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Cable Solutions

Cable Solutions Limited

Research Note

July 2024

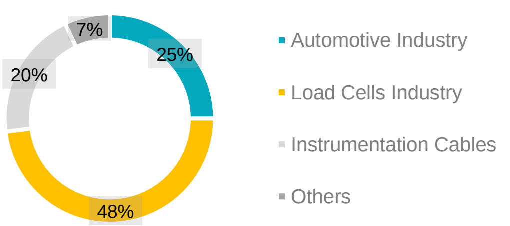
We rate the IPO as a "Buy/ Subscribe" with a 12M Price Target of LKR 9.00

Cable Solutions Limited ("CSL" or "the Company") upcoming IPO is priced at c. 8x on estimated forward earnings of LKR 0.95 per share in FY25E. Whilst the valuation on a comparative basis is higher than many listed counters in the manufacturing/ capital goods space, we believe that CSL's secular growth potential in terms of large total addressable markets, high margin profile through its product/ business differentiation and exposure to fast growing global industries justifies the premium on a relative basis. We assign a 12M share price target of LKR 9.00 in July 2025 based on an 8.5x forward multiple on our FY26E EPS estimate of LKR 1.06. This implies a PEG ratio of c. 0.8 based on expected average earnings growth >12% in FY26E through FY27E. Whilst management guidance on revenue/ EPS for FY26E is higher than our forecast, we believe that slower economic growth in the US/ EU and exchange risks with LKR volatility poses risks for growth projections which underlies our more conservative forecast. CSL's execution in-line with management guidance in FY25E and 1H FY26E would be a catalyst for us to revise our forecast estimates and price targets.

Large addressable markets with exposure to fast growing global industries

CSL is a B2B producer of customized cables and provides cabling solutions to several fast-growing industries within the global electronics supply chain, including automotive/ EV's, renewable energy, instrumentation and load cells. The Company was founded in 2008 with the collaboration of Flintec, a leading European manufacturer of load cells. CSL has since evolved to produce a range of custom-made cables including automotive/ EV charging cables, instrumentation cables, co-axial, composite/ hybrid cables, telecom/ data cables, high-temperature cables and solar/ renewable energy cables in addition to load cell cables. In 2019 majority control in CSL was acquired by a consortium including ACL Cables PLC ("ACL"), Sri Lanka's leading electrical cable manufacture who now owns 51% of the Company. CSL differentiates itself from generic/ off-the-shelf cable manufacturers through its high level of specialization. The Company designs and prototypes cables for exacting customer specifications for highly specialized products. The customized engineering process and international accreditations allows CSL's to entrench itself as the sole and/or accredited supplier for the global electronics OEM's which comprise its customer base. The global wire and cable market, estimated at >USD 210 Bn in 2023, is expected to grow at a USD CAGR of >5% through 2028 with selected sub segments growing at a faster pace.

Chart 1a: CSL Revenue Mix by Industry



Source: CSL IM

Product specialization and focus on total cabling solutions supports high margin profile

The highly customized nature of the cables manufactured by CSL and focus on providing total cabling solution allows the Company to sustain gross margins at c. 30% (see Chart 1b).

IPO Price	LKR 7.50
Bloomberg Ticker	n.a.
Est. Market Cap (LKR Bn) I (USD Mn)	LKR 3.5 Bn I USD11.6Mn
No. of Shares Offered (Mn)	80.8
IPO Float	17.16%
Share Price at Pre-IPO Transactions	Jan 2024: LKR 7.50
IPO Opening Date	23 July 2024
P/E (X) (TTM EPS)	16.3x
P/E (X) (FY25E EPS)	8.0x
PBV (X) at Pre-IPO Book Value	2.1x
Industry and Year End	Capital Goods | 31 Mar

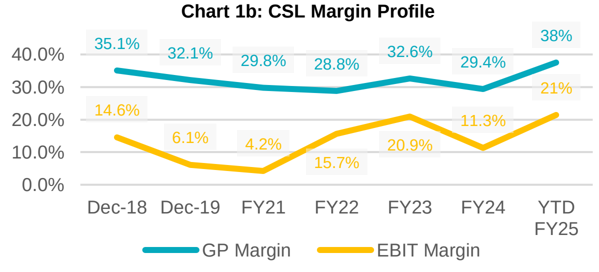
IPO Recommendation	
Rating as of	(Jul-24)
Rating	**Buy/ Subscribe**
12M Target price (LKR)	9.00
Potential upside (%)	**20%**
FY25E DPS (LKR)	0.25
Total return (%)	**23%**
Industry view: Materials	In-Line

Post-IPO Shareholding Structure	Shares (Mn)	%
ACL Cables PLC	240.0	51.0%
Mr. Pawan Tejwani	91.2	19.4%
Insite Holdings (Pvt) Ltd	31.9	6.8%
Others	26.8	5.7%
IPO Shareholders	80.8	17.2%
Total	**470.7**	**100.0%**

CSL as a further value-added offering, manufactures customized cable harnesses which are used directly in the final assembly of various electronic, automotive and aerospace products. This allows blended gross margins to exceed 30% levels.

