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AJCON'S
Diwali picks
Samvat 2078

Aarti Industries

Asian Paints

Canara Bank

Dwarikesh Sugar Industries

Sona BLW Precision Forgings

UGRO Capital

Aarti Industries Limited (AIL), "BUY", Target price: Rs. 1,200, Upside: 26.5%

CMP: Rs. 948|Book value: Rs. 138|FV: Rs. 5|Market Cap: Rs. 34,338 Crore|EPS (TTM): 15.02 |EPS (FY21): Rs. 18.06 |RoE: 18%| RoCE: 14%| 52 Week High/Low: Rs. 1168/Rs. 495

Investment Rationale

1) Impressive background and Business Model

Established by first generation technocrats in 1984. Aarti Industries (AIL) is amongst the most competitive benzene-based, speciality chemical companies in the world. The Company is a rare instance of producing global speciality chemicals that combine process chemistry competence (recipe focus) with scale-up engineering competence (asset utilisation).

The Company's Pharma operations covers APIs, intermediates and Xanthene derivatives.

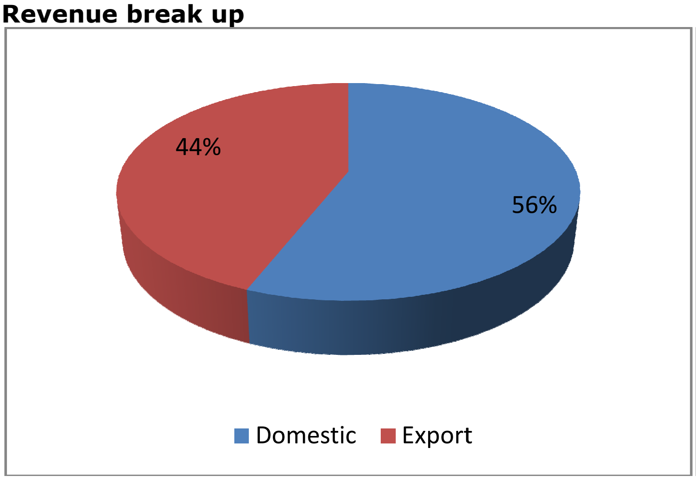
Over the last decade, AIL transformed from an Indian company servicing global markets to what is fundamentally a global company manufacturing out of India. The Company ranks between #1 and #4 globally for 75% of its portfolio and is a 'Partner of Choice' for diverse major global and domestic customers.

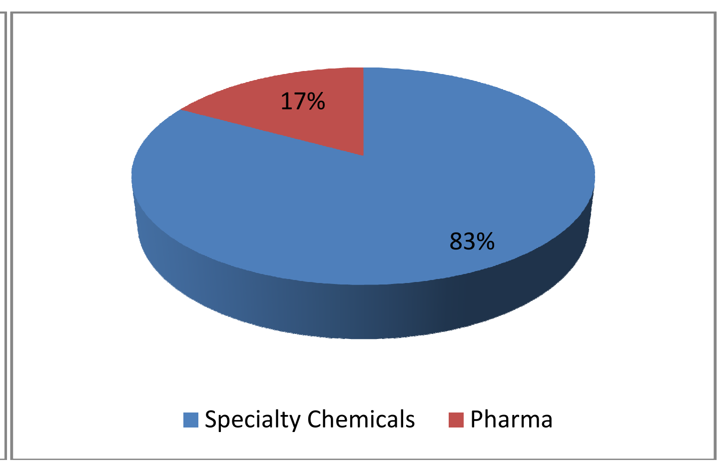
Strong R&D capabilities – 4 R&D facilities; dedicated pool of about 400+ engineers & scientists; IPRs for developing customized products.

Plants located in western India with proximity to ports: 15 for Speciality chemicals; 5 for Pharma (2 USFDA and 3 WHO/GMP)

Speciality chemicals make up the Company's core business segment, contributing maximum to the revenue. The Company uses feedstock materials such as benzene, toluene, nitric acid, chlorine, methanol, aniline, sulphur etc., along with a wide range of reactions to service leading chemical companies around the globe. In FY21, 83 percent revenue in the business was generated by customers with whom the Company had a relationship for over five years. The Company also enjoys a diversified customer base, with the largest customer contributing to less than 5 percent of the sales.

Revenue break up





Source: Company

2) De-risked business model

AIL has a de-risked, multi-product, multi-geography, multi-customer and multi-industry portfolio. Its 200+ products are sold to 700+ domestic and 400+ export customers in 60 countries across the globe, with major presence in USA, Europe and Japan. Its speciality chemicals and intermediate products find usage in Pharmaceuticals, Agrochemicals, Polymers, Pigments, Printing Inks, Dyes, Fuel additives, Aromatics, FMCG and other industrial sectors. Agrochemicals, Pharmaceuticals and FMCG, which are generally agnostic to economic cycles, contribute 55-60% of AIL's revenue, while other end-user industries, such as Polymers, Pigments, Printing Inks, Dyes, Fuel additives, Aromatics, among others are generally dependent on global and domestic economic cycles – accounting for the remaining 40-45% of revenue. This mix provides steady growth opportunity and stability to the business.

3) Competitive advantages

a) The Company is among top 3 Nitro Chloro Benzenes (NCB) manufacturers globally
b) The Company is among top 3 Di-Chloro Benzenes (DCB) manufacturers globally
c) The only manufacturer in India for Nitro Fluoro Aromatics (via Halex chemisatry)

4) Well placed to benefit from Industry Tailwinds

a) Significant opportunity for exports arising from environmental related shutdowns in China
b) Structural drivers in places for a robust domestic demand growth

5) Pharma - Significant growth with diversification

a) API & Intermediate market (domestic & exports) expected to witness strong growth
b) Xanthine Derivatives are expected to continue the growth momentum

5) Strong return profile despite significant capex

a) Expanded capacities and diversified into new products while maintaining return profile
b) New capacities are still ramping up providing operating leverage

