

CMP: Rs. 111 BUY PRICOL

12th August, 2016



STOCK DATA

Market Cap	1051 Cr
Debt	77 Cr
Cash	27 Cr
Enterprise Value	1101 Cr
Promoters Holding	40.72%
52 week high/low	124.25/28.55
Shares outstanding	9.47 Cr

KEY FINANCIALS

(Rs. in Cr)

Y/E MARCH	2013	2014	2015	2016
Total Revenue	1059	1101	1151	1462
Operating exp	982	1045	1157	1355
EBITDA	77	56	-6	107
Depreciation	40	42	46	52
Interest Expense	20	10	13	20
Exceptional Item	0	52	24	-3
PBT	17	56	-41	32
Taxes	-1	18	-5	31
PAT	18	38	-36	1

VALUATION:

The company Trades at 11.5 times FY 2017 standalone earnings, with expected ROE of 28% and growth of 20% Plus. We believe in the management and it's a good bet with limited downside risk.

PRICOL LTD.

Thesis – A Perfect Turnaround

Pricol is a Coimbatore based auto ancillary company which until now has not been able to perform well. Company was typically facing problems of huge debt, bleeding cash and huge labour problems. We believe that Pricol is a missed priced bet with high expected growth and ROE mitigation leading to change.

What has changed?

A lot of things have changed in the company which makes our conviction in this stock idea stronger.

- Management change
- Financial Turnaround
- Strong Management guidance
- ROE Mitigation

What doesn't kill you makes you stronger!!!

History -

Since a long time the company was facing acute labour problems which was one of the reasons for the company to not perform well operationally. The conflict between the management and the workers proved fatal in 2009 as the workers killed the HR head of the company.

The company also saw many senior level exits which resulted in the promoter family to take control over the management. The company's image was hit leading to falling revenues and profits. Since 2011, the company entered into a restructuring phase where they relooked on their product mix, market leadership, management financials and future road map. On August 2014,

The company appointed new professionals as the management team and also signed a wage agreement with workers in Coimbatore and Manesar unit. This has not only improved their image in the market but also won the confidence of their customers. **The Promoter Group took complete control of the management in June 2015 and the turnaround has started.**

Present-

The effect of the management change and restructuring process is already visible on their financial statement. This company which has grown at a CAGR of only 10% in last 5 years has managed to grow its topline by 26% in the last year and have turned positive on the profitability front. **The new management has a simple strategy** of focusing on the products to make it the top three and if they are unable to do, they will immediately exit those products. They not only want **market leadership in all their products but also aim at having multi location plants to meet customer requirements just in time.**

Future -

Vision 2020- Expect a CAGR growth of 20% for next 4 years.

Company expects to grow its revenue from current 1450cr levels to Rs. 3000 Cr by 2020. The company's 40% revenue comes from two-wheeler business and 30% comes from tractor and commercial vehicles respectively. The company intends to increase its sales from tractors. The Company is targeting EBITDA Margins of 15-16% and PAT margin of above 10%.

About Pricol Ltd.

Pricol Ltd is an auto component manufacturing company. It manufactures auto parts for two, three, four wheelers, commercial vehicles, tractors and construction and tooling segments across global markets. The company has 8 manufacturing units and 7 business offices across the globe including India, Indonesia, Brazil, USA, Germany, Singapore and Japan.

Subsidiaries

The company has 7 subsidiaries in and outside India which contributed revenues of 321 Cr for FY16 but these are the main ones.

- 1) PT Pricol Surya Indonesia** – In FY16, the company achieved sales of Rs. 85 Cr as against 94 Cr in the previous year. The company's customers are 2 wheeler manufacturers to whom they supply Instrument clusters.
- 2) Pricol Asia Pte Limited, Singapore** - This purchasing arm of the Company mainly assists in global procurement of raw materials and components to supply the Company and associate companies. For FY16 the company achieved sales of Rs. 123 Cr and a profit of 2 Cr as against 104 Cr and 1 Cr respectively.
- 3) Pricol do Brasil Componentes Automotivos Ltda, Brazil** – Pricol took this company over in January 2015 for 1 Real (free) as the company was bankrupt. This company serves a wide range of international and domestic customers like Volkswagen, Fiat, General Motors and Harley Davidson.

The Management believed that buying over this company gave them technology advantage over its competitors. Due to unfavourable market conditions in Brazil their revenue for 2016 declined from 171 Cr to 130 Cr and made a loss of 46 Cr.

