Sharekhan by BNP PARIBAS

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Stock Update

Sundram Fasteners Limited

Riding the recovery wave

Automobiles	Sharekhan code: SUNDRMFAST	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. 569**	
Price Target: **Rs. 650**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

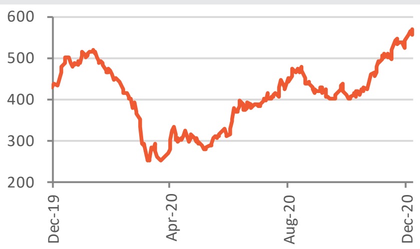
Company details

Market cap:	Rs. 11,975 cr
52-week high/low:	Rs. 585 / 289
NSE volume: (No of shares)	1.12 lakh
BSE code:	500403
NSE code:	SUNDRMFAST
Free float: (No of shares)	10.6 cr

Shareholding (%)

Promoters	49.5
FII	8.9
DII	18.6
Others	23.0

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-15.2	48.4	11.1	-24.5
Relative to Sensex	-15.2	1.5	-7.7	-13.0

Sharekhan Research, Bloomberg

Summary

- We maintain our Buy rating on Sundram Fasteners Limited (SFL) with a revised PT of Rs. 650, factoring in better multiples on a strong traction in business outlook and an upgrade in earnings estimates.
- Interaction with the management indicates that strong growth traction in automotive industry led by growth in sales of passenger cars, light commercial vehicles, tractors and two wheelers, with the exception of MHCVs. Export and non-automotive segments continue to be the focus area with a strategy to de-risk business from cyclicality.
- We expect SFL's earnings to grow by 69.4% in FY2022E and 40.6% in FY2023E, driven by a 25.2% CAGR during FY2021E-23E and a 310-bps improvement in EBITDA margin.
- Stock trades attractively at P/E multiple of 22.1x and EV/EBITDA multiple of 13x its FY2023E estimates.

We interacted with the management of Sundram Fasteners Limited (SFL) to understand the current business outlook. The management is witnessing strong traction in domestic, driven by growth in sales of passenger cars, light commercial vehicles, tractors and two wheelers, with the exception of medium & heavy commercial vehicles. Export and non-automotive segments continue to be the focus area with a strategy to de-risk business from the automobile industry's cyclicality. We believe SFL to be the beneficiary of improved automotive business outlook and its diversified portfolio. Export markets have also witnessing sequential recovery in US markets, where SFL has significant exposure. The company has a well-diversified customer and product portfolio, de-risking its business model from dependency on one-customer or one-product. We expect strong earnings growth going forward, driven by new client acquisitions and expansion of product portfolio. Exports will also be a key driver as the company is committed to expand its export portfolio to 50% of overall revenue from the current 36% contribution to total revenue. The company has a strong long-term revenue visibility, given its strong relationships with OEMs, both in India and globally. We have raised our earnings estimates to factor in the impact of a better business outlook. We expect SFL's earnings to grow by 69.4% in FY2022E and 40.6% in FY2023E, driven by 25.2% CAGR during FY2021E-23E and 310 bps improvement EBITDA margins. We retain our Buy rating on the stock with a price target of Rs. 650.

Our Call

Valuation - Maintain Buy with a revised PT of Rs. 650: SFL is witnessing a strong traction from domestic and global OEMs, driven by recovery in automotive and non-automotive demand. Outlook remains positive with strong recovery expected from FY2022, driven by normalisation of economic activities. Operating profit margins would expand on the back of operating leverage and cost-control measures. We have increased our earnings estimates to factor in an improved business outlook. We have valued the stock by assigning P/E multiple of 25.3x, a 10% premium to its average long-term P/E multiples, on SFL's FY2023E earnings to arrive at a revised PT of Rs. 650. We believe the premium is justified given the company strong promoters pedigree and improved business prospects. The stock is attractively valued at a P/E multiple of 22.1x and EV/EBITDA multiple of 13x its FY2023 estimates. We retain our Buy rating on the stock with a revised PT of Rs. 650.

