Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Schaeffler India Limited

Growth run to continue post strong quarter

Automobiles	Sharekhan code: SCHAEFFLER	Result 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. 5,128**	
Price Target: **Rs. 5,900**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Company details

Market cap:	Rs. 16,031 cr
52-week high/low:	Rs. 4,960/ 3,025
NSE volume: (No of shares)	17,823
BSE code:	505790
NSE code:	SCHAEFFLER
Free float: (No of shares)	0.8 cr

Shareholding (%)

Promoters	74.1
FII	4.8
DII	14.7
Others	6.4

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	11.6	33.0	42.9	9.1
Relative to Sensex	6.5	13.1	7.1	-16.3

Sharekhan Research, Bloomberg

Summary

- We retain a Buy rating on Schaeffler India Limited (SIL) with a revised PT of Rs. 5,900, led by a strong outlook for its automotive and industrial businesses, and an upgrade in earnings estimates.
- It was yet another strong quarter, beating our earnings estimates by 17%, led by robust revenue growth and better-than-expected rise in EBITDA margins.
- Given a robust outlook, we expect its earnings to grow at 38.6% CAGR from CY2020-22E, driven by a 21.4% revenue CAGR during CY2020-22E and a 240 bps improvement in EBITDA margins.
- The stock trades below its historical average at P/E of 28.7x and EV/EBITDA of 16.4x its CY2022E estimates.

Schaeffler India Limited (SIL) reported another strong quarter, beating our earnings estimates by 17%, led by robust revenue growth and better-than-expected rise in EBITDA margins. Net revenue grew by 22.9% y-o-y to Rs 1,274 crore in Q4CY20, aided by stronger recovery in automotive division than the industrial division, and an improvement in content per vehicle. The company received new projects during the quarter, which further enabled better performance. EBITDA margin improved by 459 bps y-o-y to 18.8% in Q4CY20, aided by cost reductions, operating leverage benefits and a richer product mix. As a result, EBITDA margin grew by robust 62.7% y-o-y to Rs 239 crore, while sequentially, it rose by 185 bps, largely driven by product mix and operating leverage benefits, despite a rise in input prices. Adjusted PAT increased by a strong 67.5% y-o-y to Rs 142 crore on strong operational performance. We have raised our earnings estimates for SIL to factor in the impact of a better business outlook. SIL would benefit from industrial and automobile aftermarket segment, strong growth traction in export markets and better prospects for the bearings business. The company is focusing on introducing new products in the industrial and automotive aftermarkets by bringing in localisation and boosting its market share. We are positive on the automobile sector and expect the industry to clock double-digit growth in FY22. SIL will be the key beneficiary of this trend, as it focuses on increasing content per vehicle. In the industrial OEM segment, the company is witnessing strong growth in the Railways segment with the introduction of new products and supplies to Metro Rail projects. Moreover, the increase in content due to shift towards Linke Hofmann Busch (LHB) coaches for passenger trains and dedicated freight corridor (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 clock strong growth in this space. Exports is a high growth area for SIL, given the pedigree of its parent company. We expect Schaeffler to benefit from industrial and automobile aftermarkets, strong growth traction in railways and export segments and better prospects for the bearings business, amid stricter norms. We expect SIL to benefit from richer product mix with aftermarket to OEM sales ratio rising and high margins in the traded goods segment. Given the robust outlook for SIL's business, we expect its earnings to grow at 38.6% CAGR from CY2020-22E, driven by a 21.4% revenue CAGR during CY2020-22E and a 240 bps improvement in EBITDA margins.

Our Call

Valuation - Maintain Buy with a revised PT of Rs. 5,900: SIL's performance has been improving strongly over the last two quarter after COVID-19 lockdown in Q2CY10, aided by a strong recovery in automotive segment and industrial segment. Exports continue to contribute ~10% of revenues. We expect a good bounceback from CY2021 driven by normalisation of economic activity, improvement in in content per vehicle in auto OEMs, strong growth in the wind power and railways businesses and launch of new products in the aftermarket segment. We have increased our earnings estimates by 6.8% and 5.4% for CY2021E and CY2022E respectively to factor in an improved business outlook and firm rise in margins. 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. The stock is trading below its historical average at P/E of 28.7x and EV/EBITDA of 16.4x its CY2022E estimates. We retain a Buy rating on the stock with a revised PT of Rs. 5,900.

