY29
Revenues	125%	70%	19%	25%	42%	44%	24%	8%
EBITDA	119%	37%	113%	24%	54%	55%	30%	8%
PBT	346%	46%	161%	27%	63%	63%	34%	9%
Net profit	205%	27%	167%	25%	63%	63%	34%	9%
EPS	NA	27%	167%	8%	38%	63%	34%	9%

Ratios

Year to March	FY22	FY23	FY24	FY25	FY26	FY27	FY28	FY29
Gross margin	19.6%	23.9%	39.4%	43.0%	47.1%	51.1%	54.5%	54.5%
Current ratio	1.3	1.1	1.5	2.6	2.6	2.7	3.2	3.7
Inventory days	39.4	29.2	37.3	51.8	43.8	34.3	35.1	36.5
Receivables days	89.5	67.3	65.8	69.8	64.1	59.2	64.6	69.7
Payables days	76.9	55.5	42.7	39.8	35.3	29.6	30.5	31.7
Cash conversion cycle	52.0	41.0	60.5	81.8	72.6	64.0	69.2	74.5
Net debt /EBITDA	2.6x	3.4x	2.0x	0.5x	0.4x	0.3x	0.0x	-0.3x

Balance Sheet (INR cr, unless specified)

Year to March	FY22	FY23	FY24	FY25	FY26	FY27	FY28	FY29
PPE	22	30	41	75	100	122	146	168
Capital Work in progress	2	5	2	9	9	9	9	9
Long term loans & Advanes	0	1	1	2	2	2	2	2
Total non-current assets	**24**	**36**	**44**	**86**	**111**	**133**	**157**	**179**
Inventories	7	9	15	26	23	32	38	41
Trade receivables	16	20	22	33	38	57	72	79
Cash and cash equivalents	0	1	1	40	38	36	51	80
Other current assets	1	4	5	4	4	4	4	4
Total current assets	**24**	**33**	**42**	**104**	**104**	**130**	**166**	**205**
Total Assets	**48**	**69**	**87**	**190**	**215**	**263**	**322**	**384**
Total Equities	**13**	**18**	**30**	**111**	**136**	**177**	**231**	**289**
Long Term Borrowings	16	19	26	37	37	37	37	37
Other Long term liabilities	1	1	2	2	2	2	2	2
Total Non Current liabilities	**17**	**20**	**27**	**39**	**39**	**39**	**39**	**39**
Short Term Borrowings	3	15	16	15	15	15	15	15
Trade payables	14	15	12	20	20	28	33	36
Other current laibilities	1	1	2	4	4	4	4	4
Total Current liabilities	**18**	**31**	**29**	**39**	**39**	**47**	**53**	**55**

Cash Flow (INR cr, unless specified)

Year to March	FY22	FY23	FY24	FY25	FY26	FY27	FY28	FY29
Profit before tax	4	6	16	21	34	55	74	80
Add: D&A	1	2	3	4	5	7	9	10
(Less) Other Income / (Add) financial expenses	1	2	3	3	3	3	3	3
Less: change in working capital	-1	-6	-14	-13	-2	-20	-16	-8
Other operating cash flow	0	-2	-2	-4	-9	-15	-20	-22
Net cash flow from operating activities	**6**	**1**	**5**	**10**	**31**	**31**	**51**	**64**
Capex PPE	-6	-14	-11	-45	-30	-29	-33	-32
Free cash flow	**1**	**-12**	**-6**	**-35**	**1**	**2**	**18**	**32**
Other investments	0	0	0	0	1	1	1	1
Net cash flow from investing activities	**-6**	**-14**	**-10**	**-45**	**-29**	**-29**	**-32**	**-31**
Net cash flow from financing activities	**-1**	**13**	**5**	**74**	**-4**	**-4**	**-4**	**-4**

