Sharekhan
by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Schaeffler India Limited

Steady Growth

Automobiles	Sharekhan code: SCHAEFFLER	Company Update

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 4,573**	
Price Target: **Rs. 5,258**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Company details

Market cap:	Rs. 14,333 cr
52-week high/low:	Rs. 4,960 / 3,025
NSE volume: (No of shares)	38.5 lakh
BSE code:	505790
NSE code:	SCHAEFFLER
Free float: (No of shares)	80.9 cr

Shareholding (%)

Promoters	74.1
FII	3.9
DII	16.0
Others	6.0

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	16.7	25.9	29.7	815.0
Relative to Sensex	10.0	2.5	-4.5	799.0

Sharekhan Research, Bloomberg

Summary

- We maintain our Buy rating on Schaeffler India Limited (SIL) with a revised PT of Rs. 5,258, factoring in better multiples on strong traction in business outlook and upgrade in earnings estimates.
- We expect Schaeffler to benefit from industrial and automobile aftermarkets, strong growth traction in railways and export segments and better prospects for bearings business, amid stricter norms.
- Earnings likely to grow by 51.7% in CY2021E and 32.9% in CY2022E, driven by a 21.4% CAGR during CY2020E-22E and a 320 bps improvement in EBITDA margin.
- Stock trades attractively at P/E multiple of 27x and EV/EBITDA multiple of 15.2x its CY2022E estimates.

We have raised our earnings estimates for Schaeffler India Limited (SIL) to factor in the impact of a better business outlook. SIL to benefit from industrial and automobile aftermarket segment, strong growth traction in export markets and better prospects for bearings business. The company is focusing on introducing new products in the industrial and automotive aftermarkets by bringing in localisation and boost its market share. We are positive on the automobile sector and expect the industry to grow in double digits in FY22. SIL will be the key beneficiary of this trend, as it focuses on increasing content per vehicle. In the petrol passenger vehicle segment, the company has increased content per vehicle by 30% to Rs. 4,700, due to advancement of BS-VI regulations. In the industrial OEM segment, the company is witnessing strong growth in the Railway segment with the introduction of new products and supplies to metro railways. Moreover, the increase in content due to shift towards LHB coaches for passenger trains and DFC for goods train is expected to boost growth in the medium term. With new additions of customers in the wind power business, we expect SIL to hold strong business in the sector. The company has recently introduced lubricants under the "True Value" brand and aims to introduce more products going forward. Moreover, its parent company has identified SIL as a manufacturing base for supply to Asia-Pacific region. Exports is a high growth area for SIL, given the pedigree of its parent company. We expect SIL to benefit from richer product mix with aftermarket to OEM sales ratio rising and high margins in the traded goods segment. We expect SIL's earnings to grow by 51.7% in CY2021E and 32.9% in CY2022E, driven by a 21.4% CAGR during CY2020E-22E and a 320-bps improvement in EBITDA margin. We retain our Buy rating on the stock with a revised price target of Rs. 5,258.

Our Call

Valuation - Maintain Buy with a revised PT of Rs. 5,258: Schaeffler is witnessing recovery in demand with both industrial and automotive segments reporting growth in Q3CY20. We expect strong recovery from CY21 driven by normalisation of economic activity. An increase in content/vehicle in auto OEMs, strong growth in wind power and railways segment and new product introduction in aftermarket segment would continue to drive growth. We have increased our earnings estimates by 5-7% for CY2021-22E to factor in an improved business outlook. We have valued the stock by assigning P/E multiple of 31x, a 10% premium to its average long-term P/E multiples, on SIL's CY2022E earnings to arrive at a revised PT of Rs. 5,258. We believe the premium is justified given the company's strong parentage and improved business prospects. The stock is attractively valued at a P/E multiple of 27x and EV/EBITDA multiple of 15.2x its CY2022E estimates. We retain our Buy rating on the stock.

