

Oct 28, 2020

PICK OF THE MONTH

VOL-6, NO-19

Industry: Other Elect. Equip.

Salzer Electronics Limited

BUY

CMP: Rs101

TARGET PRICE: Rs130

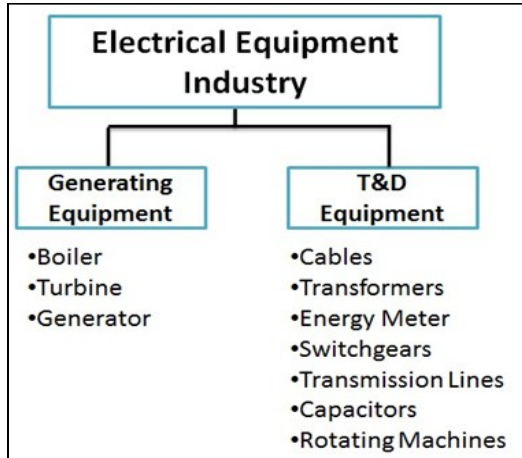
TIME : 12 months

OVERVIEW:

Industry– Electrical Equipment:

The electrical equipment industry is quite huge and fragmented with a number of players in the domain of electrical motors, lighting fixtures, switches etc. The industry has slowly started moving towards energy efficient electrical equipment and a lot of R&D is carried out in this sub segment. Electrical Equipment industry broadly consists of equipment related to generation of electricity and transmission & distribution (T&D). On a global level, there has been an increase in demand for electrical equipment owing to increase in power transmission capacities, increase in capacity utilization (by businesses), need for energy efficient equipment etc. In addition to the regular requirement of the industry, there lies huge opportunities in data management, analytics, sensing, and power electronics. All these new generation technologies will try to cater to smart grid, smart metering and other transformations in the electrical equipment sector.

Exhibit 01: Electrical Equipment Industry



Source: <https://sesei.eu/wp-content/uploads/2019/03/Electrical-Equipment-including-Consumer-Electronics-industry-2019.pdf>, Progressive Research

Power Sector in India:

India is the 3rd largest producer of electricity in the world and 2nd largest consumer. As on July, 2020, India has the 5th largest installed capacity of 371.97GW. Electricity demand in the country is growing and is anticipated to grow further as India progresses. With the intention of sustainable growth in electricity production, India has aimed to invest USD90bn on clean energy and is ranked 6th in the list of countries making significant investment in clean energy. Currently, India produces USD43bn worth of capital goods and electrical equipment and has proposed to invest USD1.5tn in infrastructure, out of which 71% will be across road, rail, energy and urban infrastructure, as per a report by E&Y. The transmission and distribution sector contributes around 85% to the industry, while generation equipment sector contributes the remaining 15%. During FY19-20, there was subdued capex by companies owing to the headwinds faced due to global turmoil and economic downturn. Furthermore, owing to the outbreak of the pandemic, investment on infrastructure had taken a backseat and healthcare became a priority. However, the Indian government has renewed its focus on infrastructure/engineering in order to revive the Indian economy. Domestic players are also focusing on technological up-gradation in order to leverage operational efficiencies to compete with competition from foreign as well as Indian players. Over past few years, India has emerged as a global manufacturing and engineering hub as many global companies have partnered with Indian counterparts for setting up engineering units across various industries. Within the anticipated increase in infrastructure spending, the government is expected to focus on digitization, urban infra and expansion of smart cities programs. Thus, the electrical equipment industry is set to witness strong domestic demand.

