

Harsha Engineers International Ltd.

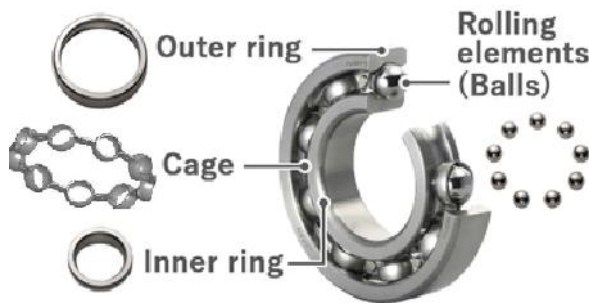
Recommendation		SUBSCRIBE		BACKGROUND																																																							
Price Band		Rs. 314-330		<p>HEIL (Harsha Engineers International Ltd) is the largest manufacturer of precision bearing cages, in terms of revenue, in organised sector in India, and amongst the leading manufacturers of precision bearing cages in the world. HEIL manufactures brass, steel and polyamide cages and stamped components with production facilities located in Asia (India & China) and in Europe (Romania).</p> <p>Details and Objects of the Issue</p> <ul style="list-style-type: none"> The total issue size is Rs. 755 Cr constituting (i) Offer For Sale of up to 0.91 Cr equity shares aggregating to Rs. 300 Cr; and (ii) fresh issue of up to 1.38 Cr equity shares aggregating to Rs. 455 Cr. The offer shall constitute 25.1% of the post-offer paid-up equity capital of the company. HEIL shall utilise the proceeds from the fresh issue for pre-payment or scheduled payment of a portion of existing borrowing; funding capital expenditure towards purchase of machinery; infrastructure repairs and renovation of existing production facilities and general corporate purposes. <p>Investment Rationale</p> <ul style="list-style-type: none"> Strong growth outlook for the Global Bearings and Bearing cages industry Import substitution together with development of India as a manufacturing hub for exports at the bearings industry level shall propel higher growth in the bearings rings industry Comprehensive product portfolio makes the company a preferred supplier Long standing customer relationships; geographically diversified revenue base Manufacturing capabilities offering scale, flexibility and locational advantage Strong financials and balance sheet strength Strong, experienced and dedicated senior management team and qualified workforce <p>Valuation and Recommendation</p> <p>HEIL is a proxy play on (i) rising global outsourcing of bearing components from in-house facilities of clients in Europe & US to India (ii) relocation of global supply chains from China to India and (iii) strong upturn in domestic industrial and auto segments reflecting in strong growth outlook provided by bearing clients. With increasing utilization rates, turnaround in solar EPC business (6% of revenue) and debt being repaid, we expect ROCE to improve to 20% levels in a couple of years. We appreciate HEIL's quality of business, industry positioning (industry leadership in India) and cash flow generation. We recommend subscribing to the issue.</p>																																																							
Bidding Date		14-16 Sept																																																									
BRLM		Axis Capita; Equirus Capital, JM Financial																																																									
Registrar		Link Intime India Pvt Ltd																																																									
Sector		Automotive Component																																																									
Minimum Retail Application																																																											
Number of Shares		45																																																									
Min. Application Money		Rs. 14,850																																																									
Discount to retail		N.A																																																									
Payment Mode		ASBA																																																									
Financials (Rs Cr)		FY21	FY22																																																								
Total Income		874	1321																																																								
EBITDA		122	169																																																								
Adjusted PAT		45	92																																																								
Valuations		Upper Band																																																									
Market Cap (Rs Cr)		3,005																																																									
EPS		10.1																																																									
P/E Ratio		32.7																																																									
EV/ EBITDA		19.8																																																									
Enterprise Value (Rs Cr)		3,343																																																									
Post Issue Shareholding Pattern																																																											
Promoters		43.5%																																																									
Institutions		31.1%																																																									
Public		25.4%																																																									
Offer structure for different categories																																																											
QIB (Including Mutual Fund)		50%																																																									
Non-Institutional Investors		15%																																																									
Retail		35%																																																									
Post Issue Equity (Rs. in Cr)		77.25																																																									
Issue Size (Rs in Cr)		755																																																									
Face Value (Rs)		10																																																									
<p>Jehan Bhadha (+91 22 6273 8174) Sr. Research Analyst jehankersi.bhadha@nirmalbang.com</p> <p>Mahima Mehta (+91 22 6273 8186) Research Associate mahima.mehta@nirmalbang.com</p>				<table border="1"> <thead> <tr> <th>Financials (Rs Cr)</th> <th>FY20</th> <th>FY21</th> <th>FY22</th> </tr> </thead> <tbody> <tr> <td>Net Revenues</td> <td>886</td> <td>874</td> <td>1321</td> </tr> <tr> <td>Growth</td> <td>-14%</td> <td>-1%</td> <td>51%</td> </tr> <tr> <td>EBIDTA</td> <td>86</td> <td>122</td> <td>169</td> </tr> <tr> <td>EBITDA Margins</td> <td>9.7%</td> <td>13.9%</td> <td>12.8%</td> </tr> <tr> <td>PBT</td> <td>32</td> <td>61</td> <td>127</td> </tr> <tr> <td>Growth</td> <td>-63%</td> <td>92%</td> <td>109%</td> </tr> <tr> <td>Adjusted PAT</td> <td>22</td> <td>45</td> <td>92</td> </tr> <tr> <td>EPS</td> <td>2.4</td> <td>5</td> <td>10.1</td> </tr> <tr> <td>ROCE</td> <td>8%</td> <td>12%</td> <td>17%</td> </tr> <tr> <td>EV/Sales</td> <td>-</td> <td>-</td> <td>2.5</td> </tr> <tr> <td>EV/EBITDA</td> <td>-</td> <td>-</td> <td>19.8</td> </tr> <tr> <td>P/E</td> <td>-</td> <td>-</td> <td>32.7</td> </tr> </tbody> </table> <p>Source: Company data, NBRR</p>				Financials (Rs Cr)	FY20	FY21	FY22	Net Revenues	886	874	1321	Growth	-14%	-1%	51%	EBIDTA	86	122	169	EBITDA Margins	9.7%	13.9%	12.8%	PBT	32	61	127	Growth	-63%	92%	109%	Adjusted PAT	22	45	92	EPS	2.4	5	10.1	ROCE	8%	12%	17%	EV/Sales	-	-	2.5	EV/EBITDA	-	-	19.8	P/E	-	-	32.7
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Company Background

