

# Schaeffler India | BUY

## Merging all India businesses into listed entity: A first by an MNC

Schaeffler Group announced merger of its unlisted subsidiaries i.e. INA Bearings (INA) and Luk India (LuK) into the listed subsidiary Schaeffler India (SCHFL), to form a single India wide entity. The consideration will be paid through share swap, resulting in an increase in parent company's holding to 74.1% (vs 51.3%). The transaction value is pegged at INR 62bn, valuing the combined entity at PE of 48x CY16 (32% premium to SCHFL) and EVE of 23x CY16 (8% premium to SCHFL). We believe its first time an MNC is consolidating all its business under the listed entity and the premium paid over Schaeffer India is justified as a) higher revenue share from fast growing automotive segment is likely to improve the growth profile of the combined entity, b) uniting all India entities under one umbrella can help provide combined solutions and increase transparency, c) provide cost synergies in areas of logistics, distribution, sales, marketing and admin services and d) other associated benefits (flexibility in production, reduction in intercorporate transactions). We continue to maintain BUY rating with our TP of INR 5,000.

- Transaction value pegged at INR 62bn; 48x TTM PE and 23x TTM EVE:** Acquisition value of the group companies (INA+LuK) is pegged at INR 62.2bn (INA: INR 35bn, LuK: INR 27bn), implying 48x CY16 PE (32% premium to SCHFL) and 23x CY16 EVE (8% premium to SCHFL). In our view, the premium valuations are justified given better growth profile of these companies due to higher share of automotive segment (88%/100% for INA/LuK vs 31% for Schaeffler India). Over CY13-16, the group companies have grown at sales/EBITDA CAGR of 13%/63% vs 8%/17% for SCHFL. The transaction consideration will be paid through issue of 14.64 mn additional shares of Schaeffler India, resulting in an increase in parent's shareholding to 74.1% (vs 51.3%).
- Rationale:** The merger is likely to be value accretive for Schaeffler India as a) higher revenue share from fast growing automotive segment is likely to improve the growth profile of the combined entity (3-yr sales/EBITDA CAGR for INA+LuK:13%/63% vs SCHFL: 8%/17%), b) uniting all India entities under one umbrella would help provide combined solutions (in transmission/clutch systems) and would bring increased transparency on aspects like new product introduction, product sourcing and new market entry strategy, c) provide cost synergies in areas of logistics (reduced freight and warehousing costs), distribution (independent distribution channels and complementary product profile), sales and marketing (common sales force and consolidation of offices) and admin services (shared services in IT, HR, Finance) and d) other associated benefits (flexibility in production, reduction in intercorporate transactions).
- Maintain BUY with TP of INR 5,000:** We have not considered the value of group companies in our forecast, as the merger is still awaiting several approvals from various authorities and shareholders. This is first time an MNC is consolidating all its businesses under the listed entities and we believe this will augur well for Schaeffler India. We continue to maintain BUY rating with TP of INR 5,000 as we forecast 11%/19% sales/net profit CAGR over CY16-18E.



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### Recommendation and Price Target

Current Reco.	BUY
Previous Reco.	BUY
Current Price Target (12M)	5,000
Upside/(Downside)	17.8%
Previous Price Target	5,000
Change	0.0%

### Key Data – SCHFL IN

Current Market Price	INR4,245
Market cap (bn)	INR70.5/US\$1.1
Free Float	45%
Shares in issue (mn)	16.6
Diluted share (mn)	16.6
3-mon avg daily val (mn)	INR22.8/US\$0.0
52-week range	5,167/3,774
Sensex/Nifty	31,485/9,837
INR/US\$	64.0