SNAPSHOT				
52 week H / L		Mcap (INR mn)		
131/47		1,606		
Face value: 10				
BSE Code		NSE CODE		
517059		SALZERELEC		
Annual Performance				
(Rs mn)	FY18	FY19	FY20	FY21E
Total Revenue	4,428	5,598	5,669	5,098
EBITDA	533	636	652	607
EBITDA (%)	12.0	11.4	11.5	11.9
Other Income	31	7	9	10
Interest	149	199	212	212
Depreciation	105	122	144	150
PBT	309	323	305	255
PAT	200	240	264	199
Equity (Rs mn)	155	160	160	160
EPS (INR)	13	15	17	12
Quarterly Performance				
Parameters (Rs mn)	Sep-19	Dec-19	Mar-20	Jun-20
Sales (Net)	1,378	1,347	1,323	957
EBITDA	175	167	143	96
EBITDA (%)	12.7	12.4	10.8	10.0
Other Income	3	1	(1)	3
Interest	54	50	54	48
Depreciation	36	37	37	39
PAT	56	56	86	10
Equity (Rs mn)	160	160	160	160
Ratio Analysis				
Parameters (Rs mn)	FY18	FY19	FY20	FY21E
EV/EBITDA (x)	5.5	4.6	5.1	5.4
EV/Net Sales (x)	0.7	0.5	0.6	0.6
M Cap/Sales (x)	0.4	0.3	0.3	0.3
M Cap/EBITDA (x)	3.0	2.5	2.5	2.7
Debt/Equity (x)	0.62	0.58	0.64	0.58
ROCE (%)	16	17	16	13
Price/Book Value (x)	0.6	0.6	0.5	0.5
P/E (x) (TTM)	10.6	8.8	6.3	8.1
Shareholding Pattern as on 30th Sept, 2020				
Parameters	No of Shares	%		
Promoters	57,12,762	35.74		
Institutions	18,18,214	11.38		
Public	84,51,761	52.88		
TOTAL	1,59,82,737	100		

Source: Annual Report

Note: All the data is calculated as per Market Price on 27th Oct,2020

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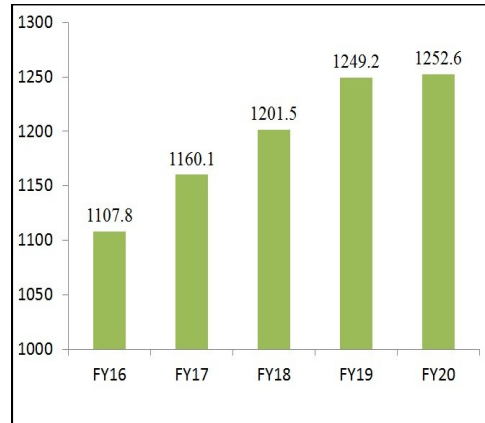
TARGET PRICE: Rs130

TIME : 12 months

OVERVIEW: Industry– Electrical Equipment (contd.)

Government Initiatives: In the Union Budget 2020-2021, GOI allocated Rs158.7bn to the Ministry of Power. GOI has continuously tried to boost the electricity/power sector through various reforms and amendments with the agenda to improve and provide financial stability to power distribution companies (discoms), reduce AT&C (aggregate technical and commercial) losses and provide electricity to consumers in rural areas. Some of these reforms introduced include, **Integrated Power Development Scheme (IPDS):** to improve financial distress faced by the sector and strengthen sub-transmission and distribution in the urban areas with IT upgradation of the distribution sector. **Ujjwal Discom Assurance Yojana (UDAY):** to improve financial distress faced by the sector by reducing debt, improving operational efficiencies through various internal methods and increasing energy efficiency and conservation. **The Pradhan Mantri Sahaj Bijli Har Ghar Yojana, Saubhagya:** to provide electricity across the country. **Deen Dayal Upadhyay Gram Jyoti Yojana (DDUGJY):** allocated Rs55bn to improve supply of electricity for consumers in rural areas through separation of agricultural and non-agricultural feeders and also aim at improving sub-transmission and distribution network in rural areas. **National Infrastructure Pipeline (NIP):** GOI has allocated from Rs24tn to the energy sector.

