

OEM slowdown and High RM cost impacted numbers. Downgrade to Accumulate.

Sterling Tools (STRT) numbers were below estimates on profitability parameters as OEM slowdown and cost rationalization by OEMs impacted margins. Revenue were in line at ₹ 1,233mn. Gross margin declined by 390 bps on YoY basis. Higher other expenditure further impacted operating margins – declined by 680 bps. However, there is some easing of RM prices on a sequential basis. We believe that this trend can continue. With OEM sales expected to recover slowly, STRT will also face top-line growth challenge. Operating margin should recover on a sequential basis aided by decline in RM prices. We rollover valuations to FY21E earnings. With recent correction of nearly 10% in the last few days, we do not expect significant downside from these levels. Bigger risk here will be the delay in revenue growth recovery and that will be the key to watch over next 2 quarters. We had a BUY rating earlier but downgrade to Accumulate considering the revenue growth challenges and limited expansion in margins. Recommend Accumulate with a target price of ₹ 369.

OEM slowdown impacts growth

STRT gets 90% of its revenues from domestic OEMs and a slowdown across the segments has hurt STRT revenue growth. Situation has definitely improved in January but the sustenance will be the key for STRT growth. We expect this recovery to happen over the next two quarters as liquidity situation improves. With decent presence across segments, STRT is insulated from a slowdown in any particular segment.

New Manufacturing facility – still away by a couple of quarters

STRT had planned for its 4th manufacturing facility at Kolar district, Bangalore. The facility is planned to be operational from Q2FY20 and will help drive the top line growth while bringing in operational efficiencies. This greenfield plant is expected to have initial capacity of 5000-6000 MT. The plant was expected to have a planned capex to the tune of ₹ 900mn.

Q3FY19 Result (₹ Mn)

Particulars	Q3FY19	Q3FY18	YoY (%)	Q2FY19	QoQ (%)
Revenue	1,233	1,088	13.3	1,393	(11.5)
Total Expense	1,055	858	22.9	1,126	(6.4)
EBITDA	178	230	(22.7)	267	(33.3)
Depreciation	48	47	3.1	46	4.5
EBIT	130	184	(29.3)	221	(41.2)
Other Income	11	23	(52.5)	17	(34.5)
Interest	6	9	(24.0)	7	(6.1)
EBT	134	198	(29.3)	231	(41.8)
Tax	52	73	(28.9)	79	(34.4)
RPAT	83	126	(34.2)	152	(45.6)
APAT	83	126	(34.2)	152	(45.6)
			(bps)		(bps)
Gross Margin (%)	61.7	65.6	(393)	59.4	224
EBITDA Margin (%)	14.4	21.2	(673)	19.2	(473)
NPM (%)	6.7	11.5	(484)	10.9	(421)
Tax Rate (%)	38.5	36.6	183	34.1	434
EBIT Margin (%)	10.5	16.9	(634)	15.9	(533)

CMP	₹ 317
Target / Upside	₹ 369 / 16%
BSE Sensex	36,547
NSE Nifty	10,944

Scrip Details

Equity / FV	₹ 72mn / ₹ 2
Market Cap	₹ 11bn
	US\$ 160mn
52-week High/Low	₹ 422/₹ 307
Avg. Volume (no)	12,338
NSE Symbol	STERTOOLS
Bloomberg Code	STRT IN

Shareholding Pattern Dec'18(%)

Promoters	65.3
MF/Banks/FIs	7.6
FII	0.0
Public / Others	27.1

Valuation (x)

	FY19E	FY20E	FY21E
P/E	22.1	17.2	12.1
EV/EBITDA	11.9	9.4	6.6
ROE (%)	20.6	23.5	28.7
RoACE (%)	18.9	22.0	27.3

Estimates (₹ mn)

	FY19E	FY20E	FY21E
Revenue	5,344	6,146	7,375
EBITDA	951	1,185	1,629
PAT	517	664	946
EPS (₹)	14.3	18.4	26.3

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Softening raw material prices