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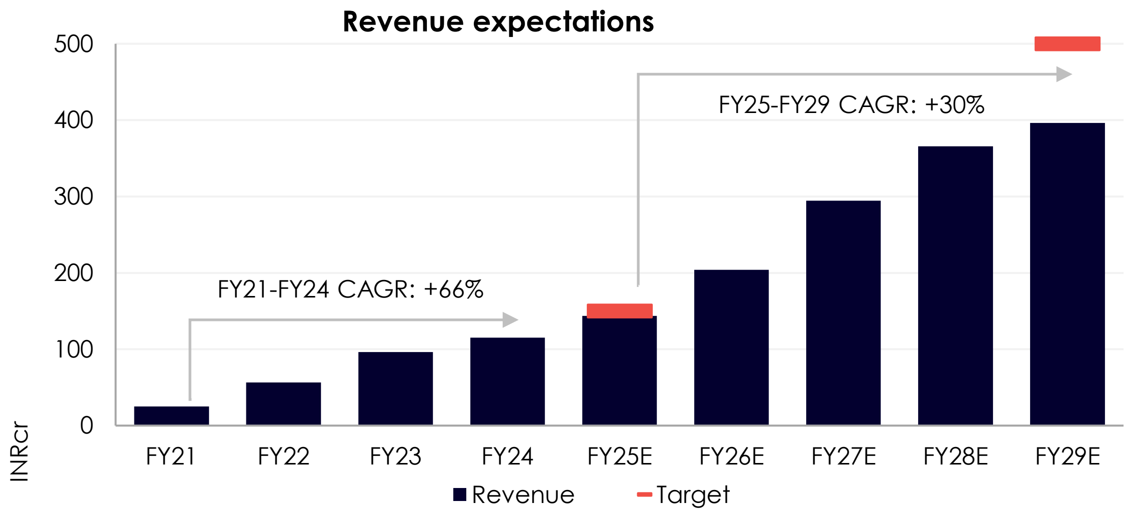
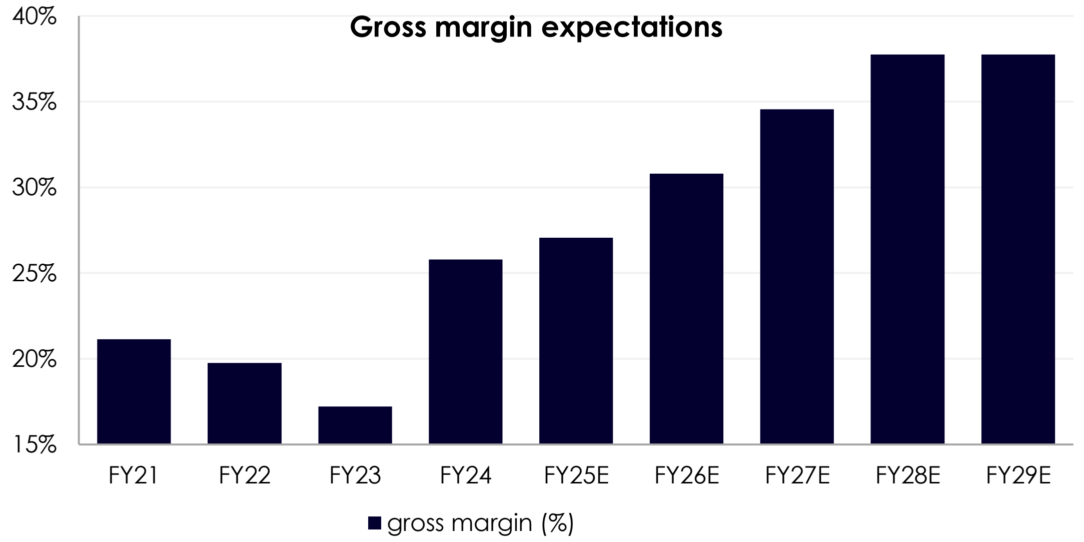
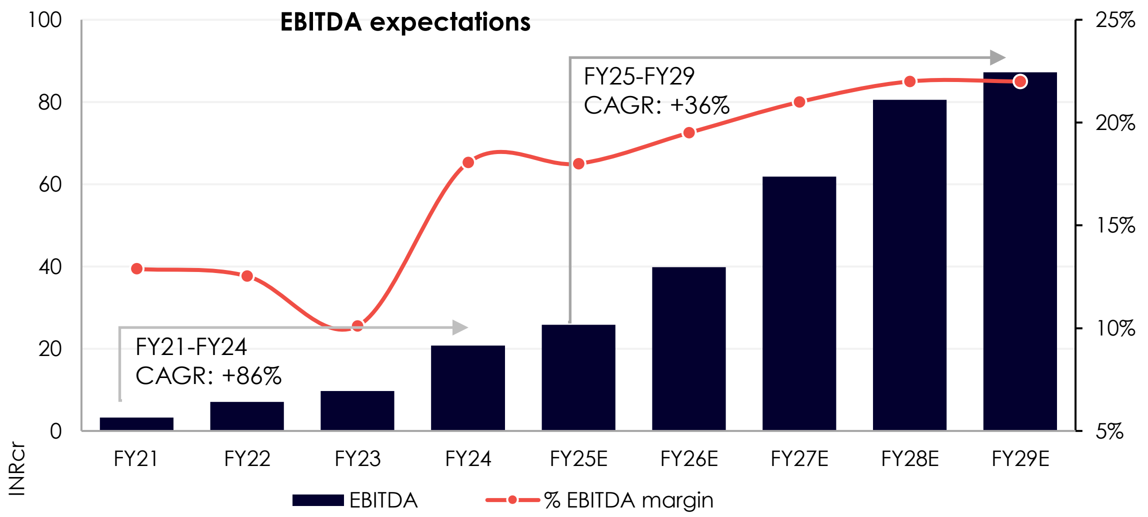
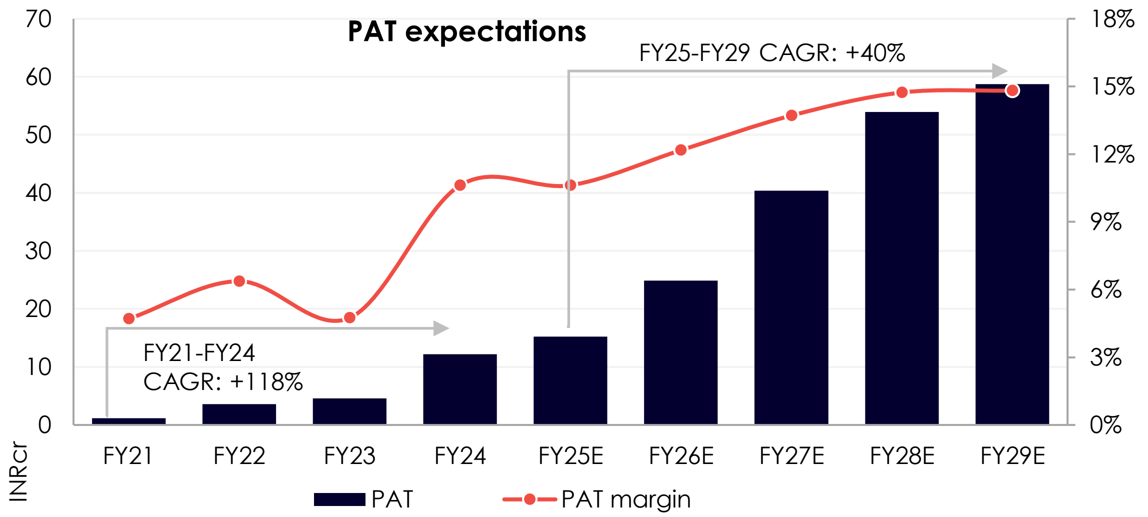
Source: Company, Nuvama Wealth Research