Exhibit 02: Electricity Production (India) (in Billion Units)



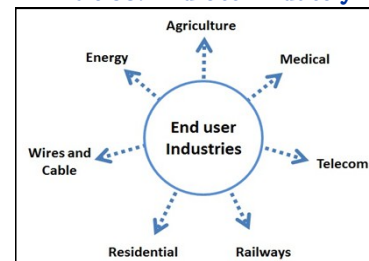
Source: IBEF, Progressive Research

Switchgear Industry: Switch gears are devices used to protect, monitor, and isolate electrical equipment used in power generation, transmission and distribution. Generally, switchgears consist of two components; **power control components** to control conduction in the equipment and **power switching components**, to break the connection in the fault incidents. Switchgears are composed of fuses, circuit breaker, electrical disconnect etc. and are used in devices used in residential, commercial, utilities by customers to ensure safety, cost-effectiveness and uninterrupted operations. According to Modor Intelligence, global switchgear market is expected to grow from USD120bn in 2020 to USD190bn in 2025, growing at CAGR of around 7%. This growth is attributable to the expected growth in infrastructure investment by various countries around the world, growing inclination in renewable energy and growing urbanization and need for integrated smart cities and industrial requirement of power grid infrastructure. In the emerging economies like China and India, apart from developed economies like US and Europe, there is increased focus on infrastructure for economic growth and thus the construction industry growth will also aid the growth of switchgears. Apart from traditional demand, power generation plants using wind, solar, hydro are set to increase need for new T&D lines. According to International Energy Agency investment in this sector has rose to USD20bn in 2020 from USD8bn in 2010. The same is anticipated to reach USD1tn by 2040 with a 15fold increase in global capacity.

Indian Switchgear Industry: According to Businesswire, Indian switchgear market is poised to grow at 6.8% CAGR during 2019-2025. This growth is attributable to the anticipated growth in residential, commercial and industrial sectors accompanied by growth in demand of electrical appliances. Government initiatives such as Deen Dayal Upadhaya, Power for all, are aimed to ensure electrification reaches every village and citizen in India, and are contributing to the increase in demand of electricity and indirectly driving the demand for development of T&D networks and thus the demand for switchgears. India’s ageing infrastructure needs modernization inviting the requirement for optimal communication between smart grids and switchgears, other network equipment and operators etc. which in turn will lead to increased demand of switchgears in India.

Wires and Cable Industry: Growth in demand for electricity will augur growth of wires and cable industry as it is one of the key segments in the power sector. Wires and cable sector in India is around 40% of the whole electrical industry and is anticipated to grow at CAGR of 15%. Growth of T&D sector will also aid growth of wires and cables. Industry 4.0, smart manufacturing, Industrial Internet of Things (IIOT) are all auguring well for the wire and cable industry. Furthermore, projects like smart city are expected to propel large-scale growth in infrastructure, telecom, power generation, T&D and engineering. Indian Railways plans to electrify 38,000km route in 5 years during FY18-23 which will further boost demand for wires and cables. However, the Indian wires and cable industry needs to rise to the challenge and understand which technology has the potential to grow exponentially and understand the type of wires and cables apt for those technologies.

Exhibit 03: End User Industry



Source: Company Website, Progressive Research

About the Company: Salzer Electronics Limited (Salzer) was incorporated in 1985 and is in the business of providing integrated and customized electrical solutions with more than 3 decades of expertise in designing, developing and manufacturing array of products including rotary switches, wiring ducts, sensor and transformers. Salzer is the largest manufacturer of CAM operated rotary switches and wire ducts in India with a market share of 25% and 20% respectively. Salzer is headquartered in Coimbatore, Tamil Nadu and has 5 state of the art manufacturing facilities. It also has an inhouse R&D wing, which is recognised by Department of Scientific & Industrial Research, GOI. The company caters to well reputed clientele and has strategic tie-ups with Indian as well as global conglomerates for synergy benefits. It has a professionally managed team, under the leadership of Mr. R Doraiswamy, as the Joint Managing Director of the company.

INVESTMENT RATIONALE:

(A) Diversified Products: Salzer has a diversified product offering of electrical equipment products which are smart and energy efficient. Its product offerings can be divided into 4 segments, namely; industrial switchgear, wires and cable, building products and energy management.