Key Risks

A second wave of COVID-19 can hamper economic activities and affect revenue growth. Also, pricing pressures from OEMs may hit profitability.

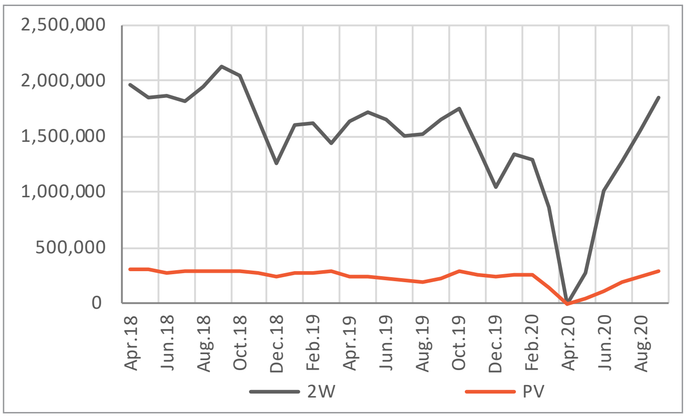
Valuations (Standalone) Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Net sales (Rs cr)	4,558	3,723	3,351	4,289	5,254
Growth (%)	18.2	(18.3)	(10.0)	28.0	22.5
EBIDTA (Rs cr)	800	593	499	725	946
OPM (%)	17.6	15.9	14.9	16.9	18.0
PAT (Rs cr)	457	325	227	384	540
Growth (%)	18.3	(29.0)	(30.2)	69.4	40.6
FD EPS (Rs)	21.8	15.5	10.8	18.3	25.7
P/E (x)	26.1	36.8	52.7	31.1	22.1
P/BV (x)	6.4	6.0	5.5	4.9	4.3
EV/EBITDA (x)	16.1	21.5	25.0	17.1	13.0
RoE (%)	24.5	16.3	10.5	15.8	19.3
RoCE (%)	21.9	14.4	11.0	16.5	20.4

Source: Company; Sharekhan estimates

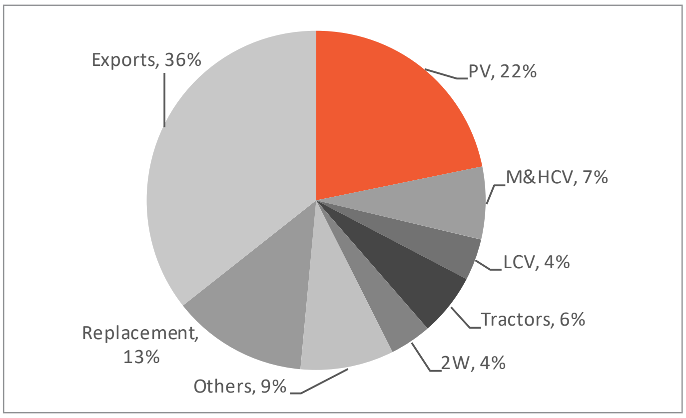
Beneficiary of improved automotive business outlook and diversified portfolio: Sundram Fasteners (SFL) is expected to be a beneficiary of improving business outlook for both the automotive and non-automotive segments. Export markets have also witnessing a sequential recovery in the US, where SFL has significant exposure. The company has a well-diversified customer and product portfolio, de-risking its business model from dependency on one-customer or one-product. SFL has a strong presence in passenger car segment, which contributes ~22% of total revenues.