Manufacture of wire harnesses is a more labor-intensive process and will be expanded with CSL's new factory in India, which is expected to focus solely on the harnessing segment. The wire harness business affords the opportunity to provide end-to-end solutions and capture a greater share of wallet of CSL's OEM customers whilst consolidating the Company's position within customer supply chains and further differentiating the Company from generic cable manufacturers. Currently c. 50% of CSL's sales comprise total solutions which encompass both cabling and harnesses.

Chart 1b: CSL Margin Profile



Key management shareholding

The founder/ CEO will retain a 19.4% stake in CSL post the IPO, which is a positive factor for aligning management and shareholder interests.

IPO proceeds and capacity expansion

The offer for subscription component of the IPO envisages raising LKR 109 Mn for capital expenditure and working capital. The current capex program is expected to replace existing machinery with new, more efficient and higher capacity machines. CSL's capacity is expected to increase from c. 3Mn meters p.m. of cables to c. 5Mn meters p.m., sufficient for the projected revenue growth in the medium term.

Interim performance in FY25E shows revenue run rate >USD 10 Mn and margin expansion

Based on first two months of FY25E, CSL's revenue run rate has picked up to over USD 10 Mn in line with our forecast assumptions for the current year. Margins have further expanded ostensibly through some degree of operating leverage and a higher mix of sales coming from end-to-end solutions.

Revenue growth over the next two years expected to be higher than historical CAGR

CSL's historical TTM revenue CAGR in USD basis is c. 7% over the last five years. Management guidance for FY26E anticipates revenue north of USD 11 Mn representing a growth rate significantly higher than the historical revenue CAGR. Management guidance is based on order visibility of existing customers and expectations of acquisition of new customers. However, we have adopted a more conservative revenue forecast (see Chart 2c) of c. USD 11 Mn in FY26E (slightly above the historical revenue CAGR) to account for potential headwinds in the US and EU economy. Both management guidance and our forecasts do not explicitly account for possible incremental revenue from the new harnessing facility in India. Although its possible that the new facility will start contributing to revenues in the current year it may not contribute to higher earnings in the short term given the time lag to scale up new factories to reach operational profitability.