(i) Industrial Switchgear Segment: contributes more than 40% of the total revenue with products like terminal blocks, rotary switches, isolators, general purpose relays, wiring ducts, motor protection circuit breakers (MPCBs), contactors, control panels, and overload relays. These products are mostly supplied to OEMs where transformers, contactors, and switches (rotary switches and other isolator switches) are the top three products in this segment. The segment can be further divided into 3 sub-segments namely: industrial component, transformers and motor control products.

(a) Industrial Components: includes products like switches, relays, cable ducts etc. where Salzer is a market leader in rotary switches and sensors. The company is the largest manufacturer of CAM operated rotary switches (used in AC and DC switching applications) in India with a market share of approx. 25%. Sensors are components which detect speed, position, pressure etc.; in addition to this, other offering under this segment includes customised panels, wire ducts etc.

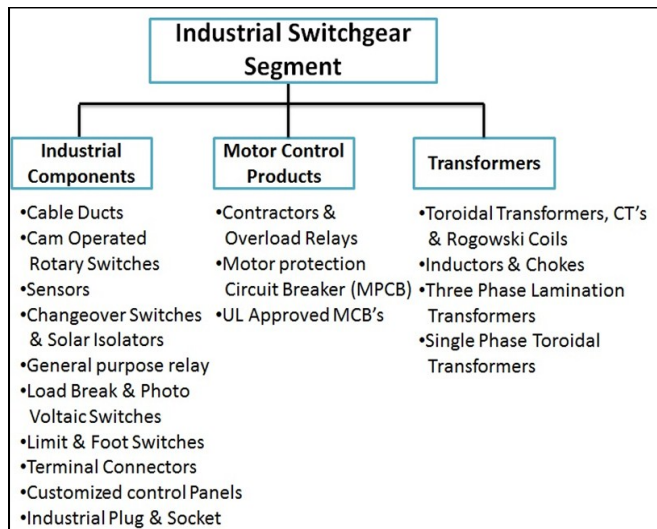
(b) Transformers: are electrical devices that pass alternating current signal from one electric circuit to another, majorly changing/ transforming the voltage and find application in renewable and non-renewable energy, railways, marines, manufacturing etc. In 2015, Salzer entered into a technical JV with Trafomodern (in Austria) seeking support for design and process technology to manufacture energy efficient transformers, inductors and chokes. According to Globalnewswire, Indian power and distribution transformer market is anticipated to reach USD2.9bn by 2022. This growth in transformers market is attributable to upgradation and expansion in T&D network. Three phase transformers and toroidal transformers have shown potential and one can expect uptick in the demand for these products and in the current scenario, the company is in talks with players from the railway sector for supplying its three phase transformers

(c) Motor Control Products: A contactor is an electrical device which is used for switching an electrical circuit on or off while overhead relays control and protects electric motors from short circuits. Contactors is one of the top 3 products of the industrial switchgear segment. Salzer offers standard contactors, mini contactors, control relays and bimetallic overload relays. Salzer has undertaken development of contactors for C3 Controls, USA which is a reputed global manufacturer and supplier of the electrical goods.

(ii) Wires and Cable: segment contributes more than 40% to the total revenue of the company and is the second largest major segment after industrial switchgear. Products in this division include wires and cables, flexible bus bars, enamelled wires, bunched conductors and tinned wires. Enamelled copper wires find application in transformers, alternators, relay coils etc. Flexible busbars find applications in UPS, stabilizers, windmills and are formulated using a special grade of insulation compound. L&T plays a major role in the off take of products in this division as the company has a marketing agreement with L&T. From FY19, Salzer started manufacturing wires and cables under its own brand name and has witnessed good demand. The company also undertakes regular brand labelling business for L&T and Crompton. The company has commissioned its LAN cable plant in FY20 and trial production has commenced. The company has also received enquiries for products under this segment for export and the management expects revenue to flow from Q2FY21.