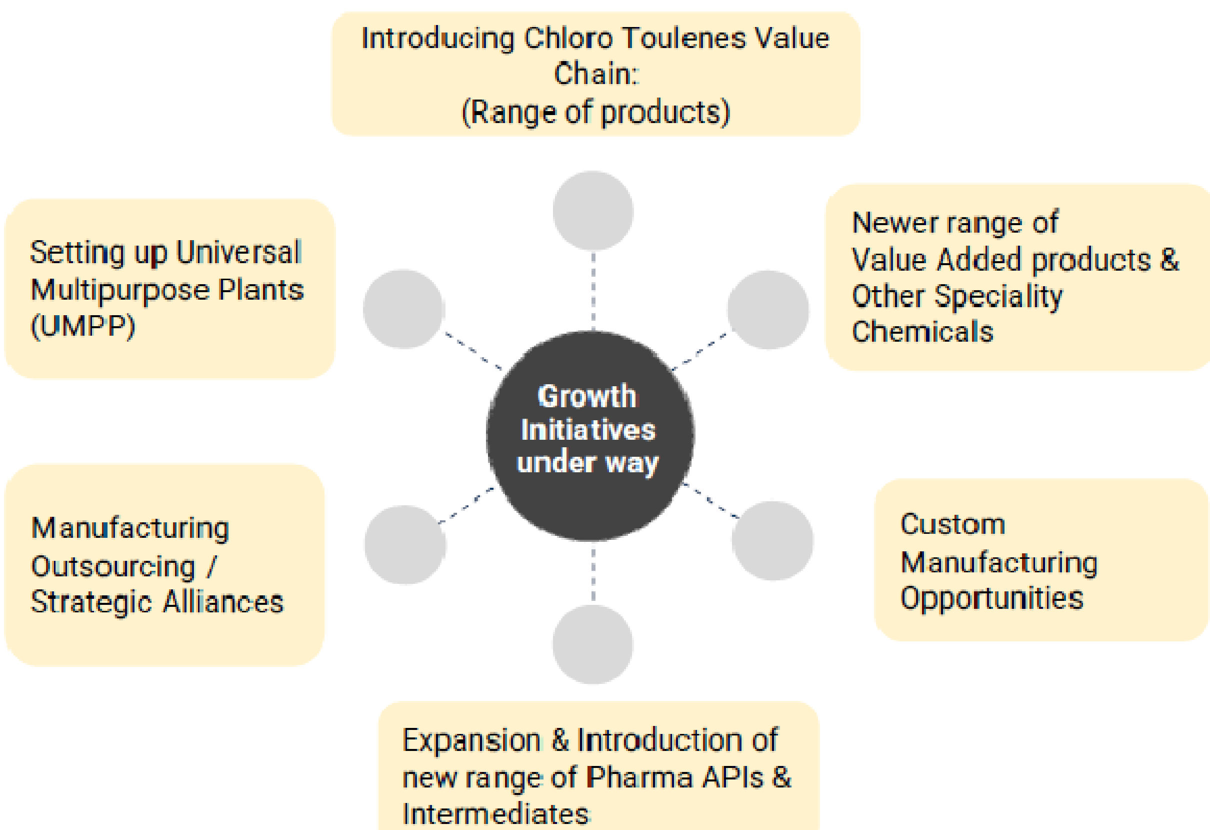
4) Good Q2FY22 result

a) The Company recorded the highest ever Topline and Bottomline in Q2FY22. Sustained revenue growth driven by volume expansion in key markets and 74 percent contribution from value-added products. Top line is also a function of variations in raw material prices linked to crude oil.
b) The Company's topline grew by 17.2 percent on QoQ basis and by 32.4 percent on YoY basis to Rs. 1,762 Crore.
c) Domestic demand for discretionary products has returned to pre-covid levels, while for exports markets the same are recovering gradually.
d) The Company's Gross margins returned to normalized levels. The absolute growth in EBITDA on YoY basis reflects the ability to pass-on the price increase to the customer.
e) The Company has taken efforts to pass on a substantial part of Fuel and Logistics costs to the customer.
f) QIP of Rs 1,200 crore raised in June 2021, assisted in reduction of debt and corresponding borrowing costs.
g) Capex in Q2FY22: Rs 317 crore; 6M aggregate capex of Rs. 620 crore – in line with guidance of Rs. 1,200-1,500 crs for FY22.
h) Key projects such as Project of Long Term Contracts, Pharma Expansion nearing the final stages and expected to commercialised in H2 FY22.
i) Discontinuation of MEIS and non inclusion of Chemical & Pharma products under RotDep Scheme impacts the sector negatively
j) Macro factors indicate positive traction to continue in near to mid-term.
k) The Company has re-iterated guidance of over 25 percent growth for FY22.
l) **Commenting on the performance for Q2 FY22, Mr. Rajendra Gogri – Chairman & MD at Aarti Industries Limited said:**

"Maintaining our growth trajectory, we have once again recorded the highest ever revenue and profitability in our operating history. We evaluate EBITDA as the key monitorable for the business and on this parameter we have delivered 22 percent growth on YoY basis. Based on the milestones achieved in the first half of FY22, we remain well-positioned to meet our growth guidance. We are further encouraged by our recent achievements that come in the backdrop of a highly volatile operating environment during this entire period – marked by significant shifts in raw material prices, coal availability, supply chain disruptions, competitive pressures as well as constantly changing dynamics in our end-user markets. We are seeing improving demand shifts across key customer segments both in international markets and within the expanding Indian chemicals ecosystem. We believe the current visibility – for India as an increasingly significant global chemicals supply destination and for players such as Aarti that are recognized as partners of choice by leading innovator companies – is likely to remain robust over the long term. On the operational front, we are witnessing progressively higher utilization of recently commissioned facilities and we remain in line for the launch of our second and third long-term customer contracts, NCB expansion and pharma capacity enhancement for both APIs and intermediates. These enhancements provide us the confidence of meeting our growth guidance for FY24. We are also aggressively pursuing the previously shared business plan and revenue targets for the rest of the current decade, supported by a well-capitalized balance sheet."

5) Future growth projects: FY22-24 (Driven by R&D and Innovation)

The Company is adding new chemistries and Value added products. 40+ products for Chemicals and 50+ products for Pharma. The EBITDA margin fo these products is expected to be ~25-30%. The Company is targeting a Capex of about Rs. 2,500-Rs. 3,000 Crore for Chemical and Rs. 350-500 Crore for Pharma. The site development work to commence on 100+ acre land at Jhagadia. The Company also acquired over 120 acres land at Atali, Gujarat. Environmental clearances has been obtained/in process. The construction will start from FY22-24.