### Price Performance

%	1M	6M	12M
Absolute	-8.8	0.5	4.7
Relative*	-6.4	-8.2	-7.2

\* To the BSE Sensex

Financial Summary	(INR mn)				
Y/E March	CY14A	CY15A	CY16A	CY17E	CY18E
Net Sales	16,322	17,244	18,139	19,512	22,218
Sales Growth (%)	14.1	5.7	5.2	7.6	13.9
EBITDA	2,417	3,053	2,961	3,534	4,128
EBITDA Margin (%)	14.8	17.7	16.3	18.1	18.6
Adjusted Net Profit	1,529	1,975	1,945	2,357	2,768
Diluted EPS (INR)	92.0	118.8	117.0	141.8	166.6
Diluted EPS Growth (%)	25.5	29.2	-1.5	21.2	17.5
ROIC (%)	16.6	20.2	18.5	22.6	24.8
ROE (%)	14.6	16.5	14.2	15.1	15.5
P/E (x)	46.1	35.7	36.3	29.9	25.5
P/B (x)	6.4	5.5	4.9	4.3	3.7
EV/EBITDA (x)	28.5	22.1	22.2	18.2	15.2
Dividend Yield (%)	0.2	0.2	0.3	0.3	0.4

Source: Company data, JM Financial. Note: Valuations as of 29/Aug/2017

JM Financial Research is also available on:  
Bloomberg - JMFR <GO>,  
Thomson Publisher & Reuters  
S&P Capital IQ and FactSet

Please see Appendix I at the end of this report for Important Disclosures and Disclaimers and Research Analyst Certification.

## Exhibit 1. Transaction snapshot

	INA Bearings	LuK India	Total (INA+LuK)	Schaeffler India (pre-merger)	Premium (%)
Swap ratio	10:65	10:35			
No of shares issued (mn)	8.2	6.4	14.6		
Value at INR 4,250/share (INR mn)	<b>34,913</b>	<b>27,321</b>	<b>62,235</b>	<b>70,623</b>	
Valuation (on CY16 basis)					
EV/EBITDA (x)	<b>25.1</b>	<b>21.4</b>	<b>23.4</b>	<b>21.7</b>	<b>8%</b>
P/E (x)	<b>51.0</b>	<b>44.7</b>	<b>48.0</b>	<b>36.3</b>	<b>32%</b>
P/B (x)	14.5	8.7	11.2	4.9	131%
Valuation (on CY17* basis)					
EV/EBITDA (x)	20.2	19.6	19.9	17.7	13%
P/E (x)	<b>42.2</b>	<b>38.7</b>	<b>40.6</b>	<b>31.7</b>	<b>28%</b>
P/B (x)	10.8	7.1	8.8	4.3	107%

Source: Company, JM Financial. \*For INA and LuK, 1H CY17 numbers are annualised to arrive at CY17 valuations

## Exhibit 2. Key Financials

INR mn	Schaeffler		INA		LuK India		Schaeffler Proforma	
	CY16	H1CY17	CY16	H1CY17	CY16	H1CY17	CY16	H1CY17
Revenue	18,139	9,205	10,418	5,855	7,298	4,078	35,694	19,077
Growth	5.2	6.9	15.1	17.3	16.6	17.3	10.2	12.1
EBITDA	2,961	1,746	1,461	892	1,262	684	5,684	3,323
Margin (%)	<b>16.3</b>	<b>19.0</b>	<b>14.0</b>	<b>15.2</b>	<b>17.3</b>	<b>16.8</b>	<b>15.9</b>	<b>17.4</b>
PBT	2,985	1,699	997	633	889	509	4,870	2,841
Tax	1,040	584	312	219	278	156	1,629	960
Tax rate (%)	35	34	31	35	31	31	33	34
PAT	<b>1,945</b>	<b>1,115</b>	<b>685</b>	<b>414</b>	<b>611</b>	<b>353</b>	<b>3,241</b>	<b>1,881</b>
Margin (%)	10.7	12.1	6.6	7.1	8.4	8.7	9.1	9.9
Shares o/s (mn)	16.6		53.4		22.5		31.3	
EPS (INR)	117.0		7.8		27.2		103.7	
Non-current liabilities	289	294	1,501	1,263	326	208	1,146	597
Non-current assets	5,520	5,556	2,733	2,659	1,957	1,874	9,244	8,926
Net working capital	2,889	3,199	777	808	836	957	4,498	4,959
Borrowings	0	0	1,410	1,170	242	113	702	113
Cash	6,406	7,210	38	202	321	518	6,764	7,930

