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5 MINUTE STOCK IDEA

BY SMART SYNC INVESTMENT ADVISORY SERVICES

THEJO ENGINEERING

WHAT WE LIKE

STRONG MARKET POSITION & SUCCESSION PLANNING

The company was incorporated 4 decades ago by K J Joseph & Thomas John (whose sons are also directors) & has emerged as one of the pioneers of conveyor belt Splicing and the Leading industrial solution provider for belt conveyor based bulk material handling systems, mining & mineral processing and corrosion protection application. Interestingly, Thejo Engineering is one of the few completely integrated companies offering manufacturing, marketing, and servicing activities under one roof.

STRONG PAST TRACK RECORD

The company has maintained a consistent sales & profit growth rate of **15% & 25%**. At the same time, it reported extraordinary return on capital owing to operational efficiency (visible from stable **OPM%** despite raw material volatility) & other competitive advantages.

A testament to the company's robust biz model is their recent ROCE% which was strong despite the increase in capacity (which came online only in March).

Segment	Particulars	FY23	FY22
Manufacture	Op. Profits	28	25.7
	Capital Employed	91	58
	ROCE%	**31%**	**44%**
O&M	Op. Profits	31	39
	Capital Employed	121	118
	ROCE%	**26%**	**33%**

COMPETITIVE ADVANTAGES

- R&D edge: The company's presence in niche-complex equipment space, customized products, leadership in the domestic conveyor services market & various patents under its name is a testament to its R&D focus.

  The R&D Centre of the Company was recognized as one of the Top 25 Innovative Companies under CII's Industrial Innovation Awards for two consecutive years in 2019 and 2020. The Company was also declared as the winner under the Manufacturing Medium Enterprise Category in the CII Industrial Innovations Awards for the year 2020.

  During the year under review, the Company had applied for patents in respect of several products/inventions. As at the end of the financial year, the Company had applied for 32 product patents and three design patents, of which 19 product patents have been awarded and the balance are in process.

- Diversified revenue profile: The company services industries like Steel, mineral processing, Cement, fertilizers, power, metal, paper pulp etc which reduces the sector-specific risks to a certain extent.
- Geographical diversification: the company is making giant strides to increase the share of exports (**~20% of overall revenues**) through its business in countries like Saudi Arabia, Australia, Brazil & Chile & it is expected to increase owing to commercializing its new capex.
- Note: Supplying products/services in export market, especially capital goods is also a big indicator of the quality of its products.

GROWTH PROSPECTS

- Strong tailwinds: the entire capital goods industry is seeing strong growth owing to capex being incurred by the end-user industries which are benefitting these ancillaries (who have more sustainability of revenues & better returns metrics!)
- **Capex:** The company's increased capacity (**50%+**) will start contributing revenues in FY24.
- Product mix: The addition of new products, the increasing contribution of higher ROE manufacturing biz (**43% of FY23 profits**) vs. operation & maintenance biz(O&M) & potential of cross-selling these services are likely to bode well for the company.

WHAT WE DON'T LIKE

SMALL SCALE OF OPERATIONS

Owing to the segment being niche, the company has been unable to scale its biz to levels that its peers like McNally Bharat Engineering Company Ltd and Elecon Engineering Company have done by offering a broader range of services.

EXPOSURE TO CYCLICALITY AND COMPETITION FROM UNORGANIZED SPACE IN O&M SEGMENT

- The end users include the likes of mining, power & steel companies which have high cyclicality affecting the company in economic downturns. Further, these larger players tend to have more bargaining power.
- The O&M business faces competition from unorganized segment due to lower entry barriers & also faces risk of labour costs inflation.

The domestic product business is prone to cyclicality in the economy, especially the core sector. The competition from the unorganized sector is a challenge for the services business of the Company. In Operation & Maintenance, there is intense competition with manpower-based contracts being bagged by industry players at lower prices, especially during times of economic downturn.

HIGH WORKING CAPITAL CYCLE

The company owing to its nature of operations (wherein it caters to larger Pvt. clients & govt. In the engineering segment) has very high working capital days.

	Mar 2012	Mar 2013	Mar 2014	Mar 2015	Mar 2016	Mar 2017	Mar 2018	Mar 2019	Mar 2020	Mar 2021	Mar 2022	Mar 2023
Debtor Days	113	117	115	108	112	120	109	102	122	104	92	83
Inventory Days	105	133	117	110	281	221	196	315	229	214	198	201
Days Payable	126	131	107	131	193	185	155	207	178	223	131	161
Cash Conversion Cycle	**92**	**119**	**124**	**87**	**200**	**157**	**150**	**210**	**173**	**94**	**159**	**123**
Working Capital Days	77	99	91	82	94	105	82	96	95	82	88	76

However, it is important to note that if receivable days & payable days are able to offset each other, then **We at SSS believe higher inventory days can also be a major barrier to entry for a smaller player.**

Nonetheless, given the high working capital requirements, effective management becomes critical to the company's success.

PRESSURE IN MARGINS

Although, the company has shown consistent growth in the margin profile from **8% in FY18 to 16% in FY22**, the company's margins dropped in FY23 owing to the re-occurrence of several costs which were absent during covid years like machine hire & maintenance + service & labor charges. Further, given the volatility of its raw materials (especially in the manufacturing segment), margins can remain lower in the coming year (as witnessed by Q1FY24 results for the segment). However, there is also a scope for the margins to expand through operating leverage which remains to be seen.

The financial performance of the Company in the year under review has shown growth in terms of turnover with a slight dip in the profitability. The turnover from Manufacturing Division has increased. The Services Division saw a better performance with increase in turnover. With expansion in progress and increase in operational costs and some indirect costs that had remained low for the past two years on account of the pandemic, the current year costs have shown a marginal spike and the same is expected to strike a balance