Harsha Engineers International Ltd (HEIL) is the largest manufacturer of precision bearing cages, in terms of revenue, in organised sector in India, and amongst the leading manufacturers of precision bearing cages in the world. The company offers diversified suite of precision engineering products across geographies and end-user industries comprising engineering business, under which they manufacture bearing cages (in brass, steel and polyamide materials), complex and specialised precision stamped components, welded assemblies and brass castings and cages & bronze bushings; and (ii) solar EPC business, under which they provide complete comprehensive turnkey solutions to all solar photovoltaic requirements.

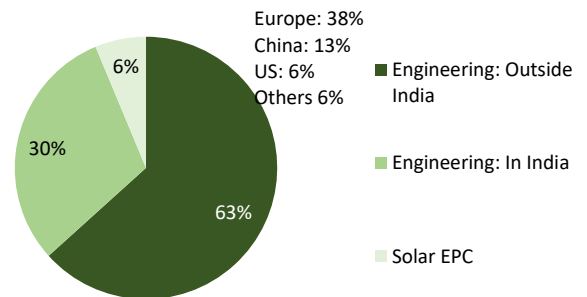
Bearing cages are critical parts of bearings and it requires high precision technology to manufacture them. Bearing cage is an important component within a bearing and requires the highest lead time for development and technical and tooling expertise for its manufacture when compared to other components of a bearing. HEIL has approximately 50-60% of the market share in the organised segment of the Indian bearing cages market and 6.5% of the market share in the global organised bearing cages market for brass, steel and polyamide cages in CY2021. HEIL offers a wide range of bearing cages starting from 20 mm to 2,000 mm in diameter and its bearing cages find application in the automotive, railways, aviation & aerospace, construction, mining, agriculture, electrical and electronics and renewables sectors. HEIL has the expertise to design and develop advance tooling in-house.