EBITDA/PAT FY25-29 CAGR of 36%/40%



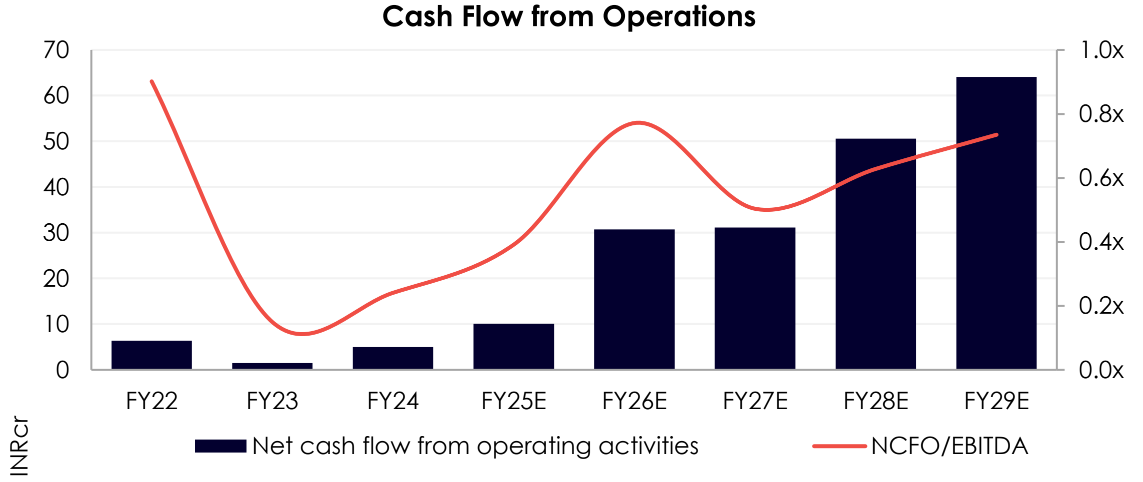


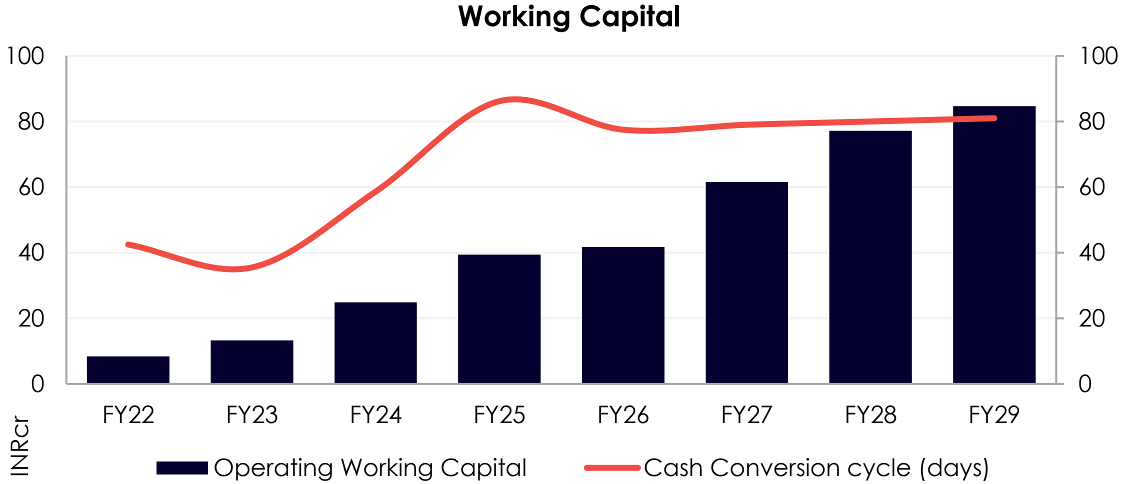


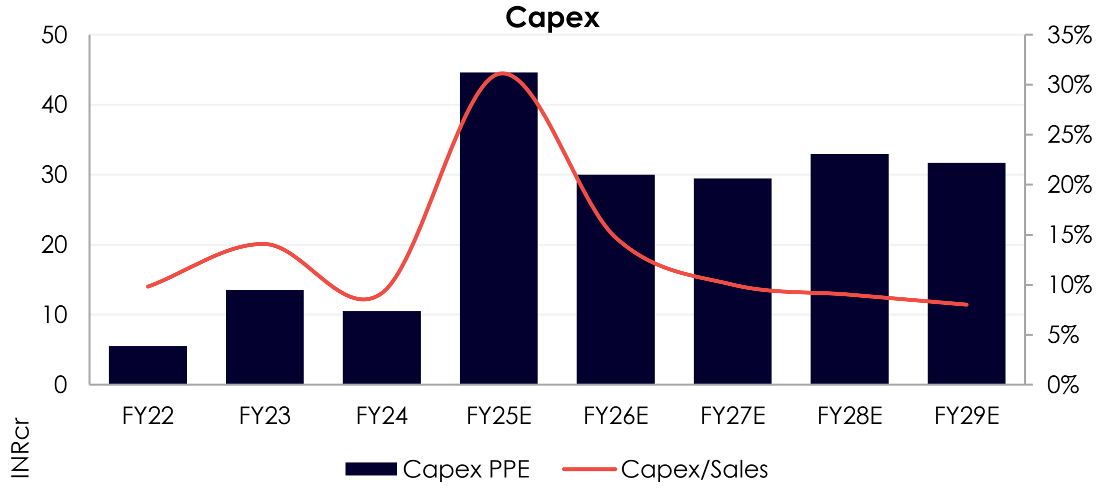


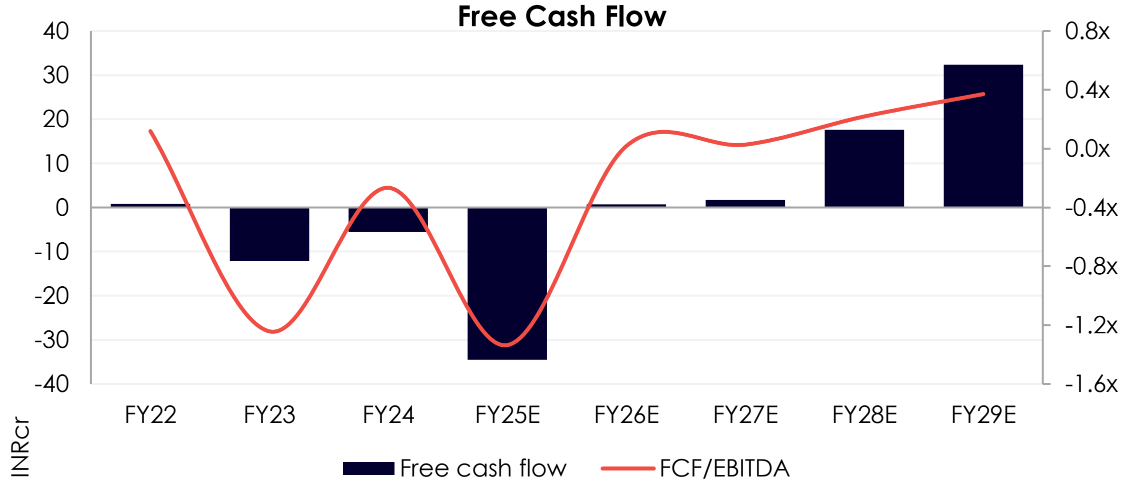
Source: Company, Nuvama Wealth Research

FCF to breakeven in FY26 and reach ~INR20cr by FY28



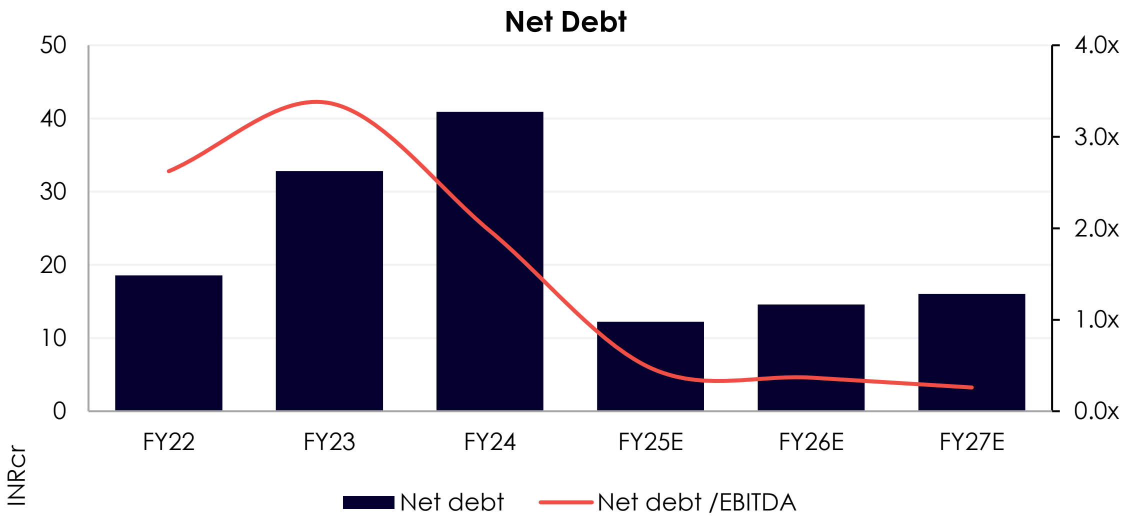


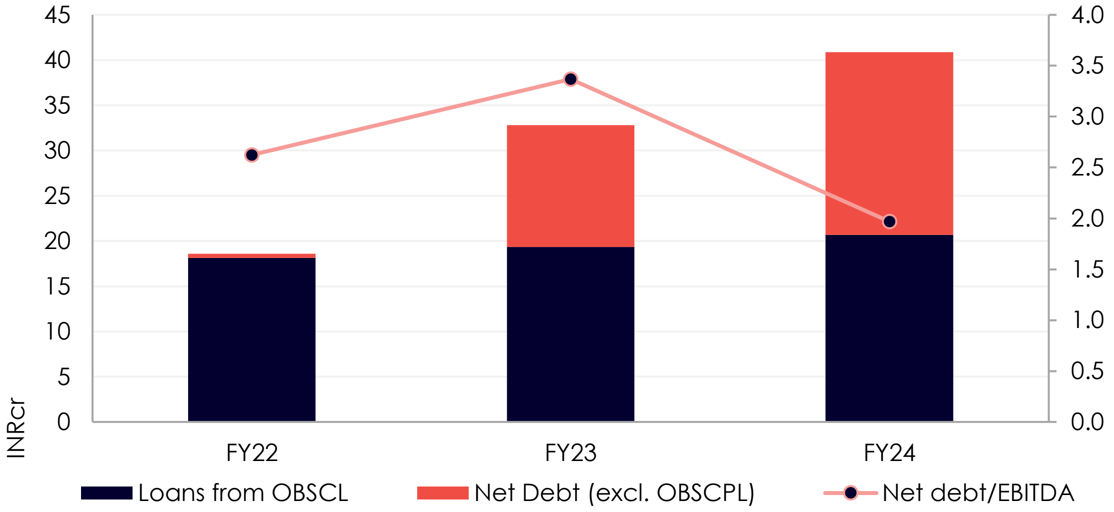


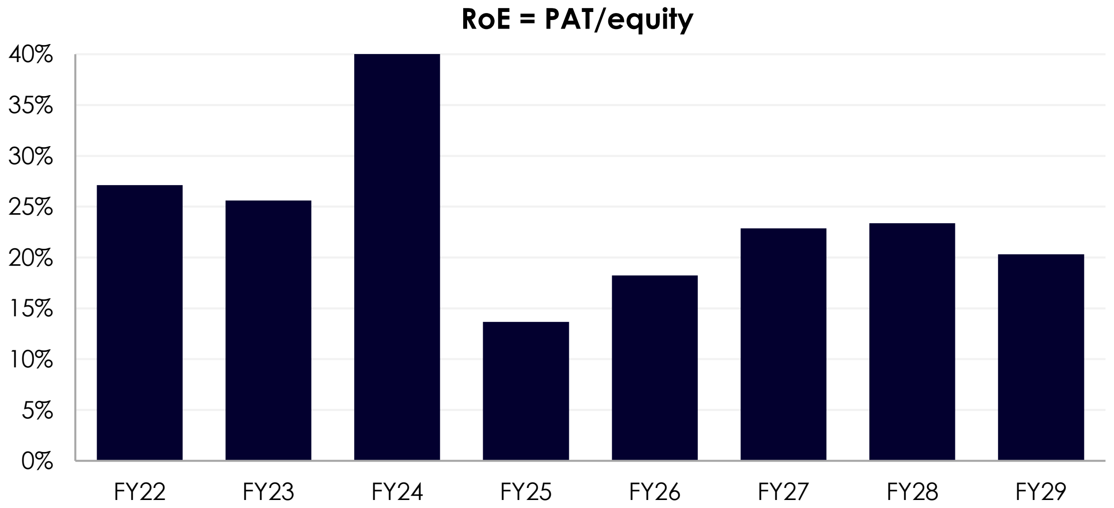


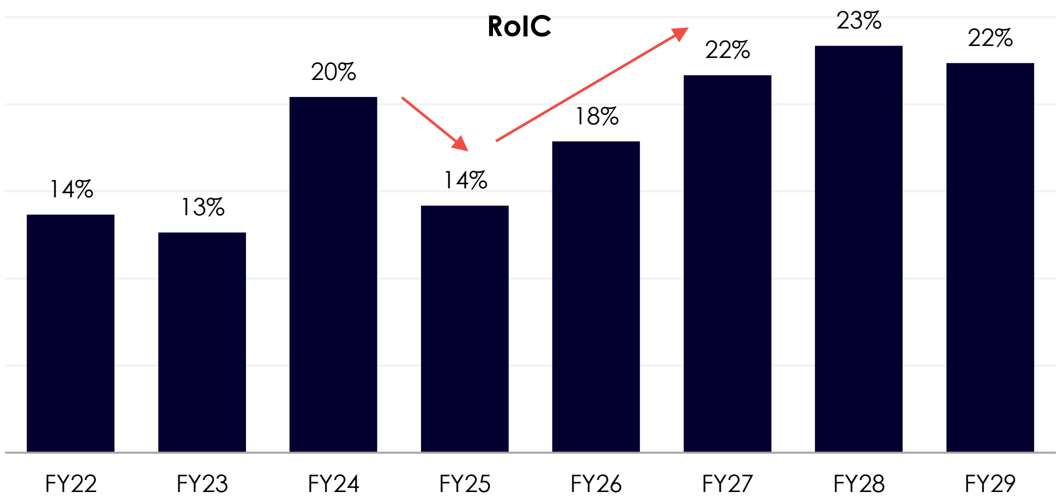
Source: Company, Nuvama Wealth Research

Capacity ramp up to drive improvement in ROIC









Source: Company, Nuvama Wealth Research

RoE driven by lower leverage, to decline in FY25 and FY26