Key risk

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

Valuation Rs cr

Particulars	CY18	CY19	CY20	CY21E	CY22E
Net Sales	4,562	4,361	3,762	4,702	5,549
Growth (%)	16.0	(4.4)	(13.7)	25.0	18.0
EBIDTA	740	634	536	724	925
OPM (%)	16.2	14.5	14.3	15.4	16.7
Recurring PAT	420	368	291	426	559
Growth (%)	8.1	(12.4)	(20.9)	46.4	31.2
EPS (Rs)	134.3	117.6	93.1	136.3	178.8
PE (x)	38.2	43.6	55.1	37.6	28.7
P/BV (x)	6.9	5.9	5.4	5.1	4.7
EV/EBIDTA (x)	21.6	25.1	29.1	21.4	16.4
RoCE (%)	15.5	12.4	9.3	12.4	14.0
RoNW (%)	22.8	17.9	12.6	16.9	19.0

Source: Company; Sharekhan estimates

Another strong quarter: Schaeffler India Limited (SIL) reported strong numbers for yet another quarter, beating our earnings estimates by 17%, led by stronger revenue growth and better-than-expected EBITDA margin expansion. Net revenue grew by 22.9% y-o-y to Rs 1,274 crore in Q4CY20, aided by a stronger recovery in automotive division than the industrial division, and improvement in content per vehicle. The realisation of new projects further enabled better performance. EBITDA margin improved 459 bps y-o-y to 18.8% in Q4CY2020, aided by cost cuts, operating leverage benefits and richer product mix. As a result, EBITDA grew by robust 62.7% y-o-y to Rs. 239 crore. EBITDA margin also saw an improvement of 185 bps q-o-q, largely driven by product mix and operating leverage benefits, despite a rise in input prices. Adjusted PAT increased by strong 67.5% y-o-y to Rs 142 crore on strong operational performance. For the full year CY2020, PAT declined by 20.9% y-o-y to Rs. 291 crore on back of 13.7% decline in revenues and a 20 bps decline in EBITDA margin at 14.3%. Annual results were impacted by COVID-19 pandemic during Q2CY20. The company declared a dividend of 380% or Rs. 38 per share for CY20.

Positive management guidance: The management was optimistic about medium-term growth prospects in the medium term, given strong traction in passenger vehicles and light commercial vehicle segments. The company expects benefits announced in the Budget this year would reap benefits going forward. The management see the CY21 to be a strong year and expects its businesses to perform well this year, driven by an expected normalisation of economic activity with the rollout of vaccines in the country.

Multiple growth levers: In the automotive OEM segment, Schaeffler is witnessing increased content per vehicle in the petrol passenger vehicle segment post the implementation of BS-VI emission norms, while in industrial OEM segment, the company is witnessing strong growth from railways segment and wind-power division. The Railway division business is driven by introduction of new products and supplies to metro railways, while the wind-power business is aide by new client acquisitions. Besides the OEM segment, the aftermarket is also poised for healthy growth driven by new product introductions. SIL has launched lubricant business under "True Value" brand. The company aims to introduce more products in the segment. Also, SIL's parent has identified it as a manufacturing base for supply to Asia-Pacific region. This provides a huge growth potential.

Margins to remain firm: EBITDA margin for Q4CY20 stood at 18.8%, a strong expansion of 459 bps y-o-y and 185 bps q-o-q. The company expects margins to remain firm, but the current levels may not be sustainable. Some of the cost-control measures which the company launched during the slowdown in wake of low revenues would have to be lifted as the growth picks up. The company expects that a high level of localisation will help keep EBITDA margins firm, bringing down imports. The company has increased the level of localisation to 75% in CY20 versus ~ 70% in CY18.

Strong growth prospects: We expect Schaeffler to benefit from the industrial and automobile aftermarkets, strong growth traction in railways and export segments and better prospects for the bearings business, amid stricter norms. 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 its earnings to grow at 38.6% CAGR from CY2020-22E, driven by a 21.4% revenue CAGR during CY2020-22E and a 240 bps improvement in EBITDA margins. Balance sheet remains healthy, given its prudent capital allocation, efficient working capital management and robust FCF generation. SIL generated FCF of Rs 452.7 crore in CY2020, a rise of 84.8% over its FCF in CY2019.

Results Rs cr

Particulars	Q4CY20	Q4CY19	%YoY	Q3CY20	%QoQ
Total Income	**1,273.8**	**1,036.5**	**22.9**	**1,120.7**	**13.7**
EBIDTA	**239.1**	**147.0**	**62.7**	**189.6**	**26.1**
EBIDTA Margins (%)	18.8	14.2	459 bps	16.9	185 bps
Depreciation	61.1	42.5	43.9	48.6	25.8
Interest	2.5	1.1	133.0	0.9	171.4
Other Income	15.5	20.7	(24.9)	12.6	22.9
PBT	191.0	124.1	53.9	152.7	25.1
Tax	49.4	39.6	24.9	39.3	25.8
Reported PAT	141.6	84.6	67.5	113.5	24.8
Adjusted PAT	**141.6**	**84.6**	**67.5**	**113.5**	**24.8**
EPS (Rs)	**45.3**	**27.0**	**67.5**	**36.3**	**24.8**

Source: Company; Sharekhan Research

Outlook and Valuation

Sector View – Demand picking up in automotive and industrial sector

The business outlook for the automotive sector 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 the key markets of the Middle East and Europe and being second-largest producer of key raw material steel. Auto component exports are expected to grow from $15 billion to $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 CY2019, the Group filed 2,400 patents, making it the second-most innovative company in Germany. The company has established strong relationships with global original equipment manufacturers (OEM) worldwide. Schaeffler India would benefit from its strong parentage and is expected to receive new businesses going forward. Also, SIL's parent has identified it as a manufacturing base for supply to Asia-Pacific region. This provides huge growth potential for the company. Schaeffler India is debt-free with RoCE and ROIC in excess of 15%. The company is expected to generate strong FCF to the tune of Rs. 1,200 crore over the next three years. We remain positive on the company's growth prospects.