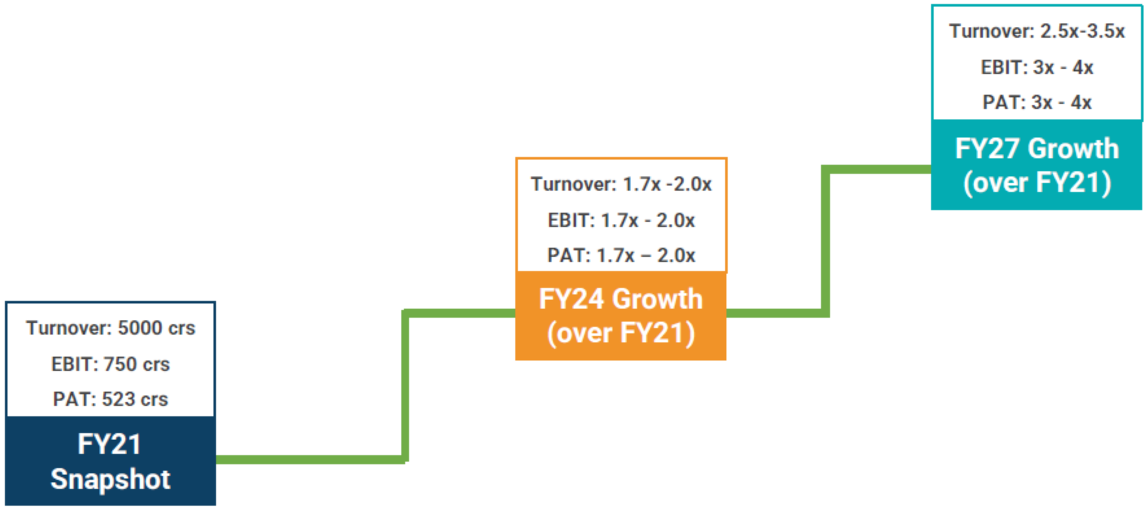


Source: Company

6) Strong growth estimates given by the Company

a) The Company is expecting robust growth fuelled with aggressive capex investment

b) Capex for FY 22-24: ~ Rs 4,500-5,000 Crore
c) Existing Products: ~ Rs 1500 Cr, New Products: Rs 3,000-3,500 Crore



Source: Company

Recommendation

At CMP of Rs. 948, the stock is valued at a P/E of 52x at FY21 EPS. We recommend a "Buy" with a target price of Rs. 1,200 (P/E of 52 x at estimated FY23 EPS of Rs. 23.07)

One year price movement chart

Source: Trading view

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Asian Paints Limited (AIL), "Buy", Target price: Rs. 3,805, Upside: 20%

CMP: Rs. 3,170.65|Book value: Rs. 137.92|FV: Re. 1|Market Cap: Rs. 3,03,883 Crore|EPS (TTM): Rs. 33.93|EPS (FY21): Rs. 32.73 |RoE: 27.3%|RoCE: 34.8%| 52 Week High/Low: Rs. 3,505/Rs. 2,117.15

Investment Rationale

1) Impressive background

Asian Paints is India's leading paint company and ranked among the top ten Decorative coatings companies in the world with a consolidated turnover of Rs. 21,712.79 Crore. Asian Paints along with its subsidiaries have operations in 15 countries across the world with 26 paint manufacturing facilities, servicing consumers in over 60 countries through Asian Paints, Apco Coatings, Asian Paints Berger, Asian Paints Causeway, SCIB Paints, Taubmans and Kadisco Asian Paints. Asian Paints is also present in the Home Improvement and Décor space in India.

2) Decorative business continues to be strong

a) Strong topline momentum continued in Q2FY22 both in terms of volume and value. Volume growth stood at 34 percent on YoY basis. Value growth stood at 35 percent in Q2FY22 as against 6 percent in Q2FY21 and 9 percent in Q2FY20 (Pre - Pandemic).

b) Strong volume growth led by growth in T1/T2 centers across regions despite covid related restrictions in certain regions & prolonged monsoon.

c) Industry beating growth over the last 3 years; strong & consistent market share gain.

d) Economy as well as Luxury range continued to grow strongly. This was led by uptick from new Launches in Luxury and Premium Space

e) The Company's expansion in the Projects business is on a stronger footing. The Company has made deeper inroads across segments - Builders, Government, Factories, Co-Op Hsg Societies.

f) The Company has witnessed high growth trajectory in the Smartcare Waterproofing portfolio.

g) The Company's Wood Finishes category expanding with range of Premium product innovations.

3) Margin pressure witnessed in H1FY22; Company doing price hikes to offset it

a) On a standalone basis, gross margin contracted by 975 bps in Q2FY22 and 827 bps for the first half compared to last year. This was led by steep material inflation - only partly negated by price increases taken over several rounds. The Company improved scale over the last year's base and optimized on overhead spends arresting fall in first half PBIDT margin to 711 bps

b) Even at consolidated level, Gross contribution margins impacted by persistently high inflation, Gross margin contraction of 966 bps for the Qtr & 816 bps for the first half compared to last year

c) PBDIT margins for first half lower than previous year by 680 bps. The Company is taking measures to protect margins from cost pressures by passing on the burden to consumers. The company undertook a 4 percent price increase in Q2FY22 on a 6 percent sequential raw material cost increase during the quarter, the management said. It has affected a 7.5 percent price increase so far this year and would raise prices over the next three months. The price hikes will be taken in a calibrated manner since too many of these could affect demand stability.