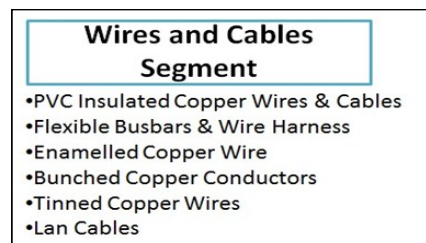
(iii) Building Segment: is the only segment which deals in B2C i.e. direct sales to the retail market. Products include modular switches, miniature circuit breakers (MCBs), wires and cables where the former are a major contributor to this segment. This segment was launched a couple of years ago and has been gaining traction since. During FY20, owing to subdued demand in residential and commercial construction sector, demand of building segment products was also impacted. Currently, the company has managed to get annual rate contracts with some major developers/builders; however, focus is on the retail segment. Management intends to increase contribution from this segment to around 10% of revenues backed by buoyancy of the real estate and construction sector expected in the next few years.

Exhibit 04: Industrial Switchgear Segment Products



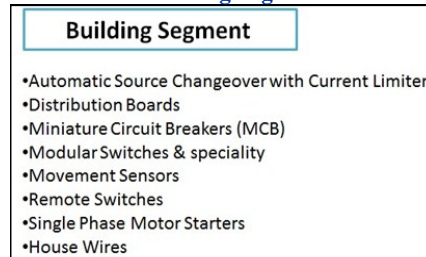
Source: Company Website, Progressive Research

Exhibit 05: Wires and Cables Segment Products



Source: Company Website, Progressive Research

Exhibit 06: Building Segment Products

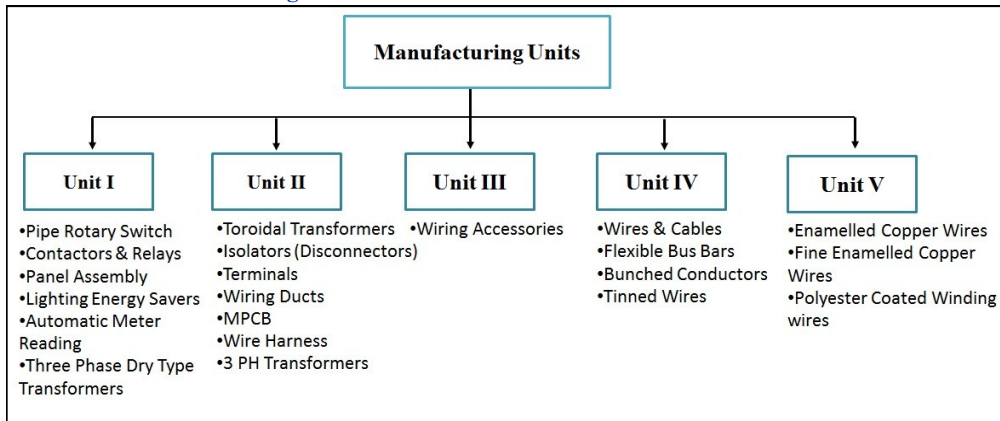


Source: Company Website, Progressive Research

INVESTMENT RATIONALE (contd.)

(iv) Energy Management: is an order driven and technologically oriented business vertical. The segment has received the CRISIL rating -Grade A, largest for Energy Service Company (ESCO). The two products under this segment (Energy savers & panels and street light controller) are developed by the in-house R&D team of Salzer and also aims to boost growth by manufacturing and installing energy efficient value-added products which yield higher margins. In the current scenario, the company is actively looking to explore newer geographies with customised product offerings.

Exhibit 07: Manufacturing Units



Source: Company Website, Progressive Research

(B) Robust Operations:

(i) Kaycee Acquisition: Salzer acquired 74.8% stake in Kaycee Industries Ltd for a total consideration of Rs181mn in FY20. Kaycee Industries Ltd is a pioneer in industrial switchgear manufacturing and also a manufacturer of various electric insulation products since last 75 years. This acquisition will provide synergy benefits to the company as Kaycee’s products align well with Salzer’s array of products. Furthermore, through Kaycee’s positioning in the railway sector and in the northern market, Salzer can improve its market share in these sectors and regions. The company intends to continue products of Kaycee under the brand name of Kaycee itself. Salzer intends to improve the operational efficiencies at Kaycee, and the aim is to bring them at par with Salzer. The company will leverage Kaycee’s marketing network and the approval strength to sell Salzer’s products in that channel and would also cross sell Kaycee products in Salzer channels. This acquisition will help expand products range and also help Salzer enter newer segments and geographies.