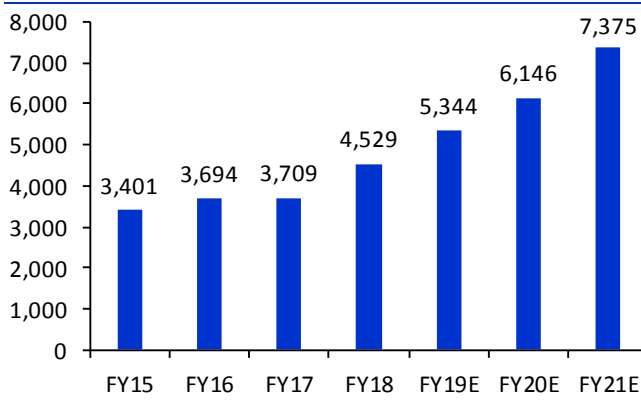
RM prices have been easing in the last couple of months. The margins are also expected to improve due to increasing specialized fasteners and economies of scale. The raw material price eased by 225bps sequentially in Q3FY9 and we expect some further improvement in the gross margins.

Valuation

STRT is a long term story with margin expansion driven by increase in proportion of specialized fasteners. We believe that STRT is facing headwinds, which are likely to ease out in next two quarters. Adding capacity will enable STRT to address OEM demand as and when it recovers. We downgrade the stock the stock as recovery is still a couple of quarters away. Downgrade to Accumulate with a target price of ₹ 369.

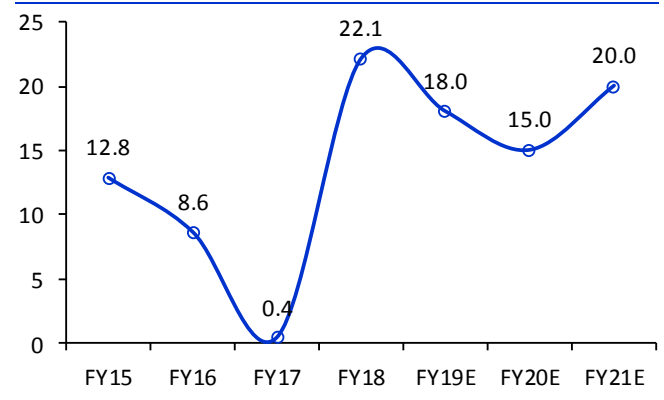
Annual Charts

Exhibit 1: Revenue (₹ Mn)



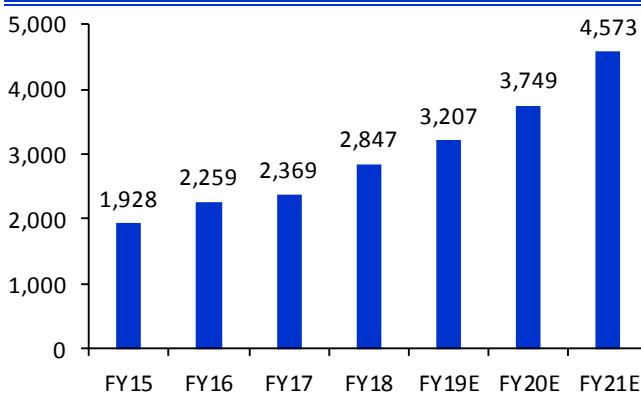
Source: DART, Company

Exhibit 2: Revenue Growth (%)



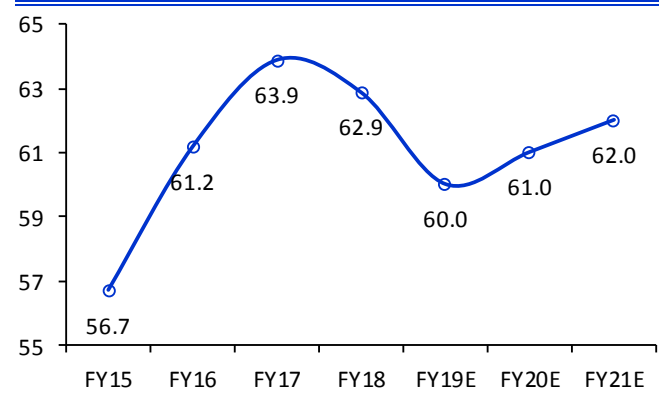
Source: DART, Company

Exhibit 3: Gross Profit (₹ Mn)