ROE Calculation. Figures in INR cr, unless specified

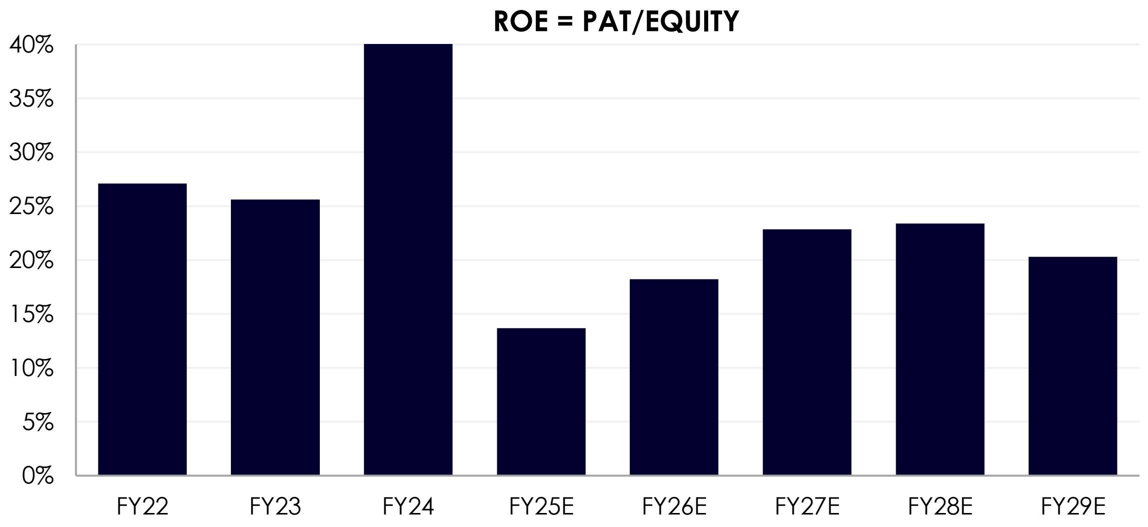
Year to March	FY22	FY23	FY24	FY25	FY26	FY27	FY28	FY29
Sales	57	96	115	144	204	295	366	396
PAT	4	5	12	15	25	40	54	59
Asset	48	69	87	190	215	263	322	384
Debt	35	51	56	78	78	87	92	94
Equity	13	18	30	111	136	177	231	289
ROE = PAT/EQUITY	***27.1%***	***25.6%***	***40.6%***	***13.7%***	***18.2%***	***22.9%***	***23.4%***	***20.3%***
PAT margin	*6.4%*	*4.7%*	*10.6%*	*10.6%*	*12.2%*	*13.7%*	*14.7%*	*14.8%*
Asset turnover	*1.2x*	*1.4x*	*1.3x*	*0.8x*	*1.0x*	*1.1x*	*1.1x*	*1.0x*
Financial leverage	*3.6x*	*3.9x*	*2.9x*	*1.7x*	*1.6x*	*1.5x*	*1.4x*	*1.3x*

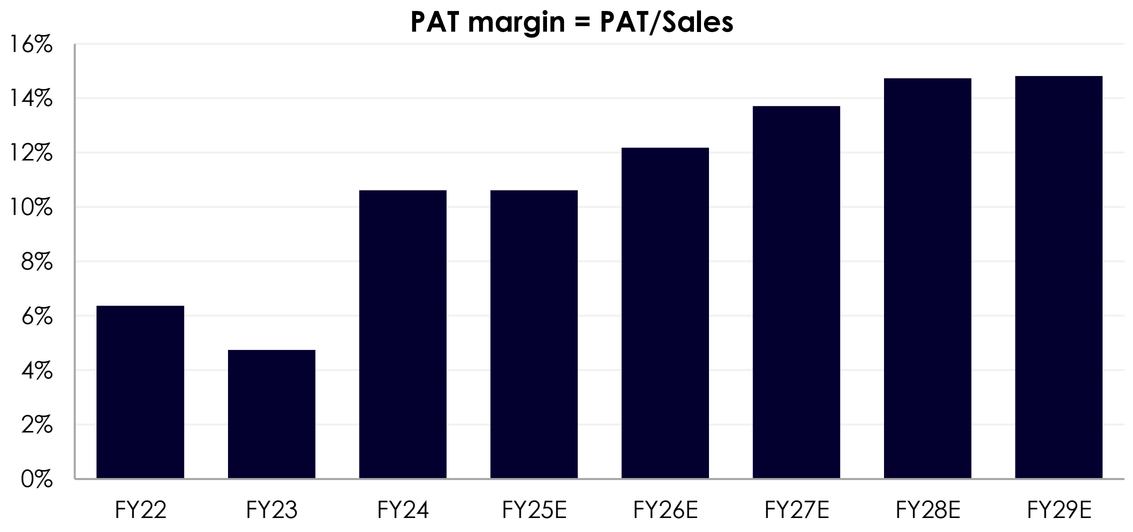