4) **Q2FY22 Business performance update**

a) "The domestic Decorative business continued to move ahead on its high growth trajectory with an unprecedented 34% volume growth in the quarter and a strong compounded growth rates over the last 2 years. The Industrial Coatings business also registered strong double digit revenue growth led by robust demand for Protective Coatings and uptick in the automotive sector. The Home Improvement business continued to scale up in a significant manner registering its highest quarterly revenues, aided by strong alignment with the Projects business. Performance in the International Business was a mixed bag with good growth in the South Asian markets while markets in Middle East & Africa were sluggish with challenges around Covid and forex availability. Steep inflation seen in raw material prices, since the beginning of this calendar year, has been phenomenal and has impacted gross margins across all businesses in the quarter. We have taken a series of price increases and would look at further price increase to mitigate the impact of this persistently high inflation and are confident that we should be able to turn this around strongly in the coming quarter. All the businesses continue to engage in some ground-breaking work to enhance customer engagement and advance the value proposition of its various product and service offerings, further enlarging the organization's value creation potential" said Amit Syngle, Managing Director & CEO of Asian Paints Limited.

b) Kitchen Business: The Company achieved Rs. 100 Crore revenue mark milestone in Q2FY22. Strong performance in Full Kitchen solutions as well as components business. Demand conditions recovering in projects. The Kitchen business PBT break even in Q2FY22 for the first time.

c) Bath Business: Improving revenue trajectory with Premium products moving well. The Company's topline in this segment is supported by growth in Projects with strong collaboration with decorative projects. The bath business was profitable in Q2FY22 with benefits of improving scale.

Recommendation

At CMP of Rs. 3,170.65, the stock is valued at a P/E of 97x. We recommend a "Buy" with a target price of Rs. 3,805 (P/E of 97x at estimated FY23 EPS of Rs. 39.23)

One year price movement chart

Source: Trading view

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Canara Bank Limited (AIL), "BUY", Target price: Rs. 281, Upside: 24%

CMP: Rs. 225.95| FV: Rs. 10| Book value: Rs. 255.16 per share| Market Cap: Rs. 35,076Crore|C/D ratio: 66.52%|NIM: 2.72%|Cost/Income: 48.07% |PCR: 82.44%| Gross NPA: 8.42%| Net NPA: 3.21%|Credit cost: 1.98%|Slippage ratio: 1.04%|RoA: 0.47%|RoNW: 12.36%

Investment Rationale

"Good recoveries witnessed; corporate credit growth would be good in the coming quarters"

1) Profitability remains good

a) The Bank's operating profit witnessed a rise of 2.24 percent on QoQ basis to touch Rs. 5,604 Crore led by growth in Net Interest Income of 1.83 percent. On an analyst query, whether Bank can achieve Operating Profit of Rs. 24,000 Crore for FY22, the Bank management said that it should not be a problem and expects coming two quarters to be better than Quarters in H1FY22.

b) Fee based income rose by 9.42 percent on QoQ basis to Rs. 1,463 Crore in Q2FY22 owing to underwriting of big credit proposals. As a result, commission and processing charges are increasing.On an analyst query whether this Fee based income would continue the Bank's MD & CEO Shri. L V Prabhakar said that in next two years, same amount of processing charges will be there. He further added that flow of sanctions would continue and new relationships are getting started. He said that the Bank is very aggressive in HAM projects, sectors like steel, cement and healthcare. With regards, to Real Estate the Bank is taking exposure to Residential Real Estate projects which are RERA compliant and backed by strong promoters.

c) The Bank's treasury performance was also robust in Q2FY22 which was guided in the preceding quarter concall. Trading income grew by 83.63 percent on QoQ basis to Rs. 1,133 Crore in Q2FY22.

d) On an analyst query, whether there was a one-off item on the expenditure side in Q3FY22, the MD & CEO clarified that there was a Family Pension Provision worth Rs. 250 Crore and interest reversal of Rs. 280 Crore in case of SREI account. He added despite interest reversal, there was good growth in interest.

e) Net Profit registered a growth of 13.25 percent on QoQ basis to touch Rs. 1,333 Crores in Q2FY22 (Rs. 444 Crores in Q2FY21).

f) On an analyst query with regards to high taxation rate of 41 percent, the Bank management said that the Bank may move to new tax regime in 1-2 years year time and with current tempo of growth it is not far away.

2) Slippages increased in Q2FY22 but would be in control in coming quarters; Asset quality improving with higher recoveries

a) Fresh slippages during the quarter stood at Rs. 6,525 Crore as against Rs. 4,253 Crore in Q1FY22. Out of fresh slippages of Rs. 6525 Crore, Rs. 3,200 Crore worth of slippages were from SREI account. Provisions of 50 percent has been made in SREI account as against RBI requirement of 15 percent.

a) Gross non-performing assets (NPAs) position improved 8 basis points to 8.42 per cent of gross advances against 8.50 per cent as at June-end 2021.

b) Net NPA position improved by 25 basis points to 3.21 per cent of net advances against 3.46 per cent as at June-end 2021.

c) The Bank is working to reduce GNPAs to 7.9 per cent and net NPAs to 2.8 per cent by March 2022. It has also guided for improvement in PCR to 83.95 per cent by end of FY22.

d) Overall provisions stood at Rs. 4,271 Crore in Q2FY22 as against Rs. 4,304 Crore in Q1FY22. Provisions on NPAs increased to Rs. 2,678 Crores in Q2FY22 from Rs. 2,335 Crore in Q1FY22. PCR stood at 82.44 percent in Q2FY22 (81.18 percent in Q1FY22).

e) The Bank witnessed higher cash recovery of Rs. 3,002 Crore (Rs.1,598 crore in Q1FY22). Upgradation and write-offs stood at Rs. 2,671 Crore (Rs. 2,292 Crore in Q1FY22) and Rs. 1,585 Crore (Rs. 2,574 Crore in Q1FY22), respectively.

f) On an analyst query as to whether the recovery from DHFL worth Rs. 1,700 Crore has been reflected in Profit and Loss Statement, Shri. Prabhakar replied that whatever has been recovered has been used for additional provision of Rs. 2,200 Crores and hence no effect in P&L.

3) Well capitalised

a) The Bank's Capital Adequacy Ratio (CAR) stood at 14.37 per cent with Common Equity Tier-1 ratio of 11.41 per cent for Q2FY22. Bank has raised Rs 2,500 Crore in equity capital from Institutional investors and additional tier-I (AT1) capital of Rs. 1,500 Crore so far in the current financial year (FY22). It intends to raise Rs 2,500 Crore in AT1 capital and Rs. 2,500 Crore in Tier II bonds in balance part of current financial year.ShriPrabhakaradded the Bank with 14.37 percent capital adequacy is comfortably placed for growth and meeting regulations.