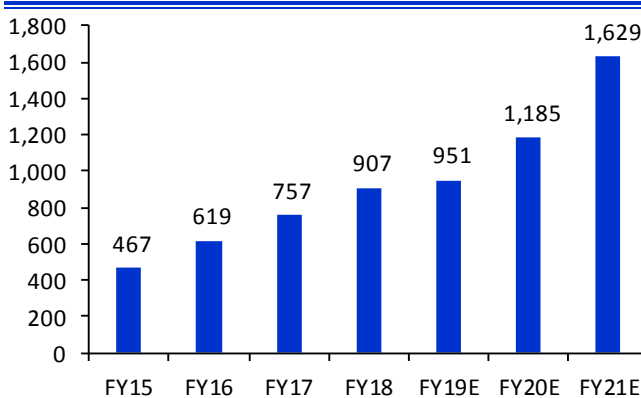
Source: DART, Company

Exhibit 4: Gross Margin (%)



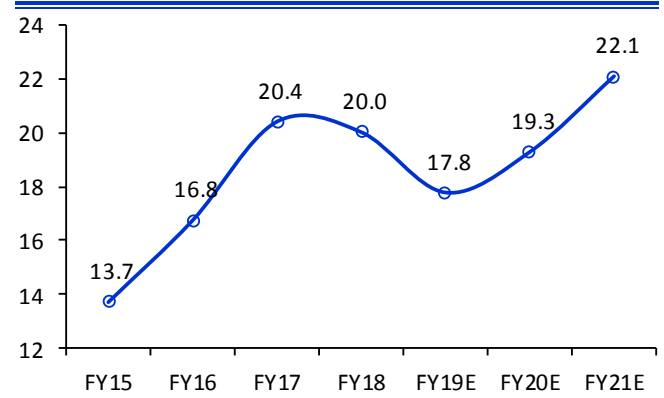
Source: DART, Company

Exhibit 5: Operating Profit (₹ Mn)



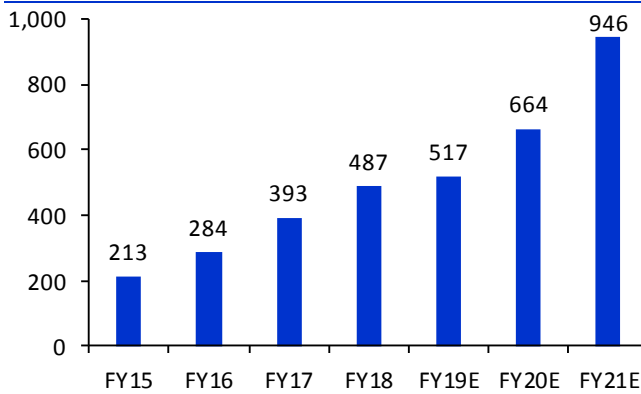
Source: DART, Company

Exhibit 6: Operating Margin (%)



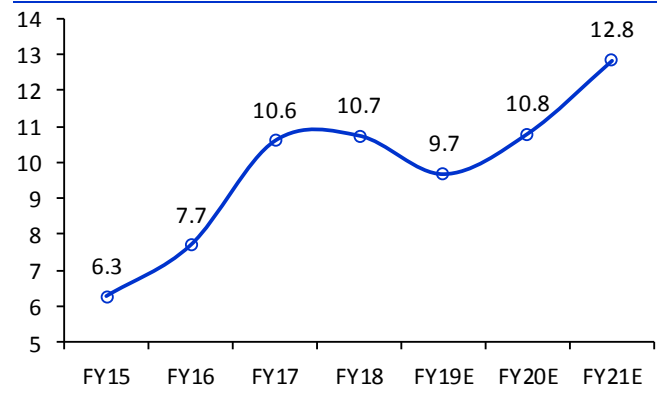
Source: DART, Company

Exhibit 7: Net Profit (₹ Mn)