ROIC Calculation. Figures in INR cr, unless specified

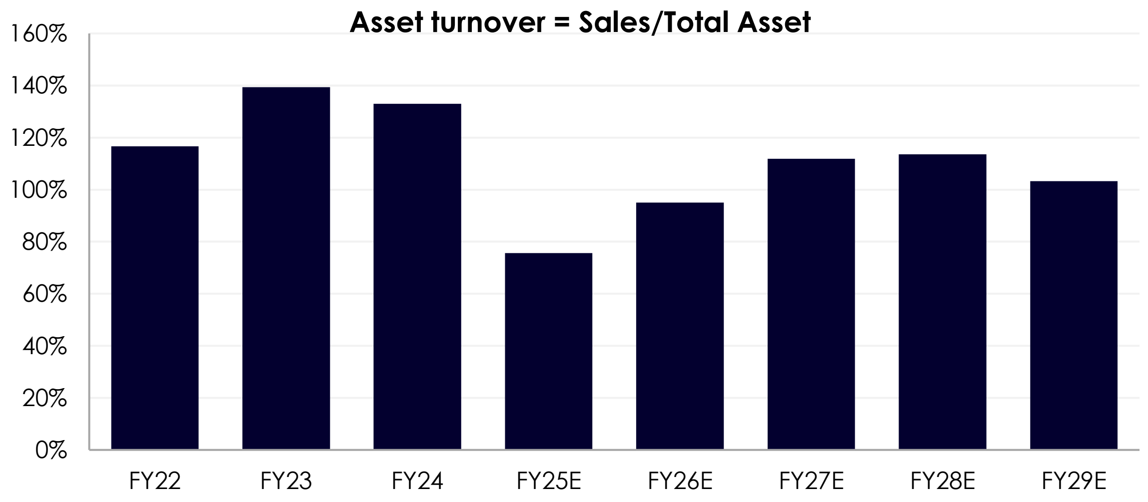
Year to March	FY22	FY23	FY24	FY25	FY26	FY27	FY28	FY29
EBIT	562	759	1,804	2,224	3,470	5,449	7,136	7,731
Tax rate	*26%*	*27%*	*26%*	*27%*	*27%*	*27%*	*27%*	*27%*
NOPAT	**416**	**551**	**1,340**	**1,624**	**2,533**	**3,978**	**5,209**	**5,644**
PPE	2,211	3,030	4,083	7,504	9,994	12,203	14,581	16,762
Working Capital	836	1,328	2,484	3,945	4,178	6,152	7,718	8,470
Invested Capital	**3,047**	**4,359**	**6,567**	**11,449**	**14,172**	**18,354**	**22,299**	**25,232**
ROIC	***13.7%***	***12.6%***	***20.4%***	***14.2%***	***17.9%***	***21.7%***	***23.4%***	***22.4%***