4) Good guidance given by Management on growth front

a) Shri. Prabhakar gave overall loan growth guidance of 7.5 percent. He further added that Retail credit growth would be of 10 percent. He said that Corporate credit consolidated in Q2FY22 and the bank would be aggressive in Corporate credit in Q3FY22.

Ajcon's view

a) We are impressed by the Bank's performance on all major fronts.

b) The bank is poised to report strong performance in H2FY22 led by good recoveries and better credit growth performance especially on the corporate side amidst faster recovery of the economy. The present management is steering the operations very efficiently which is evident from the Bank's performance. There are no major legacy issues with high visibility on recoveries in FY22. In addition, the present subsidiaries also offer a lot of value to the Bank and the Bank can unlock its value or rationalise it as and when required.

Recommendation

At CMP of Rs. 225.95, the Bank is valued at a P/BV of 0.88x which we believe is at a discount and deserves premium considering its good performance in the last few quarters. We recommend a "Buy" with a target price of Rs. 281 (P/BV of 1.1x at Book value of Rs. 255.16 as on Q2FY22).

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One year price movement chart of Canara Bank

Source: Trading view

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Dwarikesh Sugar Industries Limited (AIL), "BUY", Target price: Rs. 100, Upside: 33.6%

CMP: Rs. 74.8|Book value: Rs. 33 |FV: Re. 1|Market Cap: Rs. 1,409 Crore|EPS (TTM): Rs. 6.50 |EPS (FY21): Rs. 4.9|RoE: 15.8|RoCE: 14.4|52 Week High/Low: Rs. 83.9/Rs. 26

Investment Rationale

Impressive background

The Company was founded in 1993 by Shri Gautam Morarka with the aim to create one of the most respected sugar companies in India. Over the years, Dwarikesh Sugar has emerged as one of the most sustainable multi-product sugar companies in India. The Company is currently **one of the most efficient integrated sugar companies in Uttar Pradesh**. The Company is engaged in the manufacture of sugar, ethanol (and related products) and power. The Company is likely to embark on the manufacture of value-added chemical products to address a growing social need following the outbreak of COVID-19 pandemic.

Good manufacturing capabilities

a) 3 Plants located in UP-India's largest sugar producing state
b) 2 Plants located in Bijnor District– a District with focused concentration on cane production on highly fertile & well-irrigated land
c) Plant at Bareilly – the low-lying Ganges plains district with fertile alluvial soil
d) Access to large, clearly defined cane-producing areas in the region
e) All the three plants are well connected with major sugar consuming markets of the country, the Bareilly plant being located on the National Highway itself

Particulars	1995	2002	2004	2005	2007	2019	2020	2021
Sugar (TCD)	2500	6500	6500	14000	21500	21500	21500	21500
Power (MW)	6	6	17	26	86	91	91	91
Distillery (LPD)	-	-	-	30000	30000	100000	130000	163000

Business strategy

a) Reduce leverage through a combination of prudent financial management and prepayment/repayment of debt
b) Focus on cost control through plant efficiencies & logistics management
c) Continue educating farmers on best farming practices, high yield / sugar content seeds, pesticides etc.
d) Making timely payment to farmers to incentivize increase in area under sugarcane
e) Through continuous improvements in operating parameters, research and development and continuous farmer engagement

Big ethanol opportunity

a) The management gave a guidance of production more than 5 crore litre of ethanol in FY22E and more than 7 crore litre of ethanol in FY23E. The new distillery will be commissioned in July 2022, which would increase the annual capacity closer to 11 crore litre from 3.2 crore litre in FY21.

b) The company would only produce ethanol from B-heavy molasses in sugar season 2021-22 and would give C-heavy molasses for levy obligation.

Strong outlook for the future

a) Going ahead, the management expects growth being derived from investments in improved technologies in its older plants, expansion in the distillery capacity, extension into refined sugar and graduation into retail consumer packaging. As the quantum of capital expenditure declines, the management expects to strengthen its working capital management, increase margins and gradually turn cash-flow positive around a right-sized sugar inventory.

b) Strong revenue growth is expected from the distillery segment with around 3x increase in ethanol volumes and realisation growth of around 4 percent owing to good realisation from B - Heavy and sugarcane juice ethanol.

c) Diversion of sugarcane for ethanol production has led to higher domestic sugar prices will boost profitability and reduce sugar inventory.

Strong performance in Q2FY22 result

a) The Company witessed a topline growth of 28.9 percent on QoQ basis and 21.1 percent on YoY basis to Rs. 505.5 Crore led by higher distillery volumes and increase in sugar prices. The rise in distillery volumes was owing to higher demand from OMCs. In Q2FY22, distillery segment witnessed strong sales growth of 73.6 percent led by jump in ethanol volumes and higher proportion of B-heavy ethanol sales.

b) EBITDA grew sharply by 27.7 percent on QoQ basis and by 64.1 percent on YoY basis. Net Profit was up by 46.2 percent on QoQ basis and by 123.6 percent on YoY basis led reduction in interest cost and good growth in EBITDA.

c) Debt has reduced significantly in Q2FY22 led by liquidation of inventory.

Recommendation

At CMP of Rs. 74.8, the stock is valued at a P/E of 15x. We recommend a "Buy" with a target price of Rs. 100 (15x at estimated FY22 EPS of Rs. 6.66).

One year price movement chart

Source: Trading view

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Sona BLW Precision Forgings Limited, "BUY", Target price: Rs. 811, Upside: 25%

CMP: Rs. 649 |Book value: Rs. 28.2|FV: Rs. 10|Market Cap: Rs. 37,945 Crore| Post IPO adjusted EPS (FY21): Rs. 3.19|FY21 ROE: 17.0%| FY21 ROCE: 17.6%|52 Week High/Low: Rs. 813.25/Rs. 295.15

Investment Rationale

Impressive background - Strong play in Electric vehicles industry

Sona BLW Precision Forgings Limited ("Sona Comstar") was incorporated on October 27, 1995. Sona Comstar is one of India's leading automotive technology companies, designing, manufacturing and supplying highly engineered, mission critical automotive systems and components such as differential assemblies, differential gears, conventional and micro-hybrid starter motors, BSG systems, EV traction motors (BLDC and PMSM) and motor control units to automotive OEMs across US, Europe, India and China, for both electrified and non-electrified powertrain segments.