SFL to benefit from witnessed in automotive sector, especially in passenger vehicle segment



Source: SIAM; Sharekhan Research

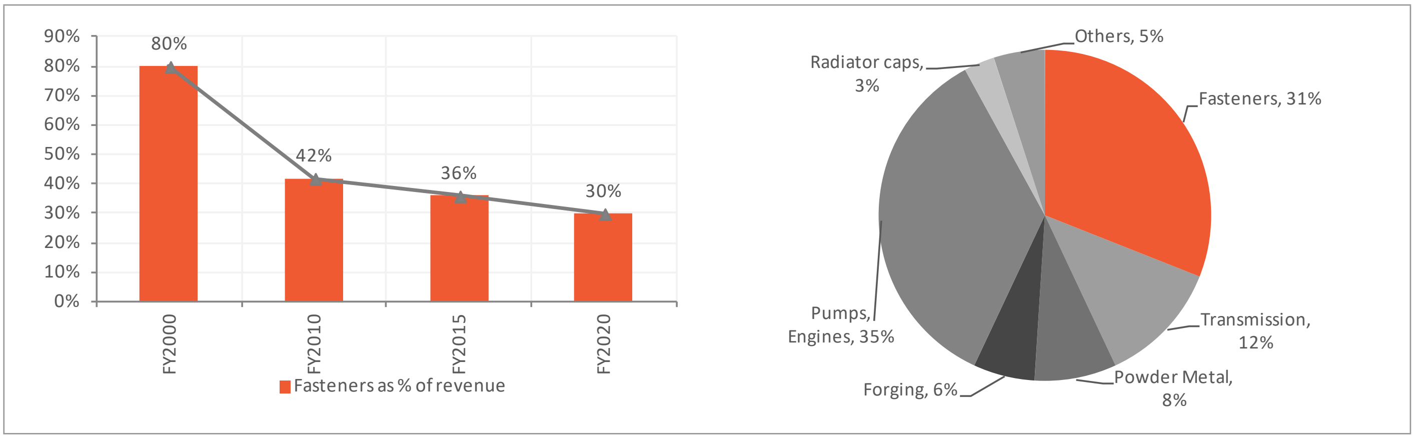
Diversified portfolio



Source: Company Data; Sharekhan Research

Strong and long-lasting client base: SFL has strong relationships with large OEMs, which offers robust revenue visibility. It's key clients in the domestic market include Maruti Suzuki, M&M, Tata Motors and Ashok Leyland. SFL is the top suppliers for most OEMs and commands a dominant 70-100% market share per product per OEM. On the back of strong relationships with OEMs, the company also enjoys preference, when it expands its product portfolio. In FY2000, SFL had revenue concentration of ~80% through sales of fasteners, which it has brought down to 30% in FY2020.

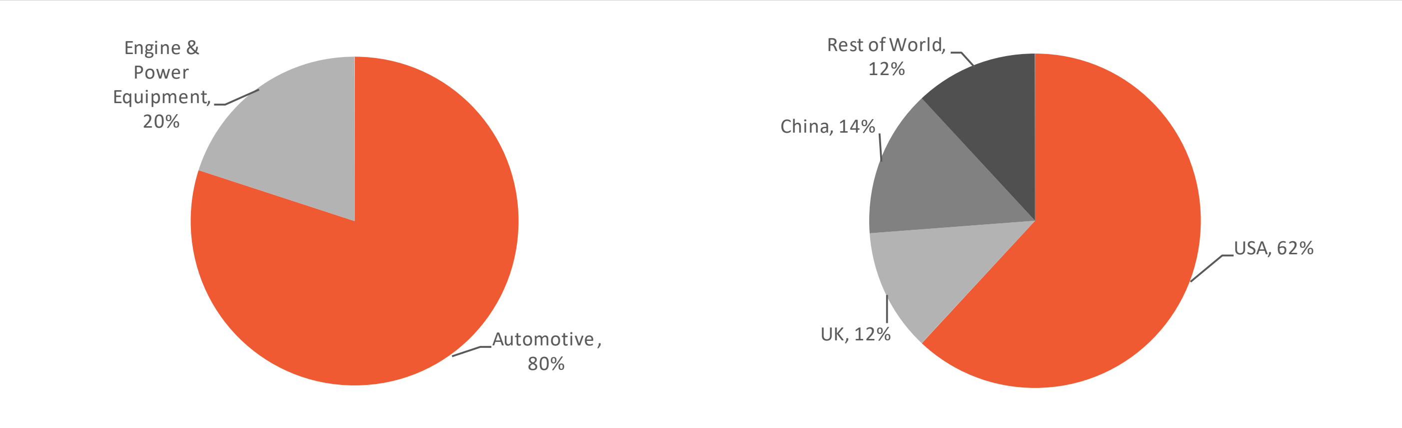
Product mix diversified over the year on strong OEM relationships