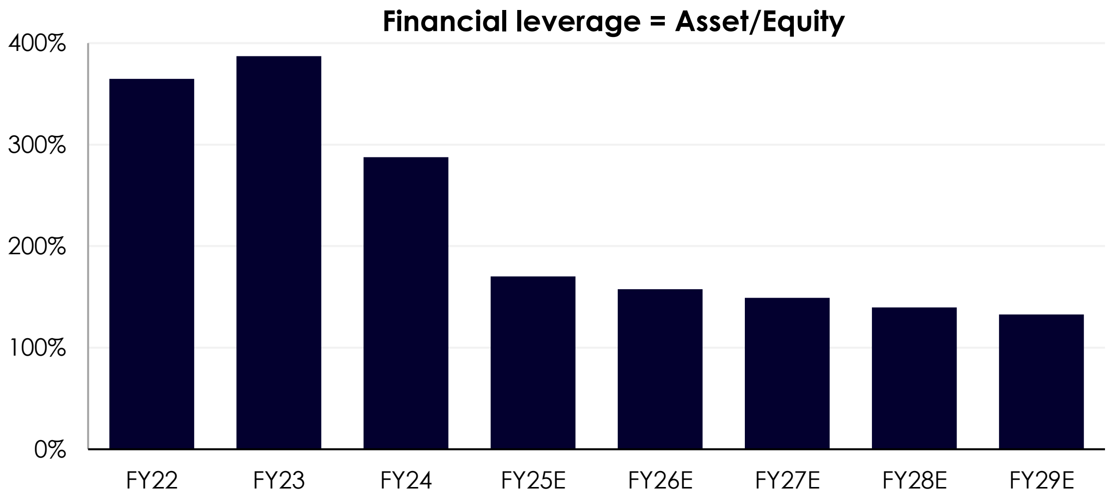
Source: Company, Nuvama Wealth Research

RoE drivers









Source: Company, Nuvama Wealth Research

Appendix

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Industry

Forging and machining industry

Industry

Forging and machining industry

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Forging and machining industry

Forging

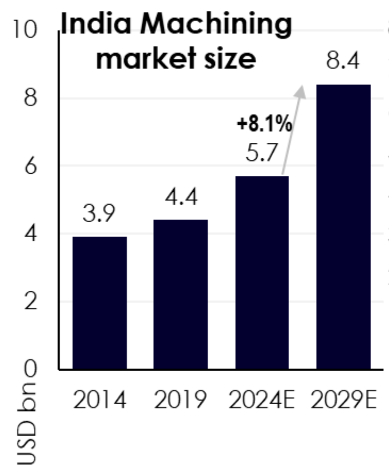
- Forging is a process by which a metal is given shape and a structure. It involves both cold and hot forging.
- Cold forging is used for simple straightforward shapes and on relatively softer metals.
- Hot forging requires a higher temperature and is used to achieve complex shapes on hard metals.
- **Pros**
  - Stronger and more durable products.
  - More complex and unique shapes.
  - Lower waste as compared to machining.
- **Cons**
  - Expensive and time consuming than machining.
  - As it is an additive process (adds metals), it doesn't give a smooth finish.

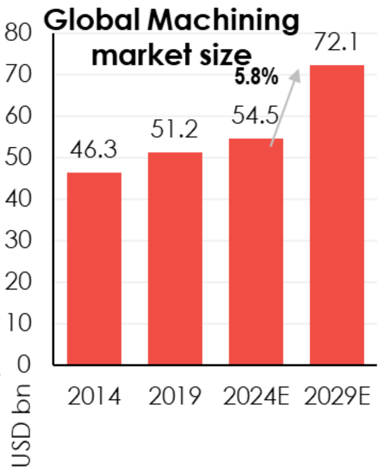
Machining

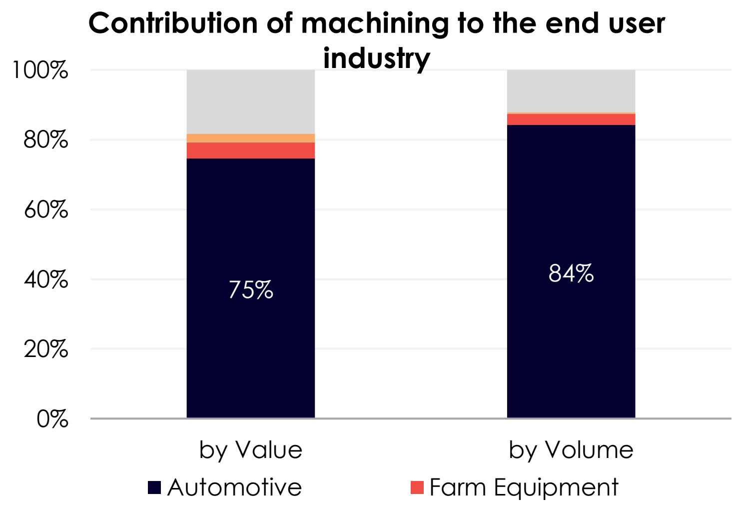
- Machining is a subtractive process as it removes metal to achieve newer shapes and a smooth finish.
- Uses CNC machines for cutting and precision shaping.
- **Pros**
  - Less time consuming.
  - A highly precise manufacturing process.
  - A more versatile process than forging.
  - Gives a smooth finish which is not easy to replicate from forging.
  - Process is much more automated than forging.
- **Cons**
  - Higher wastage and more scrap vis-à-vis forging.
  - Capital intensive: Automated CNC machine is costly (INR60-70lk)

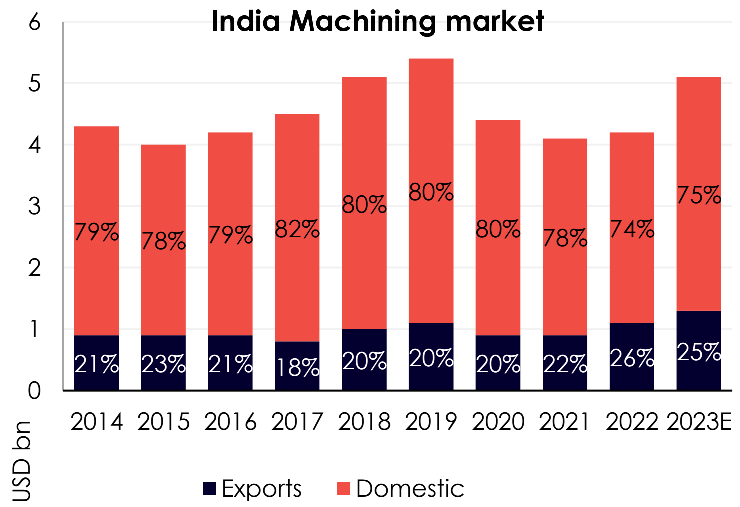
Machining industry

- OBSCP is part of the machining industry with a key focus on the auto sector.
- In value/volume terms, the global machining industry is pegged ~USD55bn/313mn units.
- The size of the Indian machining market is estimated at USD5.7bn (~10% of the global market). It is expected to touch USD8.4bn in 2029.
- Sector-wise, the auto industry accounts for 75%/85% of the industry in value/volume terms.
- **Exports gathered pace over the last two years, clocking ~20% CAGR between 2021 and 2023.**
- EU and global suppliers are increasingly outsourcing their machining and forging requirements to low-cost countries.
- This increased outsourcing is driven by the energy intensive nature of forging and machining and higher emissions and wastage.