Manufacturing facilities across the globe

Sona Comstar has 9 manufacturing and assembly facilities across India, China, Mexico and USA, of which 6 are located in India and they have 8 warehouses, of which, 5 are located in India and 3 across USA, Germany, and Belgium.

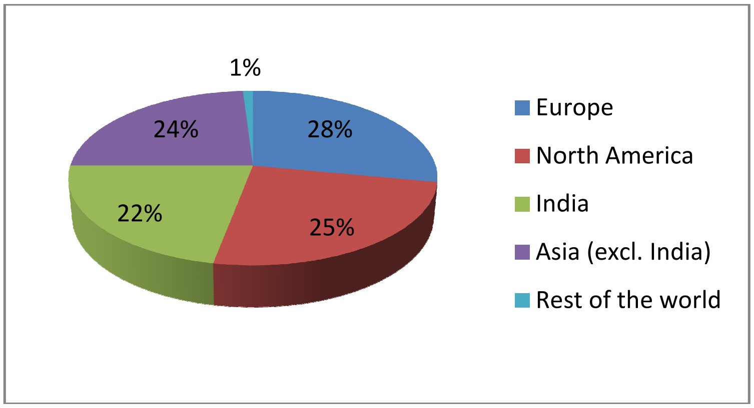
Technology and innovation driven Company - catering to the needs of Electric Vehicles (EV) Industry

Sona Comstar is a technology and innovation driven company. With a strong focus on research and development ("R&D"), the Company develops mechanical and electrical hardware systems, components as well as base and application software solutions, to meet the evolving demands of their customers. The Company is one of the few companies globally, with the ability to design high power density EV systems handling high torque requirements with a lightweight design, while meeting stringent durability, performance and NVH specifications, enabling EV manufacturers to enhance the vehicle range, acceleration and the overall efficiency.

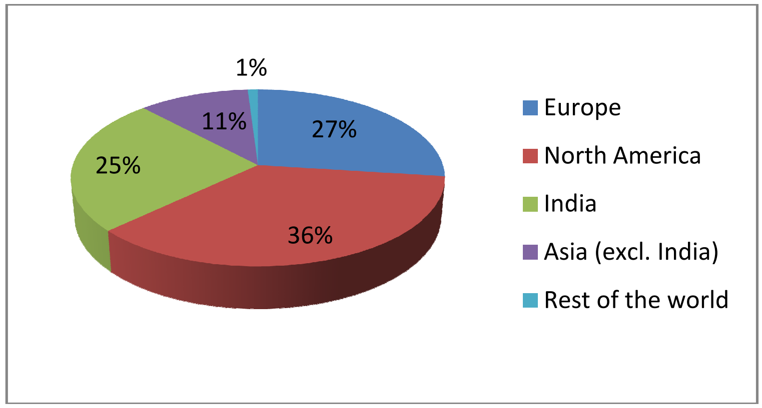
Sona Comstar has increased sales to the EV market and has registered a CAGR of 243.6 percent from Rs. 17.42 Crore in FY19 to Rs. 205.70 Crore in FY21. The Company currently supplies differential assemblies, differential gears, EV Traction Motors to customers in US, China and India, for use in hybrid and battery electric passenger vehicles, hybrid and battery electric light commercial vehicles, electric 2-wheelers and electric 3-wheelers. The Company's revenue share from Battery Electric Vehicles (BEV) has grown 16x over 3 years, with absolute BEV revenue growth at 25x at Rs. 4,412 Crore (H1FY22 annualised number) from Rs. 174 Crore in FY19.

Revenue breakup - Geography

H1FY22



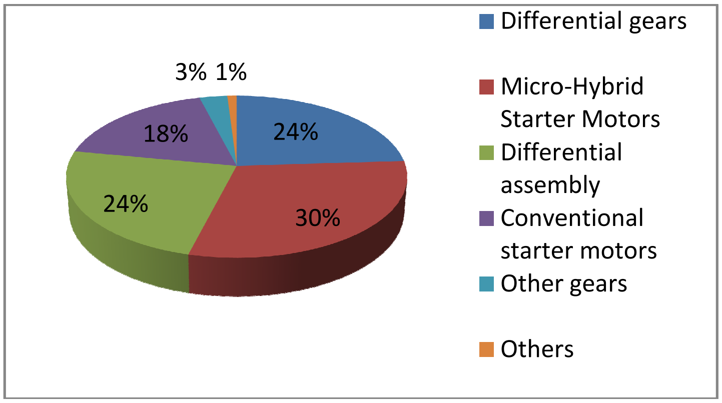
FY21



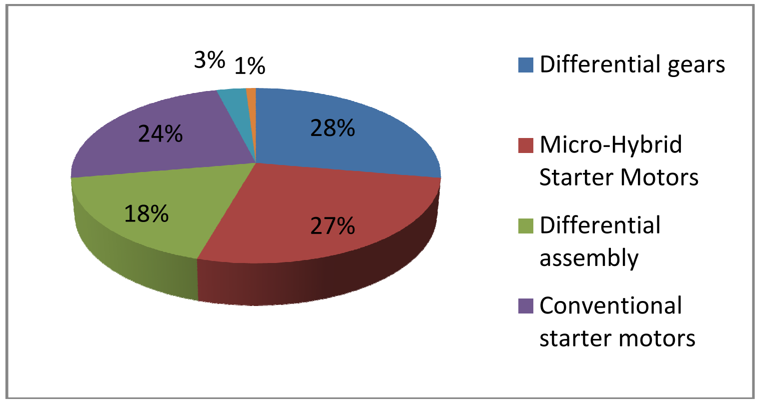
Source: Company

Revenue breakup by product

H1FY22



FY21



Source: Company

Among the top 10 players globally in the differential bevel gear and starter motor suppliers market
According to the Ricardo Report, Sona Comstar is among the top 10 players globally in the differential bevel gear market. The Company is also among the top 10 global starter motor suppliers based on their exposure to the PV segment in calendar year 2020. The Company is gaining global market share across products to reach a share of approximately 6.4% for differential bevel gears in 9MCY21 (5.0% in CY20), 5.0% for starter motors in 9MCY21 (3.0 % in CY21) and 8.7% for Battery electric vehicle ("BEV") differential assemblies, in calendar year 2020. The Company continues to dominate the Indian market for Differential Gears.