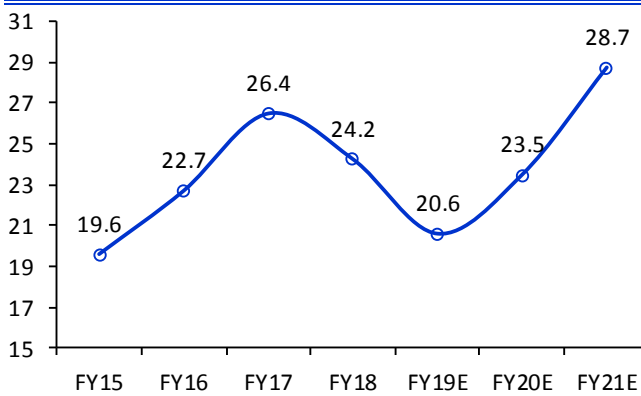
Source: DART, Company

Exhibit 8: Net Margin (%)



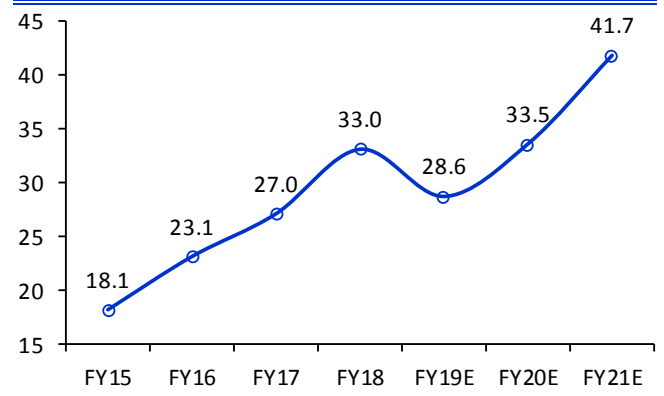
Source: DART, Company

Exhibit 9: ROE (%)



Source: DART, Company

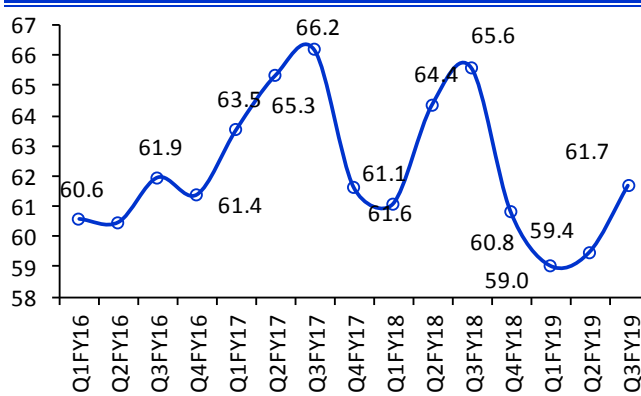
Exhibit 10: ROCE (%)



Source: DART, Company

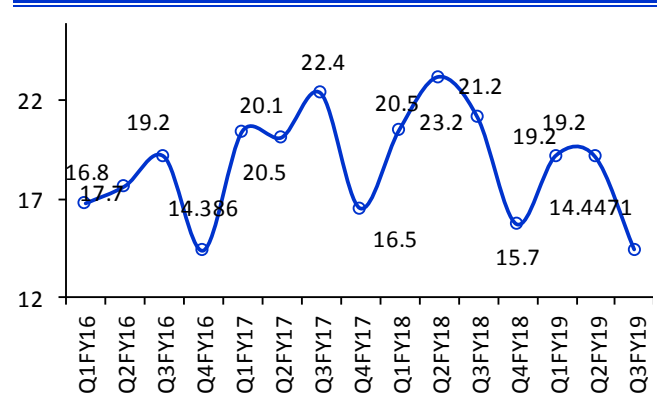
Quarterly Charts

Exhibit 11: Gross Margin (%)



Source: DART, Company

Exhibit 12: Operating Margin (%)



Source: DART, Company

Profit and Loss Account

(₹ Mn)	FY18A	FY19E	FY20E	FY21E
Revenue	4,529	5,344	6,146	7,375
Total Expense	3,622	4,394	4,961	5,746
COGS	1,683	2,138	2,397	2,803
Employees Cost	335	386	443	510
Other expenses	1,605	1,871	2,120	2,434
EBIDTA	907	951	1,185	1,629
Depreciation	176	190	209	228
EBIT	731	760	976	1,401
Interest	38	25	20	15
Other Income	56	60	65	70
Exc. / E.O. items	0	0	0	0
EBT	749	795	1,021	1,456
Tax	263	278	357	510
RPAT	487	517	664	946
Minority Interest	0	0	0	0
Profit/Loss share of associates	0	0	0	0
APAT	487	517	664	946