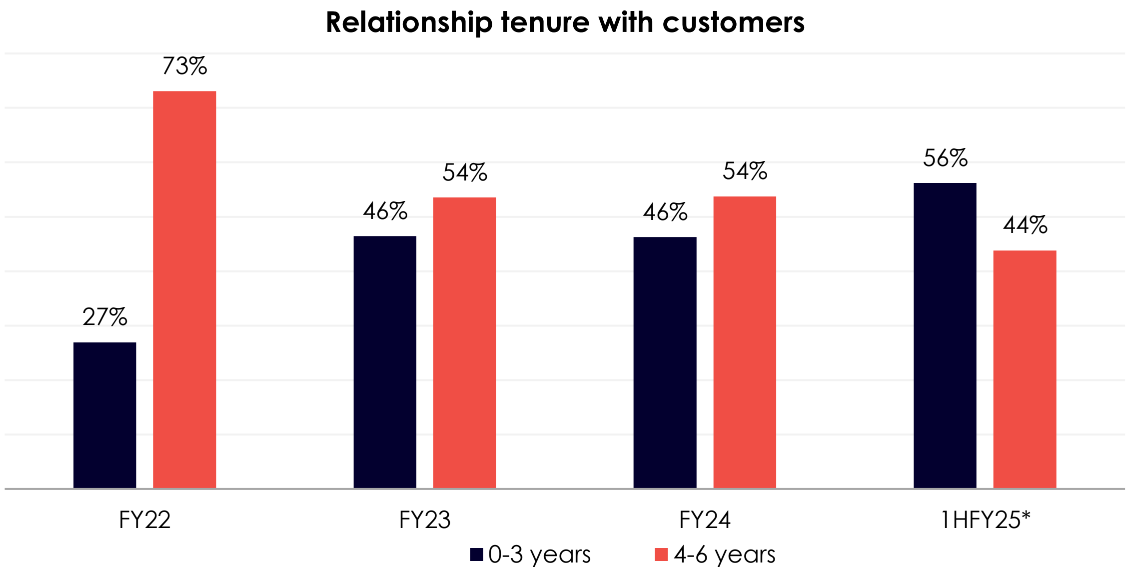




Source: Happy Forgings' prospectus, Ricardo report

Entry barriers

- Customer relationships take a long time to develop for small parts (see Slide 32 for customer acquisition process).
- But once a relationship is developed, it leads to recurring business and ensures higher orders in the future.
- Hedging of raw materials: OBSCP gets an idea on steel price movement from OBSCPL and orders accordingly.
- Quality control requires higher manpower: Around 70% of total manpower in Plant I is allocated for quality control.
- Investment casting is a higher capital and energy intensive business.



Source: Company

Company profile

OBSC Perfection

Product offerings

- OBSCP is not a direct OEM supplier but a Tier II/III one.
- It manufactures small products where:
  - Precision and quality are important and very much expected; and
  - It doesn't create the USP of end products.

Particulars	Auto	Defence	Marine	Telecom
End User	OEMs	Direct customer	Direct customer	Direct customer
Customers	ZF, Forurecia, Tenneco, Tata AutoComp Systems	BEL	Dometic	NA
Products used in	Exhaust system	Ammunition	Mechanical cables	Antenna
	Braking system	Fuses	Steering systems	Towers
	Steering system			
	Suspension system			

Piston and connecting rods

Round bar

Aluminium guide tube

Connectors

Fork bolt

Water cooled injectors

Turned fitting

Stop disc

Sensor boss

Source: Company

Top customers

Long-Standing Client Relationships:

Other Key Customers:

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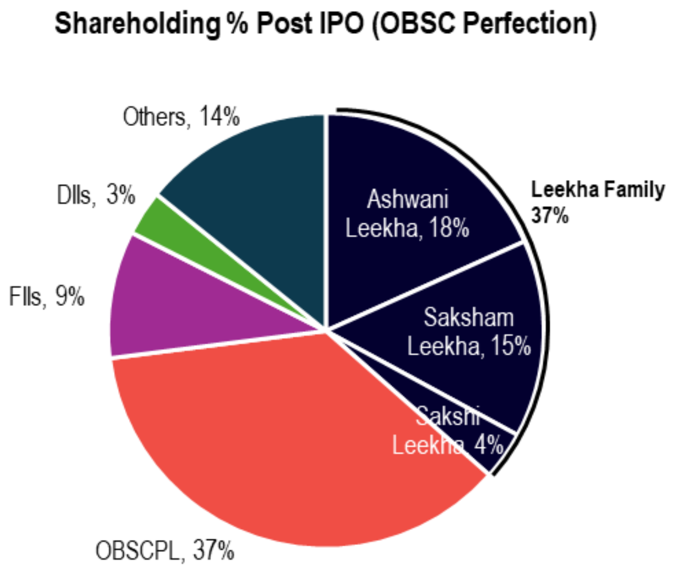
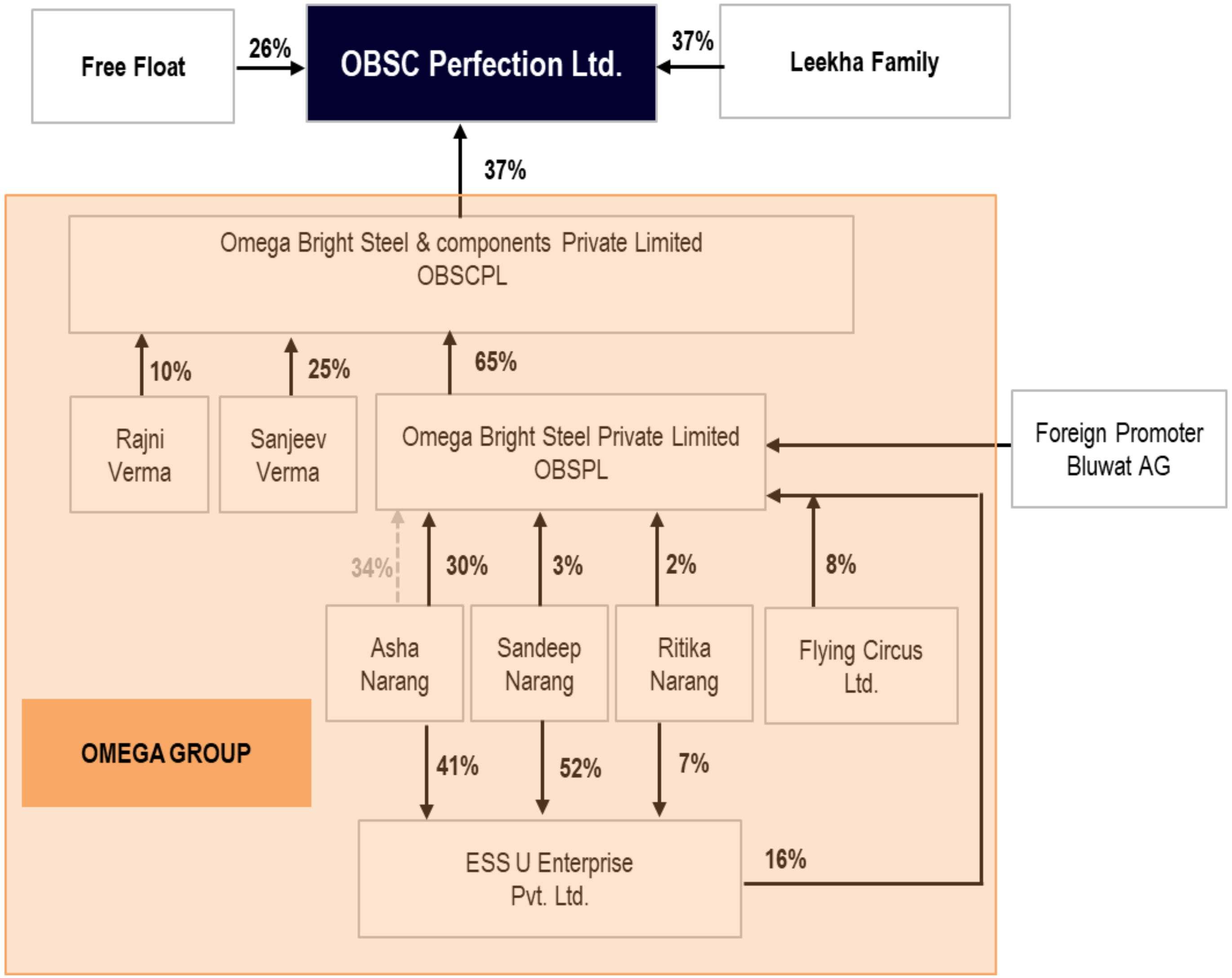
Source: Company