Source: Company, JM Financial

## Exhibit 3. Combined Entity grew much faster than respective industries

	Schaeffler India	INA+LuK	Combined	5-yr CAGR (%)	
				Combined entity	Industry
Passenger Cars	1,989	7,915	9,904	18.8%	4.3%
CVs	396	2,495	2,891	9.9%	-1.7%
Tractors	740	1,471	2,211	8.0%	0.6%
2-wheelers	2,201	2,153	4,354	10.7%	5.9%
Auto Aftermarket	305	2,561	2,866	14.5%	NA
<b>Auto subtotal</b>	<b>5,631</b>	<b>16,595</b>	<b>22,226</b>		
Industrial OEM	7,742	2,048	9,790	9.4%	2.2%
Industrial Aftermarket	4,568	438	5,006	2.6%	4.7%
<b>Industrial subtotal</b>	<b>12,310</b>	<b>2,486</b>	<b>14,796</b>		
<b>Total</b>	<b>17,941</b>	<b>19,081</b>	<b>37,022</b>		

Source: Company, JM Financial

**Exhibit 4. Schaeffler Proforma P&L statement (INR mn)**

	CY16	CY17E	CY18E	CAGR (%)
<b>Net Sales</b>				
- Schaeffler India	18,139	19,512	22,218	10.7
- INA Bearings	10,418	12,189	14,017	16.0
- LuK India	7,298	8,539	9,819	16.0
<b>Total</b>	<b>35,855</b>	<b>40,239</b>	<b>46,055</b>	<b>13.3</b>
YoY (%)	10.1	12.2	14.5	
<b>EBITDA</b>				
- Schaeffler India	2,961	3,534	4,128	18.1
- INA Bearings	1,461	1,853	2,131	20.8
- LuK India	1,262	1,434	1,650	14.3
<b>Total</b>	<b>5,684</b>	<b>6,822</b>	<b>7,909</b>	<b>18.0</b>
YoY (%)		20.0	15.9	
<b>EBITDA Margin (%)</b>				
- Schaeffler India	16.3%	18.1%	18.6%	
- INA Bearings	14.0%	15.2%	15.2%	
- LuK India	17.3%	16.8%	16.8%	
<b>Total</b>	<b>15.9%</b>	<b>17.0%</b>	<b>17.2%</b>	
<b>Net Profit</b>				
- Schaeffler India	1,945	2,357	2,768	19.3
- INA Bearings	685	828	952	17.9
- LuK India	611	706	812	15.3
<b>Total</b>	<b>3,241</b>	<b>3,891</b>	<b>4,532</b>	<b>18.3</b>
YoY (%)		20.0	16.5	

Source: Company, JM Financial

**Exhibit 5. INA+LuK has grown faster than Schaeffler India**

	Revenue (INR mn)			EBITDA (INR mn)		
	CY13	CY16	CAGR (%)	CY13	CY16	CAGR (%)
INA	6,712	10,418	15.8%	255	1,461	78.9%
LuK	5,744	7,298	8.3%	374	1,262	50.0%
<b>INA+LuK</b>	<b>12,456</b>	<b>17,716</b>	<b>12.5%</b>	<b>629</b>	<b>2,723</b>	<b>63.0%</b>
<b>Schaeffler</b>	<b>14,300</b>	<b>18,139</b>	<b>8.2%</b>	<b>1,836</b>	<b>2,961</b>	<b>17.3%</b>








Source: Company, JM Financial

**Exhibit 6. Revenue Mix – CY16**

%	SCHFL	INA	LuK	Combined entity
Passenger Cars	11	59	24	28
2W's	12	21	0	12
Wind Energy	7	0	0	3
Railway	6	0	0	3
Tractors	4	0	19	6
CV's	2	6	25	8
Auto AM	2	2	32	8
Ind AM	26	4	0	14
Ind OEM	30	8	0	18
<b>Total</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>
<b>Auto</b>	<b>31</b>	<b>88</b>	<b>100</b>	<b>62</b>
<b>Industrial</b>	<b>69</b>	<b>12</b>	<b>0</b>	<b>38</b>