Valuation – Maintain Buy with a revised PT of Rs. 5,900

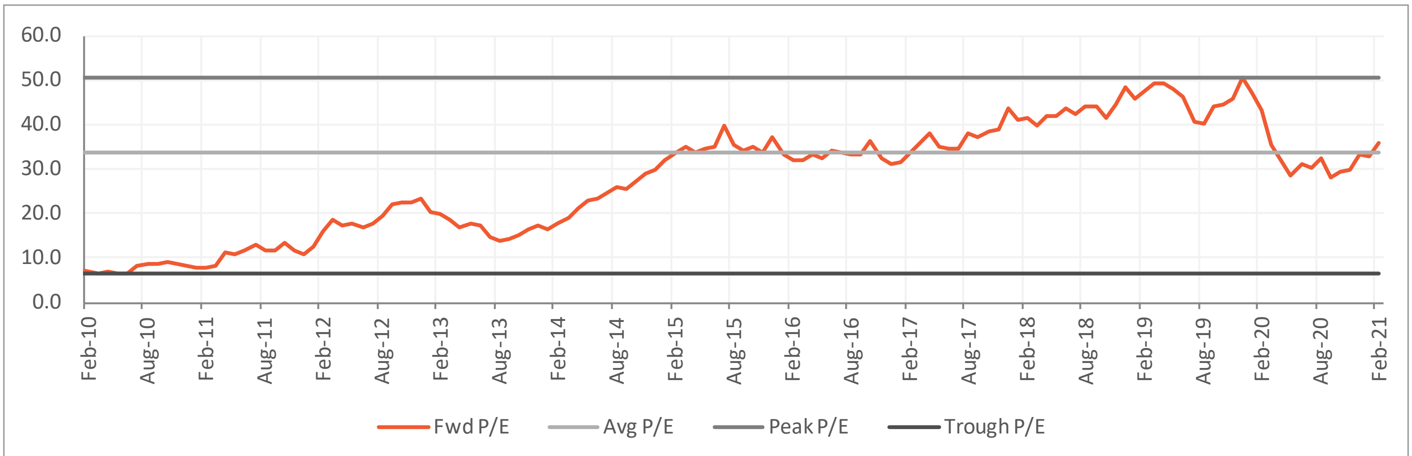
SIL's performance has been improving strongly over the last two quarter after COVID-19 lockdown in Q2CY10, aided by a strong recovery in automotive segment and industrial segment. Exports continue to contribute significantly. We expect a good bounceback from CY2021 driven by normalisation of economic activity, improvement in in content per vehicle in auto OEMs, strong growth in the wind power and railways businesses and launch of new products in the aftermarket segment. We have increased our earnings estimates by 6.8% and 5.4% for CY2021E and CY2022E respectively to factor in an improved business outlook and firm rise in margins. 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. The stock is trading below its historical average at P/E of 28.7x and EV/EBITDA of 16.4x its CY2022E estimates. We retain a Buy rating on the stock with a revised PT of Rs. 5,900.

Price Target calculation

Particulars	Rs/ share
CY2022E EPS	178.8
Target P/E Multiple (x)	33
Target Price (Rs.)	5900
Upside (%)	**15%**

Source: Company; Sharekhan Research

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Schaeffler India	55.1	37.6	28.7	29.1	21.4	16.4	12.6	16.9	19.0
Sundram Fasteners	65.8	35.3	24.7	28.7	19.6	14.7	11.4	17.1	21.3
Suprajit Engineering	27.5	19.5	15.8	16.6	12.5	10.2	15.0	18.4	20.0

Source: Company, Sharekhan estimates

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 Limited (SIL) is among the largest automotive and industrial supplier with a strong parentage of the Schaeffler Group. The company has presence in India over 50 years and have established strong relationships with leading OEMs in India and globally. Having strong manufacturing capability and R&D, SIL's parent company has identified it as a manufacturing base for supply to Asia-Pacific region and this provides a strong opportunity to the company to expand its export business. With the Indian Government focussing on 'Make in India', 'Atma-Nirbhar' and PLI programmes, SIL is well positioned to take benefit from these programmes. Also, the company has diversified portfolio – with automotive, industrial and export businesses contributing 48%, 42% and 10% of the revenues. The company's strategies to increase content per vehicle through product innovation and launches, while identifying new business divisions in industrial sector is likely to keep growth traction intact. The company's strong technological parentage and established relationship with global OEM clients would continue to provide growth opportunities. We remain positive on SIL and expect strong earnings growth driven by revenue growth and margin expansion.

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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