Chart 2a: TTM Revenue

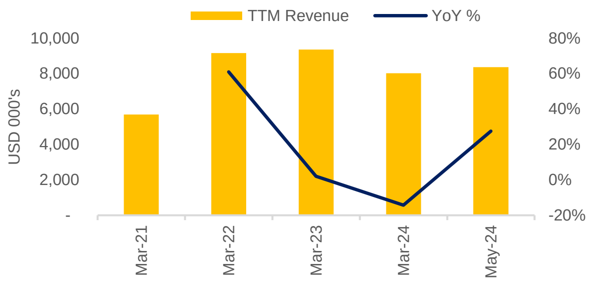


Chart 2b: TTM EBIT

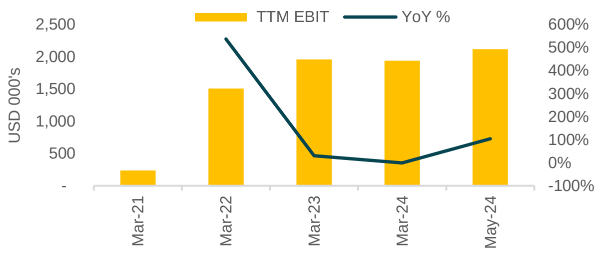


Chart 2c: Historical and Forecast TTM Revenue

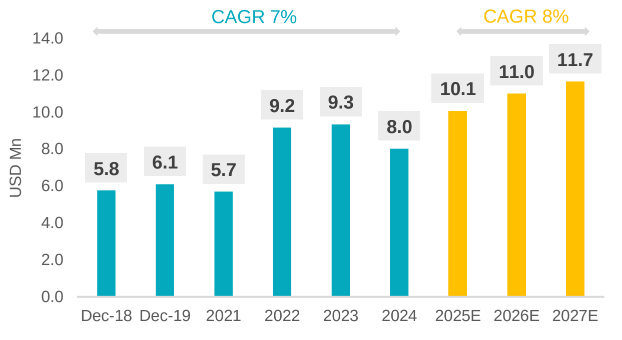


Table 1: Operating Performance Summary

In LKR Mn	Dec-18	Dec-19	FY21	FY22	FY23	FY24	2M FY24	2M FY25	YoY%
Revenue	931	1,091	1,075	1,903	3,320	2,539	404	489	21%
Gross Profit	326	350	320	548	1,079	746	125	184	47%
GP Margin (%)	35%	32%	30%	29%	33%	29%	31%	38%	666 bps
EBIT / Operating Profit	136	67	45	298	689	288	54	105	94%
EBIT Margin (%)	15%	6%	4%	16%	21%	11%	13%	21%	804 bps
Finance cost	8	19	18	17	44	40	8	8	1%
PBT	127	48	27	281	645	248	46	96	110%
Tax	24	15	6	48	109	37	7	14	110%
Net Profit	104	34	21	233	537	211	39	82	110%
Net Profit Margin (%)	11%	3%	2%	12%	16%	8%	10%	17%	712 bps
Diluted EPS (LKR)	0.22	0.07	0.05	0.51	1.18	0.46	0.09	0.18	100%
TTM EPS (LKR)	0.22	0.07	0.05	0.51	1.18	0.46	-	0.55	

Revenue growth and margins expected to revert to mean in the medium term

Our primary assumptions are that YoY revenue growth in USD basis which is expected at c. 25% in FY25E will reduce to 10% in FY26E, 6% in FY27E through FY29E and thereafter taper down to 2.5% at the terminal year in FY34E. We have assumed that the LKR will appreciate against the functional currency by 2% in the current year (representing an average exchange rate of LKR 310/- in FY25E) and depreciate by 5% per annum thereafter.

We expected that gross margins will remain on average c. 34% over the next two years and operating margins will gradually compress to 17% in the longer term from 19.5% expected in FY25E.

We have budgeted average capex of c. LKR 100 Mn per year over the next 5 years (higher than the historical average) and assumed a sales/capital ratio of 2.25x thereafter to account for higher reinvestment to secure future growth.

We have used a 17% required return on equity based on 11% p.a. risk free rate, assumed beta of 1.0 and market risk premium of 6% and estimated the WACC at 14.00% for the next 5 years based on a 70:30 target equity to debt ratio. We have assumed that the risk-free rate will reduce to 7.5% p.a. in the tenth/ terminal year (2.5% p.a. above long-term inflation target) and estimated the terminal WACC at 11.83%, equal to terminal risk-free rate plus 4.3% p.a.

Furthermore, we have assumed a dividend of LKR 0.25 in FY25E and FY26E (c. 26% payout). Refer Table 2.

Table 2: Financial Summary and Key Forecast Assumptions

For the year ended 31-March						Forecast	
	Dec-19	FY2021	FY2022	FY2023	FY2024	FY2025E	FY2026E
Revenue (USD Mn)	6.1	5.7	9.2	9.4	8.0	10.1	11.0
USD Revenue Growth (%)	-	**-6.68%**	**61.96%**	**2.05%**	**-14.28%**	**25.50%**	**9.50%**
EBIT (LKR Mn)	66.9	45.4	298.0	689.3	287.7	608.9	670.3
EBIT Margin (%)	**6.13%**	**4.23%**	**15.66%**	**20.76%**	**11.33%**	**19.50%**	**18.70%**
Effective Tax Rate	30%	22%	17%	17%	15%	25%	25%
Capital Expenditure (LKR Mn)	118	20	81	81	97	104.1	87.8
Sales to Capital (X)	-	-	-	-	-	4.5	4.5
Exchange Rate (LKR/ USD)	179	189	208	356	317	310	326
Investor Ratios							
Earnings per Share (LKR)	0.07	0.05	0.51	1.18	0.46	0.95	1.06
Earnings per Share Growth (%)	-	-33%	988%	130%	-61%	108%	14%
Dividend Payout (%)	-	-	20%	25%	-	26%	23%

Table 3: Valuation Summary

DCF Valuation					
LKR Mn	**FY2025E**	**FY2026E**	**FY2027E**	**FY2028E**	**FY2029E**
EBIT	609	670	727	789	855
FCFF	353	415	448	484	592
PV of Terminal Value					2,323
Discounted FCFF (WACC @ 14.00% to 11.83%)					2,480
Enterprise Value/ Sum of PV					**4,803**
Net Debt					262
Equity Value					4,541
Equity Value (net of NCI)					4,541
# of shares (Mn)					471
DCF based Intrinsic Value (LKR) per share					**9.65**
12M Target Share Price based on forward PER of 8.5x in July 2025 on estimated FY26E EPS of LKR 1.06					**9.00**
IPO Price per share					7.50
Potential Upside / (downside) to 12M Target Price					20%