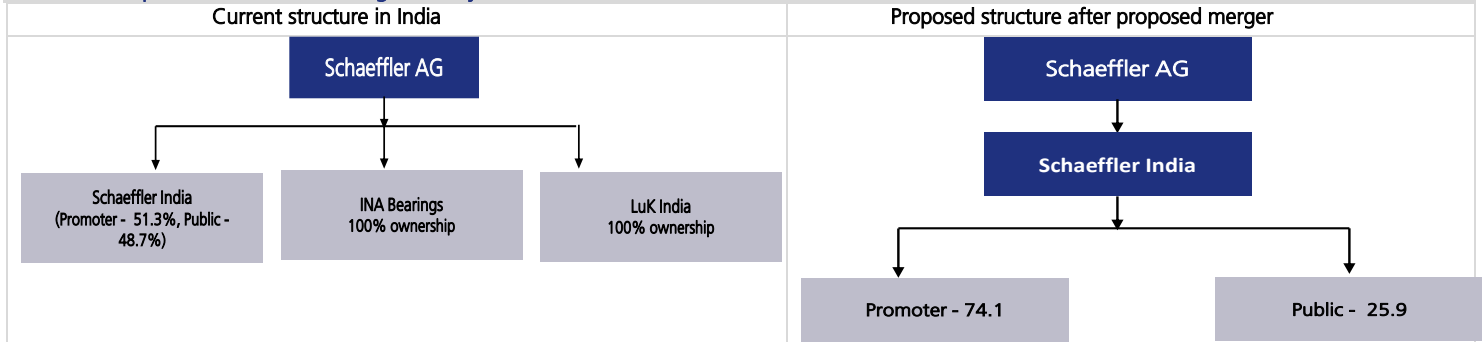
Source: Company, JM Financial

**Exhibit 7. Product and Solution Synergy**

Clutch Package			Transmission package			
LUK India		INA	INA	FAG		
						
Clutch system and linings	Clutch release systems	Clutch release bearing	Shifting systems	Needle roller bearings	Tapered roller bearings	Deep groove ball bearings

Source: Company, JM Financial

**Exhibit 8. Proposed structure of merged entity**



Source: Company, JM Financial

## Financial Tables (Standalone)

Income Statement						(INR mn)
Y/E March	CY14A	CY15A	CY16A	CY17E	CY18E	
Net Sales	16,322	17,244	18,139	19,512	22,218	
Sales Growth	14.1%	5.7%	5.2%	7.6%	13.9%	
Other Operating Income	0	0	0	0	0	
<b>Total Revenue</b>	<b>16,322</b>	<b>17,244</b>	<b>18,139</b>	<b>19,512</b>	<b>22,218</b>	
Cost of Goods Sold/Op. Exp	9,973	9,907	10,826	11,317	12,887	
Personnel Cost	1,379	1,321	1,513	1,636	1,804	
Other Expenses	2,552	2,964	2,840	3,024	3,399	
<b>EBITDA</b>	<b>2,417</b>	<b>3,053</b>	<b>2,961</b>	<b>3,534</b>	<b>4,128</b>	
EBITDA Margin	14.8%	17.7%	16.3%	18.1%	18.6%	
EBITDA Growth	31.7%	26.3%	-3.0%	19.4%	16.8%	
Depn. & Amort.	494	655	641	648	691	
EBIT	1,924	2,398	2,320	2,886	3,438	
Other Income	410	562	683	717	788	
Finance Cost	10	21	18	5	0	
PBT before Excep. & Forex	2,324	2,938	2,985	3,598	4,226	
Excep. & Forex Inc./Loss(-)	0	0	0	0	0	
PBT	2,324	2,938	2,985	3,598	4,226	
Taxes	795	963	1,040	1,241	1,458	
Extraordinary Inc./Loss(-)	0	0	0	0	0	
Assoc. Profit/Min. Int.(-)	0	0	0	0	0	
Reported Net Profit	1,529	1,975	1,945	2,357	2,768	
<b>Adjusted Net Profit</b>	<b>1,529</b>	<b>1,975</b>	<b>1,945</b>	<b>2,357</b>	<b>2,768</b>	
Net Margin	9.4%	11.5%	10.7%	12.1%	12.5%	
Diluted Share Cap. (mn)	16.6	16.6	16.6	16.6	16.6	
<b>Diluted EPS (INR)</b>	<b>92.0</b>	<b>118.8</b>	<b>117.0</b>	<b>141.8</b>	<b>166.6</b>	
Diluted EPS Growth	25.5%	29.2%	-1.5%	21.2%	17.5%	
Total Dividend + Tax	146	206	241	285	335	
Dividend Per Share (INR)	7.5	10.0	12.0	14.2	16.7	