Balance Sheet

(₹ Mn)	FY18A	FY19E	FY20E	FY21E
Sources of Funds				
Equity Capital	72	72	72	72
Minority Interest	0	0	0	0
Reserves & Surplus	2,308	2,573	2,943	3,511
Net Worth	2,380	2,645	3,014	3,583
Total Debt	302	252	202	152
Net Deferred Tax Liability	100	50	50	50
Total Capital Employed	2,783	2,947	3,267	3,785

Applications of Funds

Net Block	1,535	1,645	1,736	1,809
CWIP	21	23	25	27
Investments	179	179	179	179
Current Assets, Loans & Advances	1,431	1,558	1,809	2,307
Inventories	521	586	640	788
Receivables	409	439	505	626
Cash and Bank Balances	356	394	532	766
Loans and Advances	135	128	122	116
Other Current Assets	10	10	10	10
Less: Current Liabilities & Provisions	384	458	483	537
Payables	365	439	522	626
Other Current Liabilities	19	18	(39)	(90)
Net Current Assets	1,048	1,100	1,326	1,770
Total Assets	2,783	2,947	3,267	3,785

E – Estimates

Important Ratios

Particulars	FY18A	FY19E	FY20E	FY21E
(A) Margins (%)				
Gross Profit Margin	62.9	60.0	61.0	62.0
EBIDTA Margin	20.0	17.8	19.3	22.1
EBIT Margin	16.1	14.2	15.9	19.0
Tax rate	35.1	35.0	35.0	35.0
Net Profit Margin	10.7	9.7	10.8	12.8
(B) As Percentage of Net Sales (%)				
COGS	37.1	40.0	39.0	38.0
Employee	7.4	7.2	7.2	6.9
Other	35.4	35.0	34.5	33.0
(C) Measure of Financial Status				
Gross Debt / Equity	0.1	0.1	0.1	0.0
Interest Coverage	19.3	30.1	48.3	92.0
Inventory days	42	40	38	39
Debtors days	33	30	30	31
Average Cost of Debt	10.7	9.1	8.9	8.6
Payable days	29	30	31	31
Working Capital days	84	75	79	88
FA T/O	2.9	3.2	3.5	4.1
(D) Measures of Investment				
AEPS (₹)	13.5	14.3	18.4	26.3
CEPS (₹)	18.4	19.6	24.2	32.6
DPS (₹)	4.0	6.0	7.0	9.0
Dividend Payout (%)	29.5	41.7	37.9	34.2
BVPS (₹)	66.1	73.4	83.7	99.4
RoANW (%)	24.2	20.6	23.5	28.7
RoACE (%)	21.1	18.9	22.0	27.3
RoAIC (%)	31.8	30.5	36.9	48.7
(E) Valuation Ratios				
CMP (₹)	317	317	317	317
P/E	23.5	22.1	17.2	12.1
Mcap (₹ Mn)	11,420	11,420	11,420	11,420
MCap/ Sales	2.5	2.1	1.9	1.5
EV	11,366	11,278	11,089	10,806
EV/Sales	2.5	2.1	1.8	1.5
EV/EBITDA	12.5	11.9	9.4	6.6
P/BV	4.8	4.3	3.8	3.2
Dividend Yield (%)	1.3	1.9	2.2	2.8
(F) Growth Rate (%)				
Revenue	22.1	18.0	15.0	20.0
EBITDA	19.8	4.8	24.7	37.4
EBIT	23.8	4.0	28.4	43.5
PBT	24.1	6.1	28.4	42.6
APAT	24.1	6.2	28.4	42.6
EPS	24.1	6.2	28.4	42.6
Cash Flow				
(₹ Mn)	FY18A	FY19E	FY20E	FY21E
CFO	525	669	805	980
CFI	(313)	(302)	(302)	(302)
CFF	116	(327)	(364)	(444)
FCFF	204	366	503	677
Opening Cash	28	356	394	532
Closing Cash	356	394	532	766

E – Estimates

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