Products –

- 1) **Driver Information System (cluster System) (45% Revenue Share)**
- 2) **Oil Pump/ Water Pumps (40% Revenue Share)**
- 3) **Sensors (11% Revenue Share)**
- 4) **Vehicle Asset Management Solution (4% Revenue Share)**

- 1) **Driver Information System** – Pricol is 2nd Largest in the world in Driver Information system and has a 40% market share in India in this Niche Space. Everything that is there on the Dashboard of your 2/4 wheeler is included in this. From your speedometer, petrol meter, Security system, Lighters etc.
- 2) **Oil Pumps** – Oil Pumps help the petrol/Water reach the engine from the tank. Pricol Targets to be one of the biggest player in this segment, the management is happy with the technology it got via the Brazilian acquisition as it has taken where 5 year ahead of the Indian Competitors.
- 3) **Sensors-** Fuel Level Sensor, Temperature Sensors (AC), Reverse Sensors, Brake Sensors. After Death of Politician Gopinath Munde in a Road accident, the government of India passed a law where speed of commercial vehicles will be regulated via putting speed limiters. Pricol is the only ARAI approved company in India for Speed limiters, this law came in October 2015 for all commercial vehicles.
- 4) **Vehicle Asset Management Solution** –This is the services portion of the business where Pricol installs the hardware and software for large companies like JCB, Hitachi which give construction cranes, Trucks etc on lease where they can on the Map see the status of their vehicles, Route Monitoring, position them right, optimize the use of their asset.

Why do we Like Pricol?

We called this company a perfect turnaround for the following reasons.

- Management change
- Financial Turnaround
- ROE Mitigation

- 1) **Management Change-** The Management has been restructuring its business for the last 3-5 years, exiting business where they know they won't be able to be in the top 3 spots in the country. The Promoter group took complete control of the situation June 2015. [Click Here](#)

Positive Measures taken by the management:

- Controlling the operating cost by opening facilities in the place where they have a good market instead of manufacturing in Coimbatore (where they don't have any clients)
- Restructuring the product portfolio by exiting the products which is not adding any value to the company.
- Eyeing two acquisitions in two years. One in commercial vehicle space and other in oil and water pump space in replacement space in four wheelers and commercial segment in Europe. For all their acquisitions they will have to spend anywhere between 350-400 crore in next 3 years

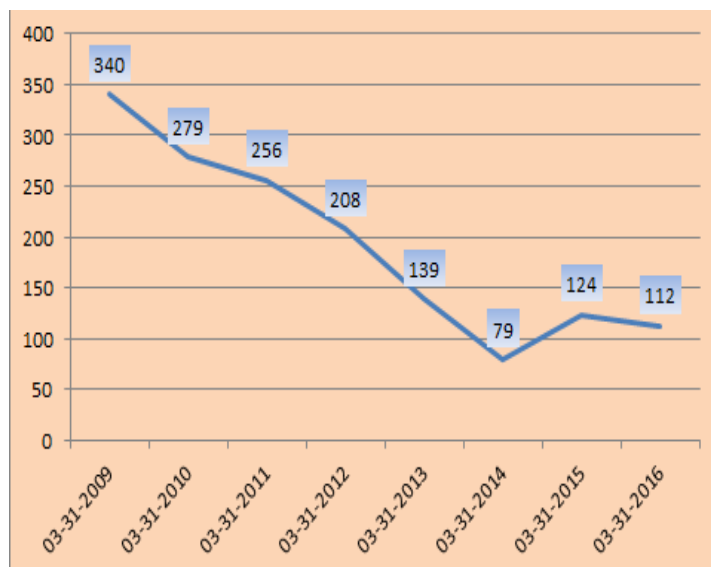
2) Financial Turnaround – Standalone Data Taken From Screener.in

	Sep 2013	Dec 2013	Mar 2014	June 2014	Sep 2014	Dec 2014	Mar 2015	June 2015	Sep 2015	Dec 2015	Mar 2016	June 2016
Sales	219.95	237.80	225.30	231.16	237.53	251.80	229.17	230.10	245.51	308.05	342.85	318.67
Expenses	206.00	213.76	212.09	213.03	226.41	274.16	237.35	218.16	233.46	282.25	296.00	280.40
Operating Profit	13.95	24.04	13.21	18.13	11.12	-22.36	-8.18	11.94	12.05	25.80	46.85	38.27
OPM	6.34%	10.11%	5.86%	7.84%	4.68%	-8.88%	-3.57%	5.19%	4.91%	8.38%	13.66%	12.01%
Other Income	0.74	1.10	1.32	0.50	9.59	-0.31	12.12	0.52	1.70	3.24	1.53	1.21
Depreciation	8.76	8.60	5.21	9.91	9.40	9.21	6.73	7.81	7.67	7.36	11.33	7.05
Interest	1.30	2.01	1.44	1.36	1.60	2.54	2.39	2.36	2.58	2.91	1.47	1.46
Profit before tax	4.62	14.53	7.87	7.36	9.72	-34.43	-5.18	2.29	3.50	18.78	35.58	30.97
Tax	1.04	2.60	0.55	1.22	0.17	-3.14	-2.78	0.66	0.72	2.06	13.51	8.79
Net Profit	3.58	11.93	7.32	6.14	9.55	-31.29	-2.40	1.64	2.78	16.71	22.07	22.18

OLD MANAGEMENT

Promoter taking Control

We clearly can see that the company is back on the path of profit and has been performing well for last 3 Quarters after Promoter Stepped in.