Source: Company, JM Financial

Cash Flow Statement						(INR mn)
Y/E March	CY14A	CY15A	CY16A	CY17E	CY18E	
Profit before Tax	2,324	2,938	2,985	3,598	4,226	
Depn. & Amort.	260	706	600	648	691	
Net Interest Exp. / Inc. (-)	0	0	0	0	0	
Inc (-) / Dec in WCap.	-461	-312	265	-350	-608	
Others	0	0	0	0	0	
Taxes Paid	-815	-1,031	-1,109	-1,241	-1,458	
<b>Operating Cash Flow</b>	<b>1,308</b>	<b>2,301</b>	<b>2,741</b>	<b>2,655</b>	<b>2,851</b>	
Capex	-40	-778	-728	-800	-1,000	
Free Cash Flow	1,267	1,523	2,013	1,855	1,851	
Inc (-) / Dec in Investments	0	44	0	0	0	
Others	0	0	0	0	0	
<b>Investing Cash Flow</b>	<b>-40</b>	<b>-734</b>	<b>-728</b>	<b>-800</b>	<b>-1,000</b>	
Inc / Dec (-) in Capital	0	0	0	0	0	
Dividend + Tax thereon	-146	-206	-241	-285	-335	
Inc / Dec (-) in Loans	0	0	0	0	0	
Others	-204	49	-71	0	0	
<b>Financing Cash Flow</b>	<b>-349</b>	<b>-157</b>	<b>-312</b>	<b>-285</b>	<b>-335</b>	
<b>Inc / Dec (-) in Cash</b>	<b>918</b>	<b>1,410</b>	<b>1,701</b>	<b>1,570</b>	<b>1,516</b>	
Opening Cash Balance	2,377	3,295	4,704	6,406	7,975	
Closing Cash Balance	3,295	4,704	6,405	7,976	9,491	

Source: Company, JM Financial

Balance Sheet						(INR mn)
Y/E March	CY14A	CY15A	CY16A	CY17E	CY18E	
Shareholders' Fund	11,075	12,892	14,525	16,597	19,030	
Share Capital	166	166	166	166	166	
Reserves & Surplus	10,909	12,726	14,359	16,431	18,864	
Preference Share Capital	0	0	0	0	0	
Minority Interest	0	0	0	0	0	
Total Loans	0	0	0	0	0	
Def. Tax Liab. / Assets (-)	154	87	17	17	17	
<b>Total - Equity &amp; Liab.</b>	<b>11,229</b>	<b>12,979</b>	<b>14,542</b>	<b>16,614</b>	<b>19,047</b>	
Net Fixed Assets	3,904	3,976	4,103	4,255	4,564	
Gross Fixed Assets	7,394	7,854	8,859	9,659	10,659	
Intangible Assets	0	0	0	0	0	
Less: Depn. & Amort.	3,691	4,397	4,997	5,645	6,336	
Capital WIP	201	519	241	241	241	
Investments	44	0	0	0	0	
Current Assets	10,395	12,578	14,466	16,635	19,353	
Inventories	1,909	2,203	2,740	2,940	3,348	
Sundry Debtors	2,901	3,364	3,318	3,475	3,957	
Cash & Bank Balances	3,295	4,704	6,406	7,975	9,491	
Loans & Advances	2,201	2,136	1,808	2,138	2,435	
Other Current Assets	90	171	195	107	122	
Current Liab. & Prov.	3,113	3,575	4,027	4,277	4,870	
Current Liabilities	2,581	3,095	3,465	3,742	4,261	
Provisions & Others	532	479	562	535	609	
Net Current Assets	7,282	9,003	10,439	12,359	14,483	
<b>Total - Assets</b>	<b>11,229</b>	<b>12,979</b>	<b>14,543</b>	<b>16,614</b>	<b>19,047</b>	