We value CSL at LKR 9.65 per share and rate the stock as a "Buy"

Based on our DCF valuation, the IPO price is at a reasonable discount of c. 17% to its intrinsic value. We assign a **12M forward price target** of **LKR 9.00 per share** based on an expected forward trading multiple of 8.5x in July 2025 on FY26E estimated EPS of LKR 1.06. The price target gives a 20% upside to the IPO price of LKR 7.50, while we estimate a DPS of LKR 0.25 per share for FY25E resulting in a total return of c. 23%.

Refer Table 5 for risk factors that may negatively impact our ratings and price targets in the next 1-2 years.

Table 4: Summarized P&L Forecast

For the year ended 31-March	Actual					Forecast	
in LKR Mn	Dec-2019	FY2021	FY2022	FY2023	FY2024	FY2025E	FY2026E
Revenue	1,091	1,075	1,903	3,325	2,539	**3,122**	**3,591**
COGS	741	755	1355	2240	1793	2,017	2,370
Gross Profit	350	320	548	1,084	746	**1,105**	**1,221**
EBIT	67	45	298	696	288	**609**	**670**
Net Interest Cost / (Income)	19	18	17	44	40	24	2
PBT	48	27	281	652	248	585	668
Tax	15	6	48	109	37	146	167
Recurring Net Profit	34	21	233	543	211	**439**	**501**
Earnings per share (LKR)	0.07	0.05	0.51	1.18	0.46	**0.95**	**1.06**
Dividends per share (LKR)	-	-	0.10	0.30	-	0.25	0.25
Dividend Yield (%)	-	-	-	-	-	3%	3%
Price / Earnings Ratio (X) *	-	-	-	-	16.3	**7.9**	**7.1**
Price / Book Value (X) *	-	-	-	-	2.1	1.8	1.5
Return on Equity (%)	-	-	-	-	**13%**	**23%**	**21%**

* For historical/ forward periods share price-based ratios calculated using the IPO price.

Table 5: Risk Factors

Risk Factors	Likelihood of Negative Impact on Ratings in Next 1-2 years	Negative Impact on Ratings	Positive Impact on Ratings
Global Economic/ Market Conditions	Moderate	Prolonged deterioration in global economic conditions in key markets and/ or prolonged adverse conditions in the global market for specialised cables/ solutions.	Sustained improvement in global economic conditions in key markets and/ or prolonged favourable conditions in the global market for specialised cables/ solutions.
Market Share/ Key accounts	Moderate	Sustained loss of market share/ key accounts in the medium term.	Sustained gain in market share/ key accounts in the medium term.
Revenue Growth	Moderate	Sustained decline in USD revenue growth rates below the growth rates assumed in our forecast.	Sustained increase in USD revenue growth rates above the growth rates assumed in our forecast.
Margins	Moderate	Prolonged margin compression from unfavourable economic/ industry conditions or company specific factors.	Sustained margin expansion from favourable economic/ industry conditions or company specific factors.
Technological Obsolescence	Moderate	Inability to keep pace with the latest technological developments in the field of cables, materials science and manufacturing can possibly lead to the obsolescence or commoditisation of the Company's products over time.	N.A.
Capital Expenditure/ ROIC	Moderate	Increase in capital intensity of the business or decline in ROIC from adverse competitive forces or company specific factors.	Decrease in capital intensity of the business or increase in ROIC from favourable competitive forces or company specific factors.
Inflation/ Cost Pressures	Moderate	Increase in localised inflationary pressures which cannot be passed on to end customers.	Decrease in localised inflationary pressures possibly leading to margin expansion.
Exchange Rate/ Currency Risk	Moderate	Sustained appreciation of the reporting currency against the functional currency can lower reported revenue/ earnings and our valuations/ price targets in LKR.	Devaluation of the reporting currency against the functional currency surpassing our forecast assumption of on avg. 5% p.a. can increase reported revenue/ earnings and our valuations/ price targets in LKR.
Changes to WACC	Moderate	Increase in market interest rates/ equity risk premium or beta values and accordingly the cost of capital or lower market valuation multiples can negatively impact our valuations and ratings.	Decrease in market interest rates/ equity risk premium or beta values and accordingly the cost of capital or higher market valuation multiples can positively impact our valuations and ratings.
Loss of Human Capital	Low	Sustained loss in talent/ key management personnel.	N.A.

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