Key Risks

Delayed approval from industrial customers and delayed launches by automotive players can impact growth.

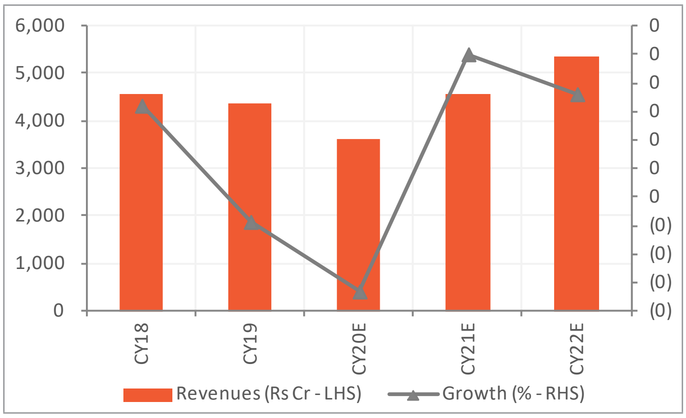
Valuations (Standalone) Rs cr

Particulars	CY18	CY19	CY20E	CY21E	CY22E
Net Sales	4,562	4,361	3,636	4,545	5,364
Growth (%)	16.0	(4.4)	(16.6)	25.0	18.0
EBIDTA	740	634	487	691	890
OPM (%)	16.2	14.5	13.4	15.2	16.6
Recurring PAT	420	368	263	399	530
Growth (%)	8.1	(12.4)	(28.5)	51.7	32.9
EPS (Rs)	134.3	117.6	84.1	127.6	169.6
PE (x)	34.1	38.9	54.4	35.8	27.0
P/BV (x)	6.1	5.3	4.8	4.6	4.2
EV/EBIDTA (x)	19.2	22.4	28.5	19.9	15.2
RoCE (%)	22.8	17.9	11.5	16.0	18.4
RoNW (%)	15.5	12.4	8.4	11.8	13.5

Source: Company; Sharekhan estimates

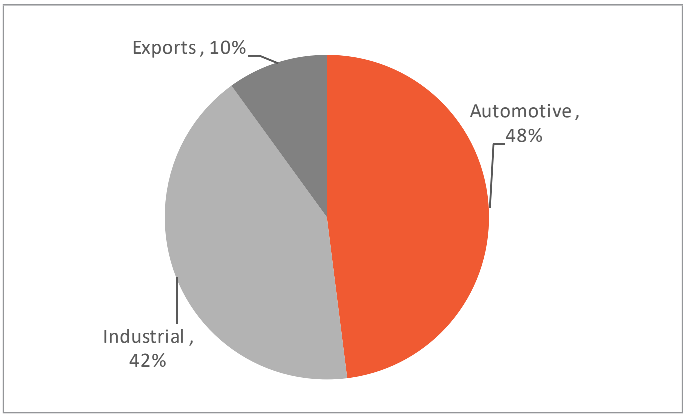
Financials in charts

Revenue and Growth Trend



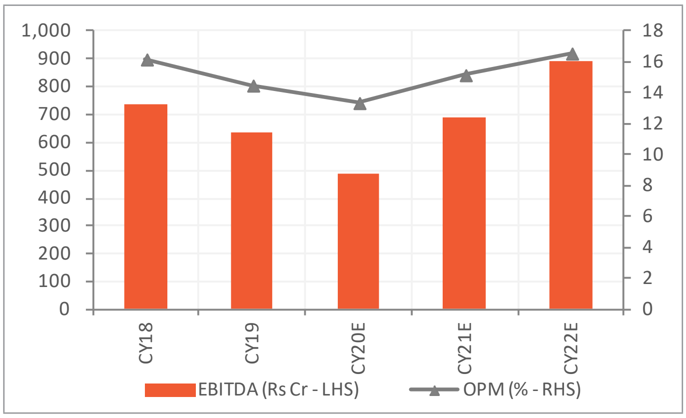
Source: Company, Sharekhan Research

Revenue Mix (%)