Key Bearing Components



Source: NSK

Business & Geographical Mix (FY22)



Source: Company

HEIL has been able to leverage its tooling capabilities and the expertise developed in the stamping employed for manufacture of steel cages to diversify and grow its stamping components business. It also provides comprehensive metal stamping solutions ranging from simple to complex designs and geometries to clients in automotive; bearing and sealing; and electrical and appliance industry.

Top 5 customers of HEIL constituted 71% of its FY22 revenue. HEIL has four manufacturing facilities for engineering business with two manufacturing facilities at Changodar and one at Moraiya, near Ahmedabad in Gujarat, India and one manufacturing unit each in Changshu, China and Ghimbav Brasov in Romania. HEIL supplies products to customers in over 25 countries. To help meet ‘just in time’ requirements of its customers, HEIL has entered into arrangements to stock inventory in warehouses spread across more than 20 locations across the world including in, Europe, US, China and South America. The combined bearing cages capacity of all their manufacturing units is 1,098 million pieces per annum as on FY22.

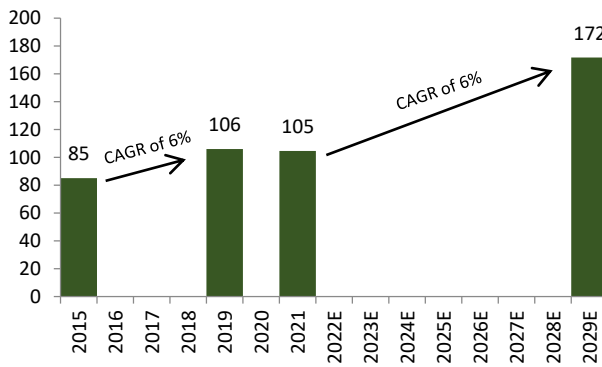
HEIL is also an EPC service provider in the solar photovoltaic industry and provides operations and maintenance services in the solar sector. It has an in-house design, engineering, procurement, project management and O&M team which has a combined experience of installing at least 500 MW and more than 60 MW commissioning experience in roof top segment as of March 31, 2022. The revenue from solar EPC business aggregated to Rs. 83 Cr or 6% of revenue for FY22.

Investment Rationale

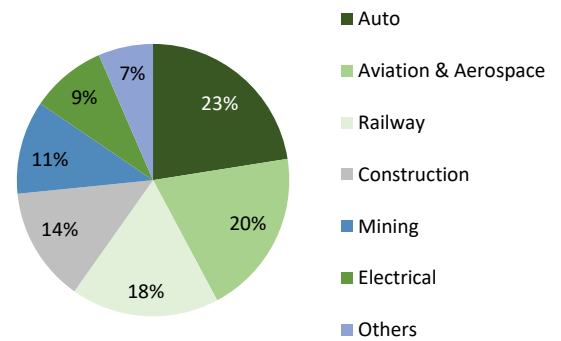
Strong growth outlook for the Global Bearings and Bearings Cages industry

The global bearings market was valued at USD 104.6 billion in 2021. The expected growth in usage of bearings in several applications such as mining, automotive, heavy machinery, infrastructure development, power generation and construction is forecasted to drive the demand for bearings market and it is expected to grow at a CAGR of 6-8% over the period 2021-29 and is estimated to be valued at USD 171.7 billion in the year 2029. The global bearing cages market is estimated at about 5% of the global bearings market.

Global Bearings Market (USD Bn).....



..... and its application wise break-up



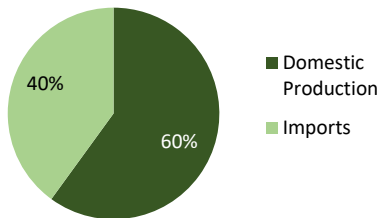
Source: RHP

Import substitution together with development of India as an outsourcing hub shall propel higher growth

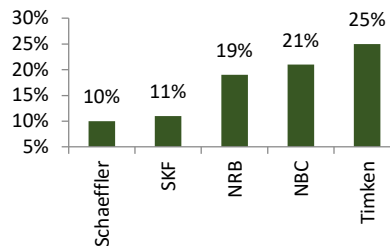
Currently, about 40% of the domestic bearing requirement is catered through imports as volume in India for certain SKUs are economically unviable for bearing manufacturers to set up dedicated lines. With an improved off-take, bearings will get increasingly localised, which will help bearing component suppliers in the medium to long term. Exports account for sizeable chunk of Indian bearing manufacturers. Employee expense accounts for ~10% of sales in India compared to ~25% in developed countries, which lends cost advantage for MNCs to set up units in India. Among the top five OEMs, Timken India derives 25% of its revenue from exports followed by NRB and NEI (at ~20%).