Source: Company Data; Sharekhan Research

Focus on export markets: Exports is one of the most key focus areas for SFL, as it continues to be a significant contributor to overall revenue. The company's long-term goal is to make exports contribution to be more than 50% of revenue from 36% currently. The company's key export clientele include General Motors (GM), Cummins, American Axles, Navistar. The export revenue is largely concentrated to GM and Cummins. Automotive business continues to dominant in the export portfolio. SFL is working towards diversifying export revenue through new client acquisition and focusing on the non-automotive segments.

Focus on non-automotive business to diversify product portfolio globally



Source: Company Data; Sharekhan Research

New businesses: SFL is planning to foray into new businesses such as electric vehicles, aerospace and defence and enter these markets. The company sees huge potential in these emerging sectors and believe it will take time to have strong foothold in new market segments. The strategy would be to first establish markets in India and then expand globally.

Capex plans: SFL has completed a major three-year capex plan in FY2020. The company had invested to the tune Rs 1,000 crore and had expanded capacity across the segments. Currently, SFL is operating at 60% capacity utilisation, similar to pre-COVID levels. The recent capex programme has enabled the company to increase revenue by 25-30% without any major capex. It expects the capex to be around Rs 150 crore every year. The next phase of expansion would be planned when the company will be operating at around a 80% capacity utilisation.

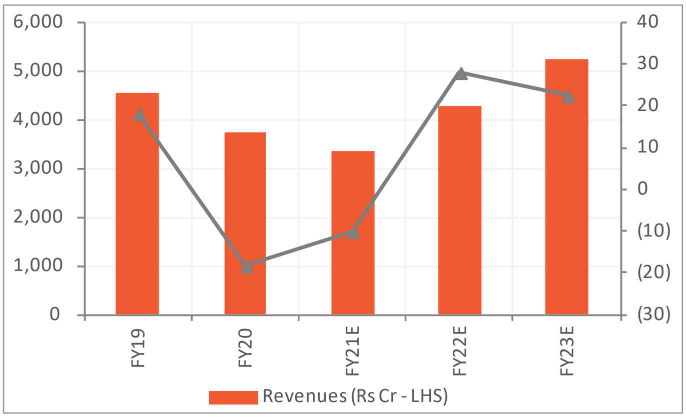
Management guidance: The company is witnessing recovery in sales is optimistic for growth in FY2022. The company expects volumes to remain robust in the coming quarters, given the normalisation of economic activities. Key areas of growth would arise from OEMs in the defence, aerospace, four-wheelers and tractors segments. The company focuses on business projects that has capability to give 25% return on the capital employed.

Latest quarterly results surprised; margins improved and likely to sustain: SFL's Q2FY21 results beat estimates driven by better-than-expected operating performance. Revenues recovered to pre-COVID levels in Q2FY21 and were flat y-o-y. Domestic revenues saw healthy recovery with sales growing 7% y-o-y to Rs 484 crore. An uptrend in domestic OEM production post opening up of economy led to recovery. Export revenues witnessed slower pick up with revenues declining by 11% y-o-y to Rs 260 cr. Operating margins improved 300 bps y-o-y to 21% driven by soft commodity prices and cost-control measures. Reduction in debt levels coupled with forex gain led net profit at Rs 96.8 crore, a strong 36% y-o-y growth.

Strong broad-based growth; expect double-digit growth in FY22: The company has a strong long-term revenue visibility, given its strong relationships with OEMs, both in India and globally. We have raised our earnings estimates to factor in the impact of better business outlook. We expect SFL's earnings to grow by 69.4% in FY2022E and 40.6% in FY2023E, driven by 25.2% CAGR during FY2021E-23E and 310 bps improvement in EBITDA margin.