(ii) R&D: Salzer also has an in-house R&D wing, which is recognised by Department of Scientific & Industrial Research, GOI, since 2004 and the company is confident of getting the approval renewed by GOI. Salzer’s R&D team leads the innovation drive of the company (registered patent for rotary switches and currently 5 products patents are pending), improvements in products and processes in order to be cost competitive. Salzer’s R&D team has developed Energy Saver products which are gaining traction and have also developed automated meter reading which provides real time data and flexibility to terminate and reconnect consumer accounts.

(iii) Clients: L&T is one of the largest customer of Salzer fetching 23-25% of total revenues; Salzer has marketing tie up with L&T (L&T markets Salzer products on pan-India basis via its own brand name and also Salzer’s brand name). Through this marketing tie-up, Salzer has access to L&T’s local network through more than 350 distributors. Even though L&T has sold its electrical and automation business to Schneider Electric, both the companies have assured Salzer that it is ‘Business As Usual’ with Salzer. Apart from this, the company, through its direct network across 50 countries and 40 international distributors, caters to reputed global clients. Schneider Electric is the second biggest customer for Salzer followed by GE. Salzer was awarded ‘Best Collaborative Supplier’ for 2019 by Schneider. The company has also received ‘Preferred Supplier’ status with GE. Other major customers include some European and American players. In India, Salzer caters to clients like BHEL, ABB, Indian Railways etc. The company is an approved supplier to Nuclear Power Corporation and also the largest supplier of rotary and load break switches to Indian Railways.

Exhibit 08: Strategic Decisions



Source: Annual Report, Progressive Research

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INVESTMENT RATIONALE (contd.)

(C) Future Growth Areas:

(i) Growing Exports: Through its well established local and global distribution network, Salzer exports goods to around 50 countries. The company has witnessed enquiries from North America, Australia and Middle East markets. The increase in enquires is aided by growing need to de-risk global supply chains and reduce dependence on any particular country. Though the change will be visible in the long term, the company is aptly placed to reap the benefits of these changes. Even prior to the lockdown, the company did receive some enquires from Australia and some other countries. Enquiries from US have also increased owing to the US-China trade war, and Salzer is working on securing projects from some large OEMs. Exports for Salzer increased from Rs850mn in FY19 to Rs970mn in FY20, aided by growth in demand in Europe, North and South America. Within exports, around 60-65% is contributed by industrial switchgear segment, while rest is from other segments. Growth in industrial segment was also attributable to increase in exports to Europe and US markets. Out of the newer enquiries, there have been few enquiries for wires and cables products as well but majority of products enquired fall under the industrial switchgear segment.

(ii) Expanding T&D Network: According to ICRA, an investment of Rs1.8lakhcr during FY21 to FY25 is expected in power transmission segment in India attributable to evacuation infrastructure required for renewable energy projects (*Power evacuation means a facility that allows generated power to be immediately transmitted from a generating plant to the grid for further transmission/ distribution to load centres*). Increase in number of smart cities and also plans for the dedicated freight corridor would increase demand of T&D network across India. This investment will augment the need for T&D network, the demand of which is in tandem with demand for products of electrical equipment products. Rise in demand for High Voltage Direct Current (HVDC) systems across the T&D network will drive the demand DC switchgears. Furthermore, GOI has planned to add Rs2.9lakh MVA of transmission capacity during 2017-2022, with the vision to strengthen transmission network and need for reliable and safe systems. GOI's expenditure on infrastructure to revive the economy and the need for upgrade in transportation will help surge the demand for transformers and other products of Salzer.