The Company has reduced its debt down from 340 Crores in 2009 to a much more manageable level of 112 Crores in 2016. The management in its analyst meet has indicated that they are averse toward taking debt and that they will mostly use internal accruals for their expansion plans.

3) ROE Mitigation -

This is the most important point of our thesis. Right now, an auto ancillary company has a Median average ROE of 14.8%. This company had extremely low ROE as compared to the industry standards. On the back of lower debt and higher topline growth and improving profit margins, the company can easily scale up its ROE for FY17 to above 25% levels.

Year	Mar'08	Mar'09	Mar'10	Mar'11	Mar'12	Mar'13	Mar'14	Mar'15	Mar'16	Mar'17 E
ROE	9.74	-11.61	19.09	11.65	7.82	7.19	10.84	-4.69	17.47	28.54

*Standalone Data

Market Leadership –

Pricol is in top 3 positions in all 4 products i.e. Driver Information System, Fuel Pumps, Sensor and Vehicle Asset Management.

Clients –

In 2 Wheeler Space the Company has all the major producers in the world expect Chinese players as Chinese 2 wheeler market is a fragmented market. Hero, Bajaj, TVS, Harley Davidson, Royal Enfield Etc. In 4 Wheeler Space passengers space the company has a lesser share and has clients like Maruti, Honda, and Toyota etc.

In the Commercial Space and tractors space, the company has all major players in India and Globally.

Peer Comparison –

There is no one competitor in this space which has the exact same products like Pricol. We have removed some fact of the Auto Ancillary space.

	Median	Pricol (FY2016)
3 Year Sales Growth	7.0%	8.8%
3 Year Profit Growth	11.0%	37.7%
PE Ratio	20	21
ROCE	15.0%	16.6%
ROE	14.8%	17.5%
D/E	0.5	0.17
1 year Sales	9.1%	18.6%

* Source – Reuters, Moneywork4me

**Data of the 52 companies in Auto Ancillary Space having a 100Cr+ Market Cap

Risk of Business –

The Biggest Risk of Pricol is its Brazilian Business. You must be thinking that Brazil is only 8% of revenue how can that be the biggest risk. In the Below Picture you will understand that Brazil car sales have fallen to the same level as 1995. The Sales of Automobiles de-grew 25% last year and expected to de-grow 15% this year as well. The Question is can it get worse out there? The company did a restructuring last year of the Brazil business and lost 46 Cr on sales of 131 Cr thus eroding standalone profits. The large loss in Brazil was due to the onetime restructuring of the company. I am personally an optimist and as Ruchir Sharma says in his book Breakout Nations “The best decisions taken by emerging markets are in period of Stress”. The Brazilian government will get its act together and in next 1-2 years “This too will pass”.



The company doesn't give consolidated data in the Quarterly Earnings, so we can't exactly understand what the international business is doing.

Revenues	2012	2013	2014	2015	2016
Standalone	965	874	891	950	1127
Consolidated	1082	1055	1097	1143	1448
Difference	117	181	206	193	321
Profits					
Standalone	17	18	31	-14	50
Consolidated	23	20	6	-49	8
Difference	6	2	-25	-35	-42

Valuation –

The Management has given a Guidance of Atleast 20-25% Growth for next 3 years and EBITDA margins of 15-16% from 11-12% in 2016. We Expect the standalone business to do a profit of 85-100cr for FY2017 a ROE of 25-30% with Expected 3 year growth of 15-22 %. We believe that Brazil subsidiary can lose 15-20 Cr this year because last year there were many exceptional items. After Discounting the Brazil business we believe 50-70% upside is there from current levels in next 9 months.

Conclusion –

The Company has posted a complete turnaround, with high growth expectations, high ROE, great portfolio of products. The management has indicated that most of the capital requirement will be fulfilled by internal requirement. The promoter family has come back to managing the company from last 4 quarters and the results are clearly visible. The stock is undervalued compared to its peers and we believe downside risk is limited to 20%.

Disclosure: Amit Jeswani & Family have no positions

Analyst Disclosures: No positions

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