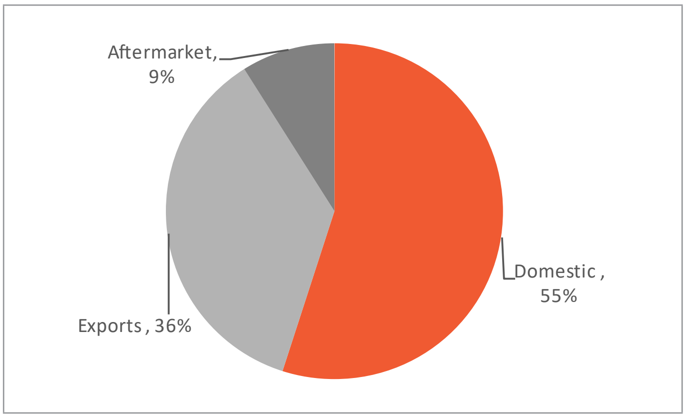
Financials in charts

Revenue and Growth Trend



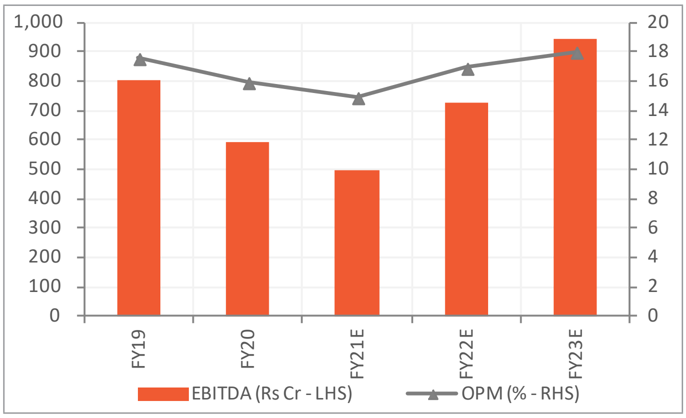
Source: Company, Sharekhan Research

Revenue Mix (%)