Marquee global customers
The Company's global OEM customer portfolio includes a Global OEM of EVs, a North American OEM of PVs and CVs, Ampere Vehicles, an Indian OEM of PVs, CVs and EVs, Ashok Leyland, CNH, Daimler, Escorts, Escorts Kubota, Geely, Jaguar Land Rover, John Deere, Mahindra and Mahindra, Mahindra Electric, Maruti Suzuki, Renault Nissan, Revolt Intellicorp, TAFE, Volvo Cars and Volvo Eicher. The Company also serves selected leading Tier 1 automotive system suppliers such as Carraro, Dana, Jing-Jin Electric, Linamar and Maschio.

Achieving significant global share from existing systems and components
Sona Comstar has increased their global market share of differential gears and starter motors to 5% and 3%, respectively in calendar year 2020 from 4.5% and 2.5%, respectively in calendar year 2019 and their global market share of BEV differential assemblies was 8.7% in calendar year 2020. As part of their strategy, they intend to penetrate the European market for supplying differential assemblies and differential gears, where they currently have limited market share for their driveline products. They also plan to expand their presence in China for supply of their micro-hybrid starter motors for PVs and LCVs as well as their 48V BSG systems for hybrid PVs, as they expect to benefit from China's growing position as a leading market for EV manufacturers. As part of their growth strategy, they set-up an assembly plant in China in 2015 and Mexico in 2017, with an aim to capture higher market share in the Chinese and North American markets.

Scaled player with high and profitable growth outlook
As on Q2FY22, the Company's net order book stood at Rs. 13,600 Crore (8.7x FY21 revenue). Net order book means the aggregate revenue from awarded programs which are either yet to start production or are yet to fullyramp up, in the next 10 years, after adjusting for the negative impact of all programs that are expected to reach end of life or be phased out. The Company has also applied a discount to accommodate any unforeseen delays or changes in program launches that may happen in the future.

Good track record of financial performance

Over the last 5 years, the Company has witnessed topline CAGR of 34.6 percent. In the same period, 5 year Average EBITDA margins stood at 27.6 percent. The Company has been generating ROE of more than 28 percent over the period FY17-21.

Strong performance in Q2FY22 and H1FY22

In Q2FY22, the Company's topline witnessed YoY growth of 52 percent to touch Rs. 586 Crore; 22 percent revenue share from BEV; BEV revenue growth stood at 143 percent on YoY basis. EBITDA registered a growth of 24 percent on YoY basis to touch Rs. 154 Crore. EBITDA margin stood at 26.4 percent in Q2FY22. PAT grew by 22 percent on YoY basis to Rs. 88 crore. PAT margin stood at 15.1 percent in Q2FY22.

Commenting on the performance, Mr. Vivek Vikram Singh, MD & Group CEO, said: "This was our best quarter yet. Revenue growth of 52 percent YoY in the second quarter has been driven by rapid scale up of revenues from BEV, which are higher by 143 percent YoY, and now represent 22 percent of overall revenues. Our profitability and return ratios remain strong, despite the impact of sharply rising input prices. With 3 new BEV programs awarded during the quarter, our net order book stands at Rs. 13,600 crore of which 58.5% is contributed by EV."

Key highlights of Q2FY22

BEV Revenue Share: Revenue from Battery EV was Rs. 124 crore and contributed 22 percent of total revenue as against 13.8 percent in FY21.

EV programs: The number of awarded programs increased from 17 to 20 across 11 different customers

Recommendation

At CMP, the stock is trading at a P/E of 160x at annualised H1FY22 EPS. It is difficult to assign a target to a Company enjoying strong growth rate in a sunrise industry. We recommend a "Buy" with a target price of Rs. 811 based on current trend of profitability.

One year price movement chart

Source: Trading view

U GRO Capital Limited, "BUY", Target price: Rs. 220, Upside: 33%

CMP: Rs. 167.25|Book value: Rs. 135.8 as on H1FY22|FV: Rs. 10|Market Cap: Rs. 1,179 Crore|AUM as on Q2FY22: Rs. 1,933 Crore| NIM: 7.7%|Cost/Income ratio: 70%|Gross NPA: 1.9%, Net NPA: 1.8%|Credit cost: 5.9%| Portfolio yield: 15.7%| FY21 RoE: 3.06 %| FY21 CRAR: 65.60 %|52 Week High/Low: Rs. 202/Rs. 70

Investment Rationale

Specialised MSME Lenders like UGRO are better positioned to bridge the MSME Credit Gap

Particulars	Specialized MSME Lenders	Traditional NBFCs	Banks
Product	Customised products based on the nature of business, non-financial parameters, end use, payment capacity/frequency of underlying customer	Loans against property, supply chain financing, unsecured loans	Loans against property, supply chain financing
Distribution	Omnichannel, Ecosystem based lending	Branch/DSA led	Branch/DSA led
Credit Appraisal	Sector specific approach, Cash Flow based, Automated Review	One size fits all Collateral/Bureau score	One size fits all Collateral/Bureau score
Turnaround time	4-5 days	15-20 days	30-45 days
	Combining traditional and non-traditional sources. Use of information available in public and private domains. Digital document submission		

GRO Score 2.0, a superior underwriting framework developed by U GRO to make the selection sharper

GRO 2.0 combines credit bureau and banking data into one model

Credit bureau	Banking
Pace of borrowing	Transaction intensity
Product mix	Turnover
Overdues	Purchases
Frequency of default	Counterparties & relative strengths
Nature of past borrowers	Payment cycles
History of raising costly debt	Balances and utilisation
Default with prime lenders	Cash withdrawals and deposits
Business activity under individual	Cheque bounces and bank charges
Credit card usage	Ecommerce
NBFC/PSU relative contribution	Utility payments