Shareholding structure

- OBSCP was set up in 2017 as a JV between OBSCPL and the Leekha family.
- OBSCPL is part of the Omega group and is completely owned by promoter.
- Day to day activities are undertaken by Executive Director Mr Saksham Leekha.

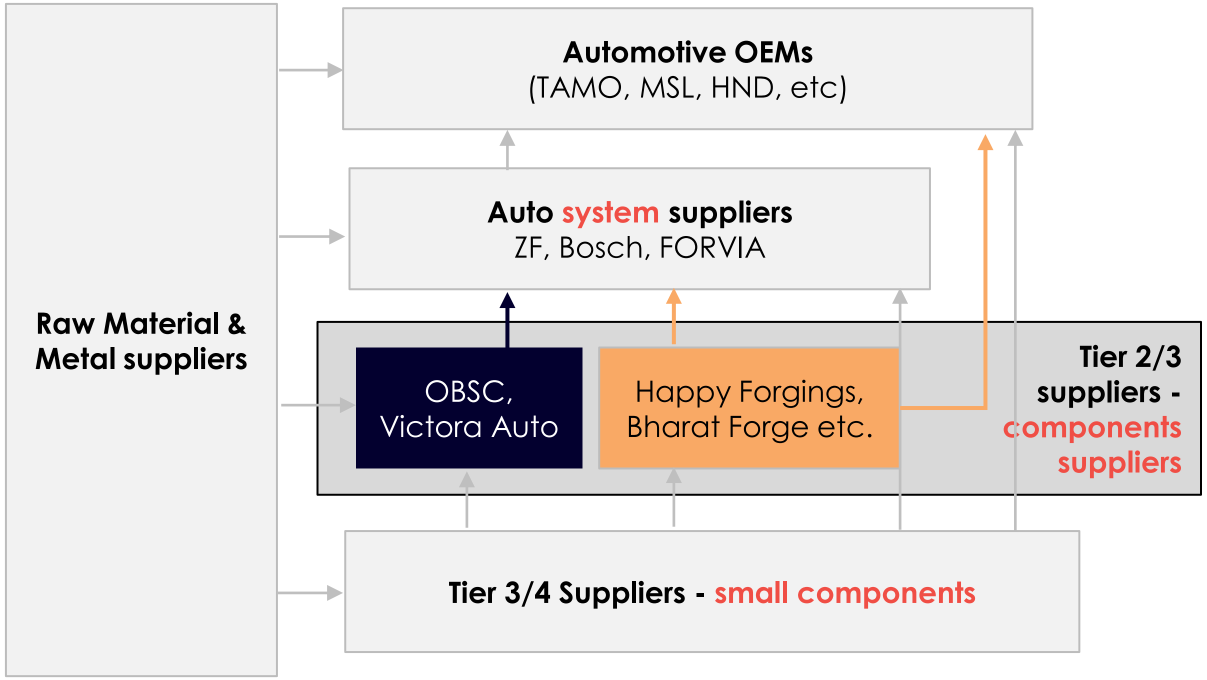




Source: Company, Nuvama Wealth Research

Auto industry

Industry structure



Source: Nuvama Wealth Research

OBSCP and other peers

Company	Products	Customers
OBSC perfection	**Connecting Rods, Piston Rods, shafts etc.**	**Auto suppliers - ZF, Tenneco, Tata Auto Comp, etc.**
SKS Fastners	Fastners, Nuts and Bolts, etc.	Auto OEMs & suppliers - Dana, Tata Motors, Mahindra etc.
RACL Geartech	Gears, Shafts, etc.	Auto OEMs & suppliers - KTM group, BMW, BRP-Rotax, etc.
Happy Forging	Crank shafts, front axle etc	Auto OEMs & suppliers - Dana India, VE CV, Ashok Leyland etc.
Bharat Forge	Front Axle, Connecting Rods, Steering knuckles, Crankshafts	Auto OEMs - VW, BMW, Mercedes-Benz

Source: Company

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Customer acquisition process

Testing takes six-to-nine months, order book conversion into revenue takes 18–24 months

Onboarding customers & understanding requirements

↓

End-to-end development from concept, design, prototyping to validation

↓

In-house rigorous testing ensures compliance with customer's granular specifications and application needs spanning 6-9 months.

↓

Development includes precision designing, advanced testing, and deploying engineering teams and resources

↓

Customer testing spans 6-9 months, extending project timelines to 1-1.5 years prebilling

Source: Company

Announced job cuts in Europe

Company	Job cuts
Valeo	1000 job cuts in Europe, leading to closure of two French plants
Michelin	1250 job cuts across two French sites
Schaeffler	Lay off 4,700 jobs in Europe mainly in Germany
Siemens AG	Siemens plans to cut 5000 jobs in its automation business
Bosch	5500 job cuts by 2032 in cross domain computer solutions and steering divisions, moslt at Germany
Forvia*	10000 job cuts in Europe by 2028
Thyssenkrupp	TKSE plans to cut around 40% of its steel workforce leading to 11,000 job cuts
ZF	Gradual reduction by 11000 to 14000 in Germany by 2028

Source: Reuters

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