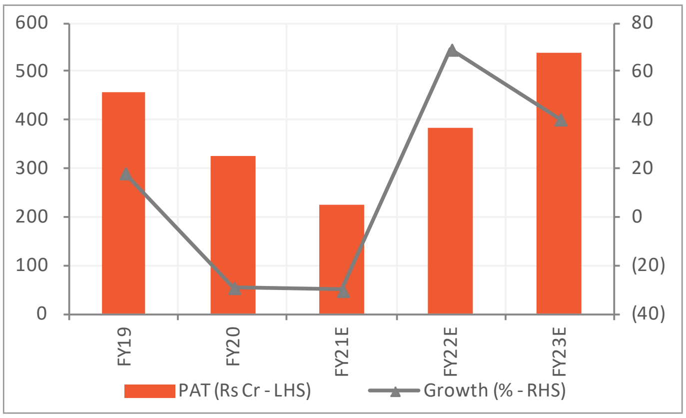
Source: Company, Sharekhan Research

EBITDA and OPM Trend



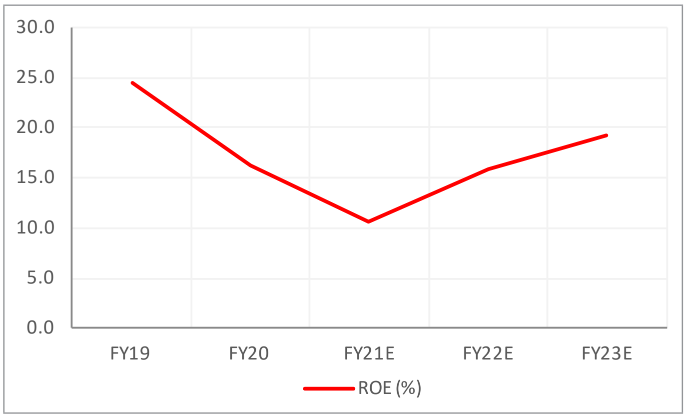
Source: Company, Sharekhan Research

Net profit and Growth Trend



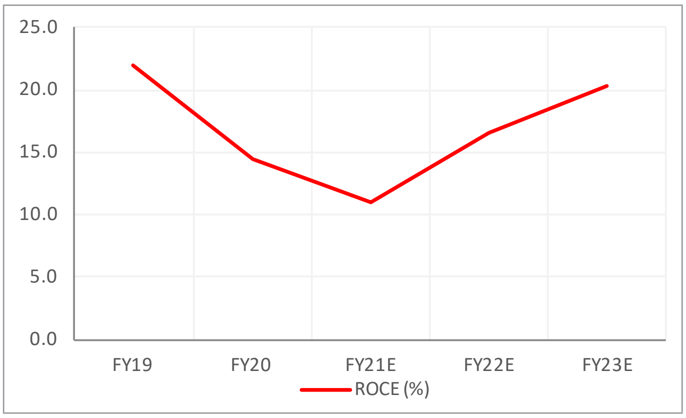
Source: Company, Sharekhan Research

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.

■ Company outlook - Strong earnings growth

We expect SFL to be beneficiary of improved automotive business outlook and diversified portfolio. Export markets have also witnessing sequential recovery in US markets, where SFL has significant exposure. The company has a well-diversified customer and product portfolio, de-risking its business model from dependency on one-customer or one-product. We expect strong earnings growth going forward, driven by new client acquisitions and product expansion. Exports will also be a key driver as the company is committed to expand export portfolio to 50% of overall revenue from the current 36% contribution to total revenue. We remain positive on SFL's business prospects going forwards.

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

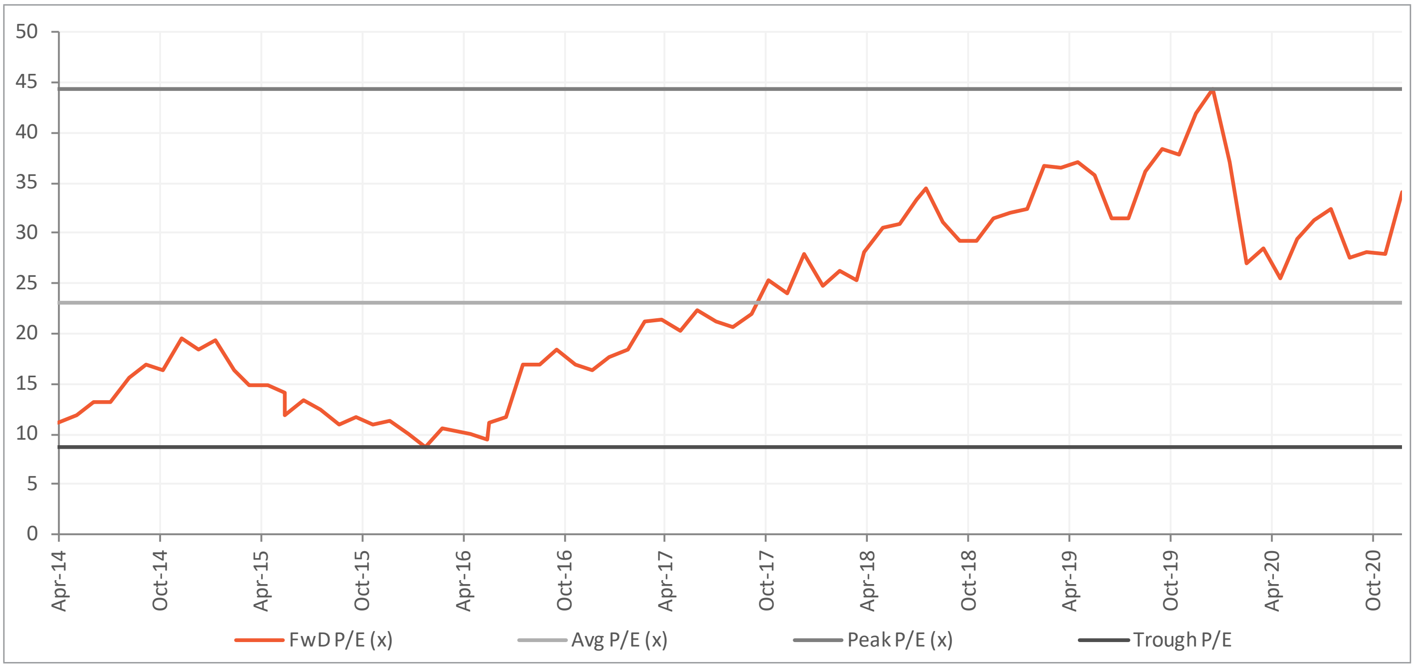
SFL is witnessing a strong traction from domestic and global OEMs, driven by recovery in automotive and non-automotive demand. Outlook remains positive with strong recovery expected from FY2022, driven by normalisation of economic activities. Operating profit margins would expand on the back of operating leverage and cost-control measures. We have increased our earnings estimates to factor in an improved business outlook. We have valued the stock by assigning P/E multiple of 25.3x, a 10% premium to its average long-term P/E multiples, on SFL's FY2023E earnings to arrive at a revised PT of Rs. 650. We believe the premium is justified given the company strong promoters pedigree and improved business prospects. The stock is attractively valued at a P/E multiple of 22.1x and EV/EBITDA multiple of 13x its FY2023 estimates. We retain our Buy rating on the stock with a revised PT of Rs. 650.