(iii) Ageing Infrastructure: Electrical infrastructure is ageing across the globe, be a developed or developing country. In the US, average age of installed base is 40 years while more than 25% of that infrastructure is more than 50 years old. This ageing infrastructure needs a major overhaul/revamp, thus presenting the opportunity for modernization and enhancing efficiencies worldwide. Surge in demand for renewable energy coupled with need for decentralized power supply will additionally require the need for changing older grids. There is also a need to change/upgrade the current power grids as they aren't structured for continuous generation of power and megawatt delivery through various interconnected systems. With the view to upgrade power infrastructure, India envisions, adding 250 million prepaid smart meters with the aim to boost revenue collections. India also plans to add SCADA (supervisory control and data acquisition systems) to better monitor and separate grids between rural and urban areas. Replacing overhead power lines with better insulated wires so as to reduce power theft is also a task that GOI intends to complete. According to government reports, 20% of potential revenue is lost due to technical and commercial reasons. This up-gradation of grids and changes in the network will drive growth of electrical products in India and around the world which will also benefit Salzer as its products are critical components in the electrical infrastructure.

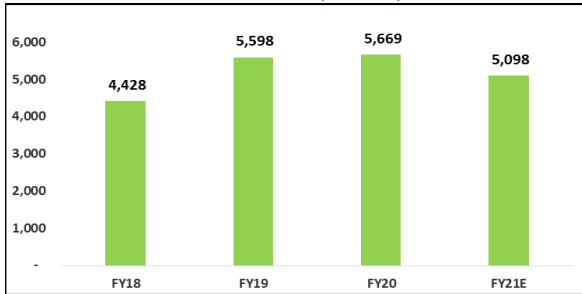
(iv) Make in India Impetus: According to Indian Electrical & Electronics Manufacturers' Association (IEEMA), India aims to make itself a preferred manufacturing hub for production of electrical equipment. Despite a de-growth in FY20, it expects increased demand for electrical equipment to aid growth of the industry coupled with government provided incentives for capacity addition in power generation. Large global companies are looking for option with a view to de-risk supply chain and India is reaping benefits of the same. With the recent shift in supply chain, Salzer has tapped the opportunity and is working on sourcing global technology to manufacture products locally, under the 'Make in India' theme. Salzer has also entered in strategic tie-ups with global partners to import technologies for manufacturing products for domestic as well as export markets. Salzer has also received enquiries from some global customers and products for testing have been supplied, and the management is optimistic about the response from customers. This shift will help generate revenue for the company and will also help increase Salzer's geographical presence.

Financials:

The company reported marginal growth of 1.3% to Rs5,607mn in revenues in FY20, while profit grew by 10% to 263mn in FY20, as compared to FY19. Barring FY20, the company has been continuously declaring dividends, the Management did not declare dividend in FY20 to conserve cash and at the same time reduce debt. Long term debt as on 31st March, stood at Rs177mn while short term debt stood at Rs1,559mn. The management mentioned that the short-term plan for FY21 is to sustain its performance. The company expects normalcy to return from Q3FY21 onwards. Salzer has also formed value engineering groups aimed at reducing costs and the company is focused in decreasing input costs so as to be globally competitive coupled with its pricing strategy. The company intends to lower its debtor and inventory day ratios. It also aims at improving Ebitda margins through sale of value-added products. The company is optimistic in terms of growth in revenues and profitability in the medium to long term scenario.

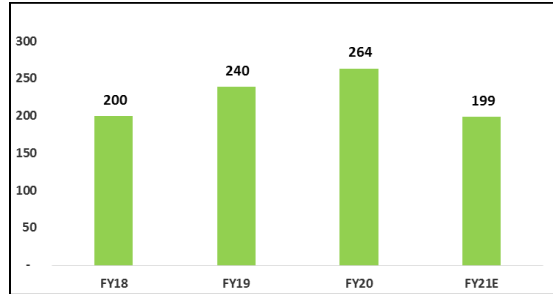
Financials:

Exhibit 09: Revenue Trend (Rs mn)