Recent industry developments such as US-China trade war and global outbreak of Covid-19 led to manufacturers setting up manufacturing units in regions other than China to emerging economies like India which bodes well for HEIL.

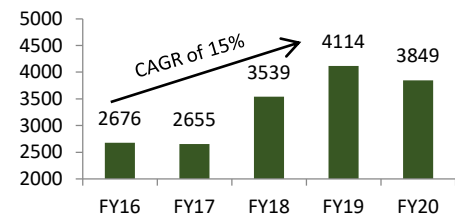
Market Mix



Share of exports in total sales



Trend in bearings exports



Source: NBRR

Comprehensive product portfolio makes the company a preferred supplier

HEIL has a comprehensive product portfolio from which till date it has offered a range of bearing cages weighing in the range of 20 mm to 2,000 mm in diameter. The company manufactures bearing cages (including cylindrical roller cages, spherical roller cages, deep groove cages, angular contact cages, thrust roller cages and taper roller cages), complex and specialised precision stamped components, welded assemblies and brass castings and bushings.

HEIL has manufactured more than 7,500 types of products in the automotive and industrial segments. It manufactures bearing cages in brass, steel and polyamide which represents **6.5% of the global organised outsourced bearing (brass, steel & polyamide) cages market in CY 2021**. HEIL has approximately 50-60% of the market share in the organised segment of the Indian bearing cages market.

The products are suitable for a wide range of end-user industries such as automotive, aviation and aerospace, construction, mining, agriculture, electricals and electronics, renewables sectors. The wide product portfolio helps HEIL in offering a wide range of products to customers, enhances the company's ability to attract new customers, improve its share of business amongst existing customers. HEIL supplies products to customers in over 25 countries covering five continents i.e. North America, Europe, Asia, South America and Africa.

Long standing customer relationships and geographically diversified revenue base

HEIL supplies its products in domestic as well as international geographies to leading global bearing manufacturers in the automotive, railways, aviation & aerospace, construction, mining, agriculture, electrical and electronics, renewables sectors. HEIL supplies products to customers in 25 countries covering five continents i.e. North America, Europe, Asia, South America and Africa. Given their wide presence, the revenue stream is diversified both geographically as well as across customers. The company has maintained long standing relations, some of their largest customers having been with HEIL for more than a decade. Top 10 customers contribute to 45% of its revenue. The bearing cages market globally is concentrated among a few global bearing manufacturers with top six global bearing manufacturers contributing to 54% of the market share in FY22 HEIL supplies to each of the top six global bearing manufacturers.

Manufacturing capabilities offering scale, flexibility and locational advantage

HEIL has four manufacturing facilities spread across three countries in India, China, and Romania. As on FY22, the aggregate installed capacity across these manufacturing facilities was 4,596 metric tonne per annum for castings and 1,097.87 million pieces per annum for bearing cages. HEIL's presence in these locations helps them overcome significant entry barriers in comparison with competitors, allowing HEIL to penetrate these markets more efficiently and become a local supplier to leading key global bearing players. Their dual-shore capabilities, which is the ability to carry out design, engineering and manufacturing of products at different locations allows them to service customer requirements from alternate locations, giving the customer the benefit of regular supply and cost-competitive manufacturing operations.

Additionally, to help meet just in time requirements of customers, HEIL has entered arrangements to stock inventory in warehouses over 20 locations across the world. Having proximity to its key customer groups gives it a strategic advantage in ensuring greater cost effectiveness, quicker delivery and faster turn-around times, allowing it to maximize customer satisfaction in a timely manner.