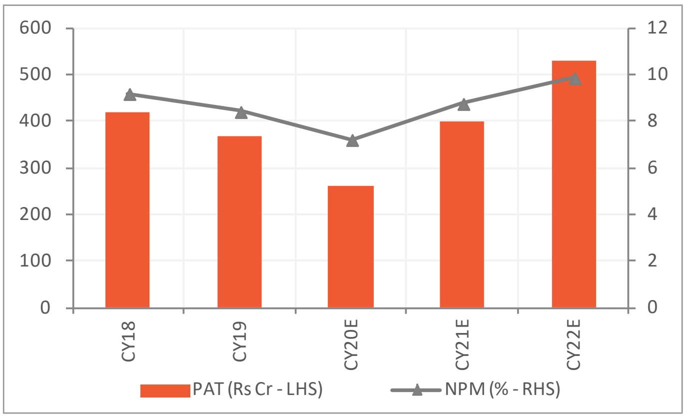
Source: Company, Sharekhan Research

EBITDA and OPM Trend



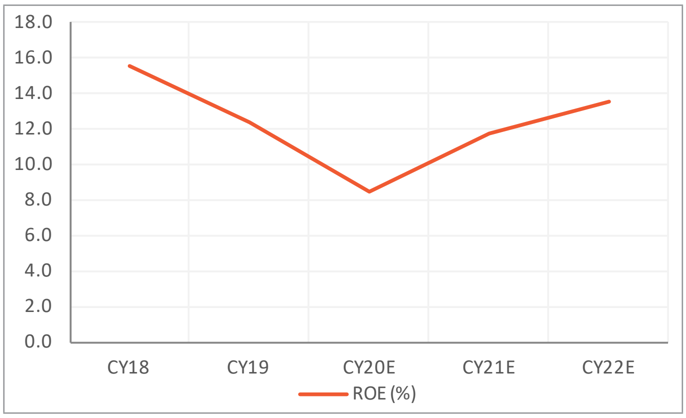
Source: Company, Sharekhan Research

Net profit and NPM Trend



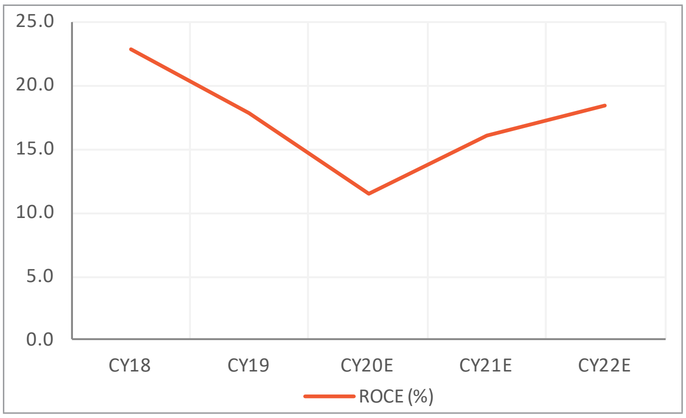
Source: Company, Sharekhan Research

RoE trend



Source: Company, Sharekhan Research

RoCE trend



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector outlook – Demand picking up in automotive and industrial sector

The business outlook for the automotive segments is improving with a normalisation of economic activities. The automotive demand is witnessing strong recovery in four-wheeler segments aided by pent-up demand, and increase in personal mobility transport. The tractor segment remains buoyant on robust farm income this year. The recovery in export destinations is auguring well for the sector. Also, exports provide huge growth potential given India's cost-effective manufacturing, being geographically closer to key markets of Middle East and Europe and being second largest producer of key raw material steel. Auto component exports are expected to grow from USD 15 billion to USD 80 billion by FY2027.