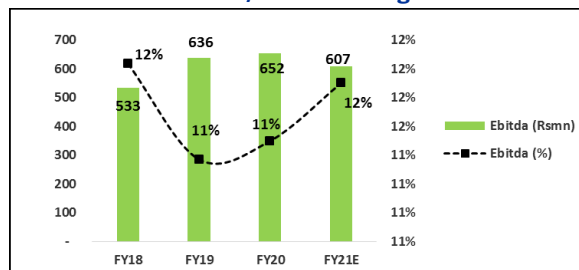
Source: Annual Report, Progressive Research

Exhibit 10: PAT Trend (Rs mn)



Source: Annual Report, Progressive Research

Exhibit 11: Ebitda v/s Ebitda Margins

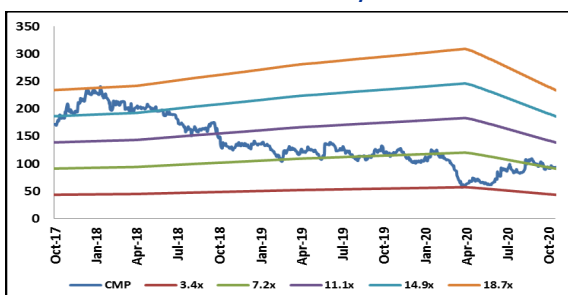


Source: Annual Report, Progressive Research

Risks and Concerns: **RM price fluctuations:** Copper is one of the key raw materials, fluctuation in prices of the same affects the gross margins and the same cannot be mitigated easily. However, these fluctuations are a pass through to the customers with a lag of 3-6 months. **Competition risk:** Salzer faces competition in every line of operation, from domestic as well as global players. Brand name, reputation and years of experience are the distinguishing factors in this business and it is aptly placed in the electrical equipment value chain. **Forex risk:** Since the company has global exposure in a number of countries, the company is vulnerable and can be affected by volatile forex fluctuations. **Regulatory risk:** This pertains to it being unable to obtain required certifications and approvals for existing and new products. The company currently has all necessary approvals and certification in place.

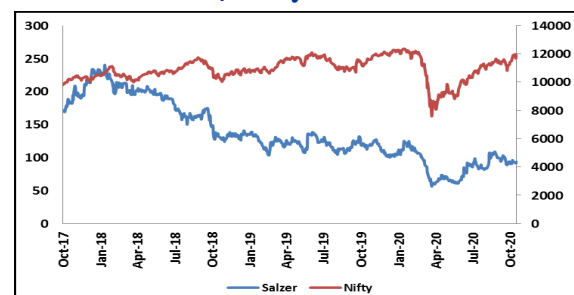
Outlook and Recommendations: Make in India push by GOI and the recent national infrastructure pipeline both augurs well for Salzer (as and when green shoots begin to reappear), as the company is aptly placed to reap the benefits of the anticipated buoyancy in the infra and power sector. Salzer has also entered various strategic tie-ups which enables it to import advanced technologies and additionally provides distribution network around the globe. The company caters to reputed clientele with whom the company has maintained long term relationships. Salzer's products are internationally approved and are preferred choice products in more than 40 countries. The company is a market leader in CAM operated rotary switch and wire ducts while newer products such as three phase transformers, wire harness etc. are seen gaining traction. The recent acquisition of Kaycee Industries will further strengthen Salzer's market share in the industrial switchgear business and through its distribution network, Salzer can reach into newer geographies and products. The company appears to be in a sweet spot to cater to the enquiries owing to the shift in global supply chain; conversion of these enquiries will benefit the company. The in-house R&D team provide an edge to the company by focussing on increasing efficiency of processes and products. Owing to complete backward integration, more than 80% of the components manufactured by Salzer are in-house. The Management's intent to focus on value added high margin products and pursuit to introduce new products will help improve margins. Considering the upcoming triggers from the Indian economy, strong R&D related to new product launches, shift in global supply chain, better operational efficiencies, brand name, reputation etc, we recommend a BUY on the stock with a target price of Rs130 with a horizon of 12 months.

Exhibit 12: One Year Forward P/E



Source: Ace Equity

Exhibit 13: Price v/s Nifty



Source: Ace Equity

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