Strong improvement in balance sheet strength

HEIL has significantly been working on improving its financial profile with debt-equity ratio improving from 1.3x in FY19 to 0.7x in FY22. Top-line and bottom-line have grown at a CAGR of 9% (Core Engineering business grew at a CAGR of 11%) and 13% respectively over FY19-22 despite the impact of covid. ROCE has breached the pre-covid levels and improved to 17% in FY22 despite the impact of covid. HEIL is a free cash flow generating company with 4 year cumulative pre-tax CFO / EBITDA being at a healthy 68%. The strong financial performance reflects the efficacy of the manufacturing and supply-chain management protocols implemented, while steady operating cash flows enables them to meet the present and future needs of their customers and develop new value-added products.

Strong, experienced and dedicated senior management team and qualified workforce

HEIL is part of the Harsha Group which was established in 1986 and has over 35 years of operating history in the engineering business. HEIL was incorporated in 2010 as Harsha Abakus Solar Private Limited. In order to consolidate the Harsha Group's India engineering and solar EPC business, and to get the benefits of synergies, a corporate reorganisation was recently completed effective from the appointed date of April 01, 2020. Pursuant to the Corporate Reorganisation, the engineering business of the Harsha Group housed in Aastha Tools Private Limited, Harsha Engineers India (Private) Limited and Harsha Engineers Limited was amalgamated into HEIL. The founder Promoters, Harish Rangwala and Rajendra Shah, have more than 35 years of experience in the precision engineering and bearing cages manufacturing sector and have played a pivotal role in innovation, success and growth of HEIL. Additionally, the second generation Promoters, Vishal Rangwala and Pilak Shah, are also involved in the overall operations, strategies and business of HEIL.

Concerns

Migration from ICE to EV

While the automotive segment is shifting towards the electric vehicles, its impact on HEIL will be limited as they are not manufacturing needle bearing cages which are engine components. Needle bearing cage used in engines and small bearing cage used in two and three wheelers are likely to be the most impacted type of bearings due to increasing penetration of electric vehicles. Further, the company believes that the electrification of vehicles will increase the precision requirements sought by customers which will help them to further improve their market share in the sector.

High dependence on top 5 clients

The company derived 71% of revenue from top 5 clients in FY22. Loss of sales to any of them due to loss of contracts, loss of market share of these clients, adverse change in financial condition of such customers, including due to possible bankruptcy or other financial hardships could have an adverse impact on the business of HEIL.

Sharp appreciation in INR could result in forex losses

63% of revenue from operations and 33% of total expenses were denominated in foreign currencies during FY22. Based on the geographical presence and business operations worldwide, HEIL primarily deals in USD, EUR, RMB, JPY and RON. While HEIL partly hedges foreign currency risk, it may still suffer losses in the event of a sharp appreciation in INR against the above mentioned currencies. HEIL's net foreign exchange gain/(loss) for FY22/21/20 was Rs. 15 Cr/ 0 Cr / Rs. 9 Cr.

Valuation and Recommendation

Peer comparison of HEIL with bearing clients and component suppliers reveals that margins and ROCE of HEIL are inferior to others. This is primarily on account of (i) the solar EPC business (6% of revenue) which is loss making at EBITDA level and (ii) Castings business being carried out in Romania (11% of revenue) has very low margins. Excluding these two segments the company has EBITDA margins in excess of 21%.

Bearing Companies & Ancillaries

<i>FY22 Figures</i>	SKF India	Timken India	Schaeffler India	Average	Rolex Rings	Harsha Engineers
Revenue	3,666	2,203	5,561	3,810	1,017	1,321
CAGR (FY19-22)	6%	10%	7%	8%	4%	9%
EBITDA Margin	15%	23%	17%	19%	23%	13%
Asset Turns (x)	1.9	1.3	1.4	1.6	1.3	1.1
ROCE	28%	26%	22%	25%	28%	17%
EV/EBITDA	43.5	49.6	56.9	50.0	24.3	19.8
P/E	62.2	77.4	90.1	76.6	40.6	32.7

Source: Companies, NBRR

HEIL is a proxy play on (i) rising global outsourcing of bearing components from in-house facilities of clients in Europe & US to India (ii) relocation of global supply chains from China to India and (iii) strong upturn in domestic industrial and auto segments reflecting in strong growth outlook provided by bearing clients. With increasing utilization rates from the current ~62% in FY22 to 75% in current year, turnaround in solar EPC business and debt being repaid, we expect ROCE to improve to 20% levels in a couple of years. We believe investors have yet not fully appreciated the intrinsic quality of business, industry positioning (industry leadership in India) and cash flow generation of niche bearing component suppliers such as Rolex Rings and HEIL. We expect both the ancillaries to re-rate and close the valuation gap vis-à-vis their OEM clients. **We recommend subscribing to the issue.**

Harsha Engineers International Ltd.