■ Company outlook – MNC company with strong technological parentage and robust balance sheet

Schaeffler India is part of the German Schaeffler Group. The Schaeffler Group has a strong research and development (R&D) DNA (in 2019, it filed 2,400 patents, making it the second most innovative company in Germany) and has established strong relationships with global original equipment manufacturers (OEM) worldwide. Schaeffler would benefit from its strong parentage and continue to win new businesses. Schaeffler is a debt-free company having ROCE and ROIC in excess of 15%. The company has cash & cash equivalents worth Rs. 875 crore and is likely to generate about Rs. 1,200 crore free cash flow from operations in the next three years.

■ Valuation - Maintain Buy with a revised PT of Rs. 650, providing an upside room of 14%

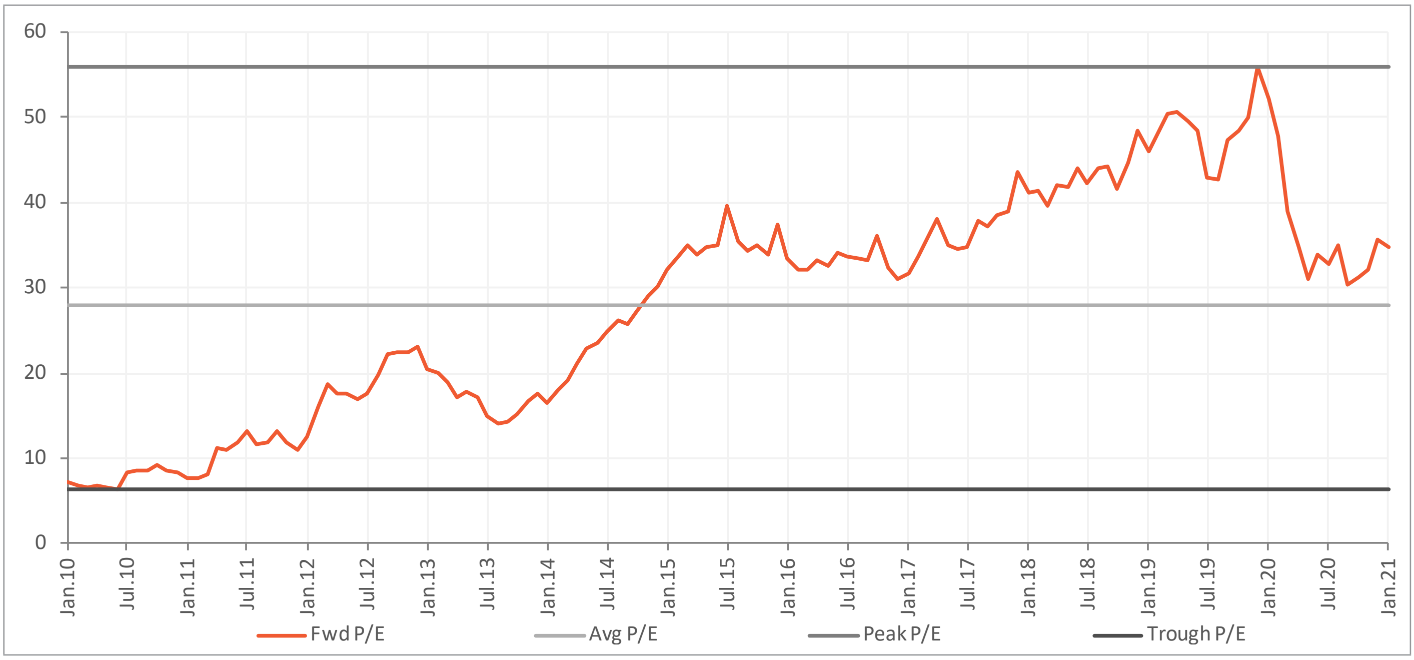
Schaeffler is witnessing recovery in demand with both industrial and automotive segments reporting growth in Q3CY20. We expect strong recovery from CY21 driven by normalisation of economic activity. An increase in content/vehicle in auto OEMs, strong growth in wind and railways segment and new product introduction in aftermarket segment would continue to drive growth. We have increased our earnings estimates by 5-7% for CY2021-22E to factor in an improved business outlook. We have valued the stock by assigning P/E multiple of 31x, a 10% premium to its average long-term P/E multiples, on SIL's CY2022E earnings to arrive at a revised PT of Rs. 5,258. We believe the premium is justified given the company's strong parentage and improved business prospects. The stock is attractively valued at a P/E multiple of 27x and EV/EBITDA multiple of 15.2x its CY2022E estimates. We retain our Buy rating on the stock.