Lending focused on selected sectors

Heathcare	
Key sub sectors	General nursing homes, eye clinics, dental clinics, diagnostic labs, radiology/pathology labs, pharma retailers
Key clusters	NCR, Mumbai, Bengaluru, Hyderabad and Chennai
Education	
Key sub sectors	K-12 schools, play schools
Key clusters	NCR, Mumbai, Coimbatore, Chennai, Hyderabad and Pune
Chemicals	
Key sub sectors	Dyes and pigments, bulk and polymers, agrochemicals
Key clusters	Mumbai, NCR, Ahmedabad, Vadodara and Surat
Hospitality	
Key sub sectors	Fine dining (standalone), QSRs, fine dining chains, manpower agencies, boutique hotels, guest houses
Key clusters	NA
Electrical Equipment and Components	
Key sub sectors	B2B, B2C
Key clusters	NCR, Pune, Bengaluru, Chennai, Aurangabad and Rajkot
Microenterprises	
Key sub sectors	Kirana stores, family run businesses, first generation entrepreneurs
Key clusters	Mumbai, Kolkata, NCR, Hyderabad, Bengaluru and numerous Tier II and Tier III locations
Food processing/FMCG	
Key sub sectors	Dairy and dairy products, non-alcoholic beverages, consumer foods, poultry, sea food, food and beverage traders
Key clusters	NCR, Mumbai, Chennai, Hyderabad and Pune
Auto & Light Engineering	
Key sub sectors	Casting and forging, medical equipment and devices, engine parts, drive transmission etc.
Key clusters	NCR, Chennai, Pune, Kolkata, Ludhiana, Bengaluru, Ahmedabad, Rajkot

Strong outlook for the future
With a target to capture 1 percent of the MSME lending market in the next five years, the Company aims to achieve an AUM of roughly Rs. 20,000 Crore and total cumulative disbursements of ~Rs. 12,000 crore by FY25E. To achieve this AUM, the Company has been taking a lot of initiatives in both assets and liabilities side.

The Company has given a guidance for RoE of 18.8 percent and RoA of 4.2 percent by FY25

1) **ROE is a function of the following variables:**

a. Growth – The Company did a disbursement of Rs. 250 Crore each in the last 2 months and have set up channels that will rapidly scale up the AUM in the coming months
b. Cost of borrowing – The Company's cost of borrowing is trending downwards and has fallen from 11.6 percent to 10.6 percent in the last one year.
c. Opex – The Company's opex has not increased on an absolute basis and is expected to realise significant benefits as it scales up and economies of scale are realised.
d. Credit cost – The Company's low GNPA and NNPA is a testimony to its good underwriting practices & conservative provisioning.

2) **The Company has been growing at a rate of 50 percent + on a YoY basis and it seems that the Company is well on track to reach an RoA of 18%+ based on current run rate.**

a) Under the branch led distribution channel, the Company made a strategic pivot with the launch of its micro business. The Company operationalised 25 new Micro Branches across 5 different states which takes the total tally of its branches to 34. Branch led channel, which will be a key lever in realising its 5-year plans, will remain as the largest contributor in total disbursals and AUM in the coming years. The Company's FY25E target is to reach total branches to 270. The Company saw the launch of its product lines which enables it to cater to the entire spectrum of the market. This includes the launch of its co-lending product, Pratham, with Bank of Baroda.
b) Under Eco-system channel, the Company will continue to build the momentum in addition of new anchors in its supply chain channel.
c) Under Partnership & Alliances channel, the Company has been growing via both the levers; addition on new partners/FinTechs and increase in disbursement throughput per partner.
d) On the liability side, the Company has increased its lender base to 36 with addition of lenders from across the entire spectrum of public & private sector Banks, NBFCs, DFIs etc. Going forward, its focus would be to get long term debt capital from Development Finance Institutions.
e) All of its distribution engines are primed, and the Company is now disbursing Rs. 250 Crore of loans every month. The above measures makes the Company confident of achieving its 5-year target of 20,000 Cr.
f) The Management believes, that in eventuality of successfully operations of some of the co-lending partnerships that are in pipeline, the 5-year targets will be achieved much sooner than the expected date.

Recommendation

At CMP of Rs. 165, the stock is valued at a P/BV of 1.22x FY21 Book Value of Rs. 135. We recommend a "BUY" with a target price of Rs. 220 (1.6x at estimated FY22 Book Value) due to the following factors: a) U GRO Capital is Tech focused Small Business Lending Platform ; b) Company's business model is well suited to the new age, c) big opportunity presented to the Company in MSME lending, d) specialized lenders like U GRO Capital are better positioned to bridge the MSME Credit gap, e) underwriting in MSME space is moving from collateral based to cashflow based f) the Company's distribution and liability strategies are both powered by proprietary technology modules, g) U GRO’s distribution model is geared towards catering MSMEs across all geographies and ticket sizes, h) Company backed by Marquee Institutions and lenders, i) the Company intends to create a specialized, scalable platform optimized for end-to-end lending, j) focus on 8-9 sectors after an extensive study of macro and micro economic parameters, k) the Company has developed a superior underwriting framework GRO Score 2.0 (combines credit bureau and banking data into one model) which helps in effective decision making, l) Risk management through "Expert Scorecards" for all Sub-sectors, l)credit process enabled by Integrated technology, m) a paperless, and seamless customer onboarding & underwriting process supplemented by physical underwriting, n) diversified lender base of 37 active lenders with addition of 23 new lenders in the last 12 months, o) the Company has demonstrated robust growth since its inception, p) decent performance during second wave of COVID-19 crisis, q) good Q2FY22 result, r) strong outlook for the future, s) Company aspires to capture 1% of MSME space by FY25, s) strong cumulative disbursement target of Rs. 12,000 Crore with RoE of 18.8 percent and RoA of 4.2 percent by FY25.

One year price movement chart of UGRO Capital

Source: Trading view

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Disclosure for Companies discussed in this research report:

a) Aarti Industries Limited
b) Asian Paints Limited
c) Canara Bank Limited
d) Dwarikesh Sugar Industries Limited
e) Sona BLW Precision Forgings Limited
f) U GRO Capital Limited

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Buy – Absolute return of 20% and above
Accumulate – Absolute return between 15% and above
Book profits: On achieving the price target given in the research report for a particular Company or on a occurrence of a specific event leading to change in fundamentals of the Company recommended
Not rated/Neutral - No recommendation but only outlook given

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