Source: Company, JM Financial

Dupont Analysis					
Y/E March	CY14A	CY15A	CY16A	CY17E	CY18E
Net Margin	9.4%	11.5%	10.7%	12.1%	12.5%
Asset Turnover (x)	1.5	1.4	1.3	1.3	1.2
Leverage Factor (x)	1.0	1.0	1.0	1.0	1.0
RoE	14.6%	16.5%	14.2%	15.1%	15.5%

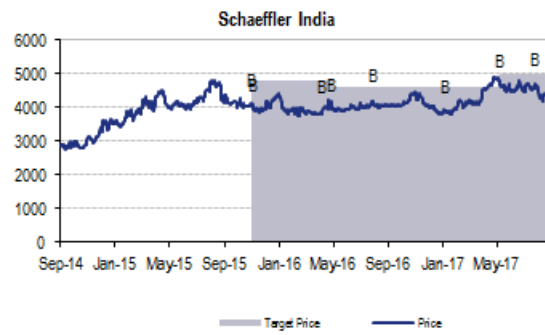
Key Ratios					
Y/E March	CY14A	CY15A	CY16A	CY17E	CY18E
BV/Share (INR)	666.5	775.8	874.1	998.8	1,145.2
ROIC	16.6%	20.2%	18.5%	22.6%	24.8%
ROE	14.6%	16.5%	14.2%	15.1%	15.5%
Net Debt/Equity (x)	-0.3	-0.4	-0.4	-0.5	-0.5
P/E (x)	46.1	35.7	36.3	29.9	25.5
P/B (x)	6.4	5.5	4.9	4.3	3.7
EV/EBITDA (x)	28.5	22.1	22.2	18.2	15.2
EV/Sales (x)	4.2	3.9	3.6	3.3	2.8
Debtor days	65	71	67	65	65
Inventory days	43	47	55	55	55
Creditor days	68	80	83	85	86

Source: Company, JM Financial

**History of Earnings Estimate and Target Price**

Date	FY18E EPS (INR)	% Chg.	FY19E EPS (INR)	% Chg.	Target Price	% Chg.
2-Nov-15	159.8				4,800	
5-Nov-15	161.1	0.8			4,800	0.0
7-Apr-16	159.7	-0.9			4,800	0.0
28-Apr-16	153.4	-3.9			4,600	-4.2
28-Jul-16	153.4	0.0			4,600	0.0
6-Jan-17					4,600	0.0
8-May-17	141.3		166.7		5,000	8.7
26-Jul-17	141.8	0.4	166.6	-0.1	5,000	0.0

**Recommendation History**



## APPENDIX I

## JM Financial Institutional Securities Limited

Corporate Identity Number: U65192MH1995PLC092522

Member of BSE Ltd. and National Stock Exchange of India Ltd. and Metropolitan Stock Exchange of India Ltd.

SEBI Registration Nos.: BSE - INZ010012532, NSE - INZ230012536 and MSEI - INZ260012539, Research Analyst – INH000000610

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Rating	Meaning
Buy	Total expected returns of more than 15%. Total expected return includes dividend yields.
Hold	Price expected to move in the range of 10% downside to 15% upside from the current market price.
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