PT valued at slight discount to average long-term P/E multiple provides 15% upside

Price Target Calculation		
CY2022E EPS (Rs. per share)	169.6	
Target P/E Multiple (x)	31	10% premium to average long-term P/E multiple
Target Price (Rs.)	5258	
Upside (%)	15%	

Source: Company Data; Sharekhan Research

One-year forward P/E (x) band



Source: Sharekhan Research

About company

Schaeffler (erstwhile FAG Bearings) with four plants and 11 sales offices has significant presence in India with three major widely known product brands - FAG, INA, and LuK. Schaeffler produces a vast range of ball bearings, cylindrical roller bearings, deep groove ball, spherical roller bearings, and wheel bearings sold under the brand name of FAG. The company manufactures engine and transmission components for front accessory drive systems, chain drive systems, valve train, shift systems, and a range of needle roller bearings and elements under the brand INA. Schaeffler also produces clutch systems and dual mass flywheels for passenger cars, LCVs, heavy commercial vehicles, and tractors, which are sold under the brand of LuK. In addition to this, Schaeffler has dedicated engineering and R&D support based in India to augment its product teams. Schaeffler also has one of the largest aftermarket networks serving industrial and automotive markets. Schaeffler derives 47% of its revenue from the automotive segment, 42% from the industrial segment, and 11% revenue from exports.

Investment theme

Schaeffler India witnessed growth in Q3CY20 with growth in both automotive and industrial segment. The management stated that recovery in demand has been swift and better than expectations. It expects Q4CY20 also to register growth driven by onset of festive and further pick up in economy. Automotive OEM business would benefit from increased content per vehicle while Industrial OEM business is witnessing good traction in wind and railway space due to new product and customer additions. Schaeffler recently introduced lubricants in the aftermarket space and would continue to add new products to drive growth. With parent identifying Indian unit as supplier to Asia Pacific region, export potential is huge. Operating leverage and increased localisation would drive earnings growth. Schaeffler's strong technological parentage and established relationship with global OEM clients would continue to provide growth opportunities. Also, SIL is a debt free company with healthy return ratios (ROCE and ROIC) in excess of 15%. We maintain our Buy rating on SIL with TP of Rs. 5,258.

Key Risks

- Delayed approval from industrial customers and delayed launched by automotive players can impact growth.
- Pricing pressures from automotive OEM customers can impact profitability.

Additional Data

Key management personnel

Avinash Gandhi	Chairman
Dharmesh Arora	Managing Director & CEO
Satish Patel	Director Finance & CFO
Chirag Shukla	Company Secretary

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	FAG Kugelfischer AG	27.28
2	VERWALTUNGS GMBH SCHAEFFLE	20.56
3	SCHAEFFLER VERWALTUNGSHOLD	15.01
4	INDUSTRIEWERK SCHAEFFLER	11.27
5	Franklin Resources Inc	2.13
6	Kotak Mahindra Asset Management Co	2.12
7	SBI Funds Management Pvt Ltd	2.11
8	HDFC Asset Management Co Ltd	1.5
9	UTI Asset Management Co Ltd	1.48
10	HDFC Life Insurance Co Ltd	1.34

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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