Financials

P&L (Rs. Cr)	FY19	FY20	FY21	FY22
Net Revenue	1029	886	874	1321
% Growth		-14%	-1%	51%
Raw Materials	516	458	415	740
% of Revenues	50.1%	51.7%	47.5%	56.0%
Employee Cost	137	149	146	158
% of Revenues	13.3%	16.8%	16.8%	12.0%
Other expenses	242	193	191	255
% of Revenues	23.5%	21.8%	21.8%	19.3%
EBITDA	135	86	122	169
EBITDA Margin	13.1%	9.7%	13.9%	12.8%
Depreciation	33	35	34	35
Other Income	16	14	3	18
Interest	31	33	30	25
Exceptional item				
PBT	86	32	61	127
Tax	23	10	15	35
Tax rate	26%	31%	25%	27%
Adj. PAT (norm. Tax)	64	22	45	92
% Growth		-66%	107%	102%
EPS (Post Issue)	7.0	2.4	5.0	10.1

Ratios & Others	FY19	FY20	FY21	FY22
Debt / Equity	1.3	1.1	0.8	0.7
EBITDA Margin (%)	13.1%	9.7%	13.9%	12.8%
PAT Margin (%)	6.2%	2.5%	5.2%	7.0%
ROE (%)	19%	6%	11%	18%
ROCE (%)	15%	8%	12%	17%

Turnover Ratios	FY19	FY20	FY21	FY22
Debtors Days	100	98	89	78
Inventory Days	85	96	112	104
Creditor Days	59	46	49	32
Asset Turnover (x)	1.0	0.9	0.9	1.1

Valuation Ratios	FY19	FY20	FY21	FY22
Price/Earnings (x)				32.7
EV/EBITDA (x)				19.8
EV/Sales (x)				2.5
Price/BV (x)				5.8

Source: Company Data, NBRR

Balance Sheet (Rs. Cr)	FY19	FY20	FY21	FY22
Share Capital	20	50	50	77
Reserve & Surplus	314	322	377	445
Networth	334	372	427	522
Total Loans	445	412	348	378
Other non-curr liab.	(0)	0	21	23
Trade payable	165	111	117	183
Other Current Liab	46	78	68	52
Total Equity & Liab.	990	973	981	1,158
Fixed Assets & CWIP	228	265	271	285
Goodwill & Other intangi	65	72	75	73
Other Tax Assets	5	11	10	11
Inventories	240	232	268	376
Other non Curr. assets	14	8	8	9
Cash	1	24	33	21
Bank	48	33	12	18
Debtors	283	239	214	283
Other Current assets	106	90	90	82
Total Assets	990	973	981	1,158

Cash Flow (Rs. Cr)	FY19	FY20	FY21	FY22
EBITDA	135	86	122	169
Provisions & Others	(144)	11	3	20
Op. profit before WC	(9)	97	125	189
Change in WC	41	30	(2)	(121)
Less: Tax	(2)	(13)	(1)	(31)
CF from operations	30	113	121	36
Addition to assets	(3)	(72)	(40)	(50)
(Purchase)/Sale of invst.	17	5	17	3
Int & Div Received	1	3	2	(5)
CF from Investing	15	(65)	(20)	(52)
Corporate DDT	-	(2)		
Repayment	(0)	0	0	0
Long term borrowings	(45)	4	(62)	28
Int & Div Paid	(11)	(41)	(30)	(25)
CF from Financing	(56)	(38)	(92)	4
Net Change in cash	(11)	10	9	(12)
Cash at beginning	12	1	24	33
Bank Balance		13		
Cash at end	1	24	33	21

Harsha Engineers International Ltd.

Disclosure:

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