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

FY2023E EPS (Rs. per share)	25.7	
Target P/E Multiple (x)	25.3	10% premium to avergae long-term P/E multiple
Target Price (Rs.)	650	
Upside (%)	14%	

Source: Company; Sharekhan estimates

One-year forward P/E (x) band



Source: Sharekhan Research

About company

Sundram Fasteners Limited (SFL), incorporated in 1966, is a part of TVS Group, headquartered in Chennai. It manufactures critical and high precision component for automotive, infrastructure, windmill and aviation sectors. The company produces fasteners, powertrain components, sintered metal products, iron powders, cold extruded parts, radiator caps, water pumps, oil pumps and wind energy components. SFL has customer portfolio including and domestic and international client. The revenue mix comprises of 52% domestic OEMs, 13% aftermarket and 35% from exports.

Investment theme

SFL revenues recovered to pre-COVID levels with flat growth on a y-o-y basis in Q2FY21 driven by improvement in economic activities post Government unlock measures. SFL is expecting further pick up in the demand and is increasing production to three shifts in its factories. SFL expects the festive season coupled with increase in the industrial activity to lead to continued better performance going ahead. With expected normalization of economic activities, we expect strong recovery in FY22. SFL would continue to focus on launching value-added products. SFL has recently introduced transmission products and is also working on hybrid electric vehicle products which would boost revenues and further reduce dependence on traditional fastener business. SFL is likely to witness increased share of business with clients driven by new product introductions, relatively low-cost advantage and stringent quality norms. Aerospace and defence would be emerging growth areas and company has earmarked Rs 100 for creating capacities in these areas.

Key Risks

- The second wave of COVID-19 can lead to slow down in the economic activities again and can impact revenue growth of the company.
- Pricing pressures from automotive OEM customers can impact profitability.

Additional Data

Key management personnel

Mr. Suresh Krishna	Chairman
Ms. Arathi Krishna	Managing Director
Ms. Arundathi Krishna	Joint Managing Director
Mr. Meenakshisundaram	Chief Financial Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Iyengar T V Sundram	25.4%
2	Southern Roadways Ltd	24.2%
3	HDFC Asset Management Co Ltd	7.0%
4	Amansa Holdings Pvt Ltd	5.4%
5	Parikh Govindlal	2.1%
6	General Insurance Corp of India	1.8%
7	Life Insurance Corp of India	1.6%
8	New India Assurance	1.4%
9	L&T Mutual Fund Tustee Ltd/India	1.1%
10	Tata Asset Management Company	1.1%

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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