Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Sundram Fasteners Limited

On an upwards trajectory

Automobiles	Sharekhan code: SUNDRMFAST	Company Update

Stock 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. 728**	
Price Target: **Rs. 850**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

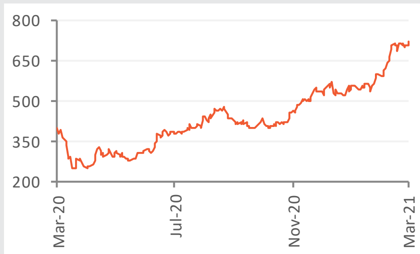
Company details

Market cap:	Rs. 15,318 cr
52-week high/low:	Rs. 755 / 249
NSE volume: (No of shares)	1.42 lakh
BSE code:	500403
NSE code:	SUNDRMFAST
Free float: (No of shares)	10.6 cr

Shareholding (%)

Promoters	49.5
FII	9.8
DII	18.3
Others	22.4

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	19.4	33.9	65.2	78.5
Relative to Sensex	18.8	21.6	34.7	45.9

Sharekhan Research, Bloomberg

Summary

- We maintain our Buy rating on Sundram Fasteners Limited (SFL) with a revised PT of Rs. 850, 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 commercial vehicles, tractors, passenger cars and two wheelers. 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 improve by 60.1% during FY21E-23E, driven by a 25% CAGR during FY2021E-23E and a 360-bps improvement in EBITDA margin.
- Stock trades at P/E multiple of 25.2x and EV/EBITDA multiple of 15.1x its FY2023E estimates.

We interacted with the management of Sundram Fasteners Limited (SFL) to understand the current business outlook. The management is witnessing stronger traction in its domestic business, driven by faster than expected recovery in commercial vehicles, especially in medium and heavy commercial vehicles. The growth from the tractor segment continues to remain robust, along with positive traction in passenger cars and two-wheeler segments. Export and non-automotive segments continue to be the focus area with a strategy to de-risk business from the automobile industry's cyclicality. Its key global clients General Motors and Cummins are witnessing a strong recovery in Q4FY21. The company is also seeing traction from the electric vehicle space where it supplies radiator caps. 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 33% 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 improve by 60.1% during FY21E-23E, driven by a 25% CAGR during FY2021E-23E and a 360-bps improvement in EBITDA margin. We retain our Buy rating on the stock with a revised price target of Rs. 850.

Our Call

Valuation - Maintain Buy with a revised PT of Rs. 850: SFL is witnessing a strong traction from its domestic and global OEMs, driven by recovery in automotive and non-automotive demand. The outlook remains positive with a strong recovery expected from FY2022, driven by the 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 a 10% premium to its historical P/E multiples. We believe the premium is justified given the company strong promoters pedigree and improved business prospects. The stock is trading at a P/E multiple of 25.2x and EV/EBITDA multiple of 15.1x its FY2023 estimates. We retain our Buy rating on the stock with a revised PT of Rs. 850.

Key risk

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

Valuations (Standalone) Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Net sales	4,558	3,723	3,574	4,561	5,587
Growth (%)	18.2	(18.3)	(4.0)	27.6	22.5
EBIDTA	800	593	533	807	1,032
OPM (%)	17.6	15.9	14.9	17.7	18.5
PAT	457	325	236	446	605
Growth (%)	18.3	(29.0)	(27.3)	88.8	35.7
FD EPS	21.8	15.5	11.2	21.2	28.8
P/E (x)	33.4	47.0	64.7	34.3	25.2
P/BV (x)	8.2	7.7	7.1	6.2	5.3
EV/EBITDA (x)	20.3	27.1	29.7	19.5	15.1
RoE (%)	24.5	16.3	10.9	18.0	20.9
RoCE (%)	21.9	14.4	12.1	18.7	22.1

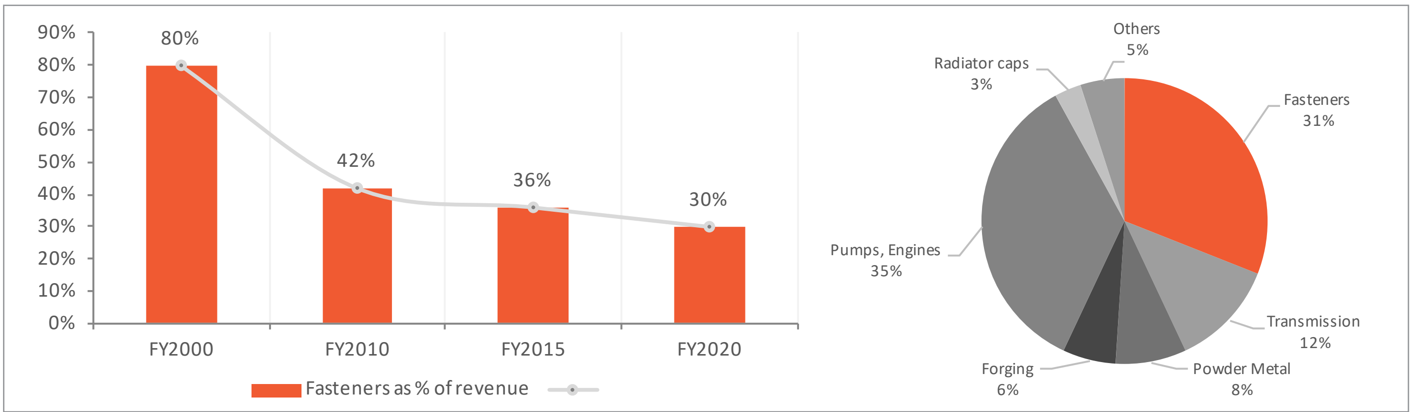
Source: Company; Sharekhan estimates

We interacted with the management of Sundram Fasteners Limited (SFL) to understand the current business outlook. The key highlights of the discussions are as below

SFL continues to benefit from strong demand: The management is witnessing stronger traction in its domestic business, driven by faster than expected recovery in commercial vehicles, especially in medium and heavy commercial vehicles. The growth from tractor segment continues to remain robust, along with positive traction in passenger cars and two wheeler segments. Export and non-automotive segments continue to be the focus area with a strategy to de-risk business from the automobile industry's cyclicality. Its key global clients General Motors and Cummins are witnessing a strong recovery in Q4FY21. The company is also seeing traction from electric vehicle space where it supplies radiator caps. SFL has a strong presence in the passenger car segment, which contributes to ~22% of its total revenues. The company is witnessing increasing offtake from its key clients. The revenues in Q4FY21 is expected to remain robust.

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. Besides the strong relationships with clients, the company has been diversifying and widening its product portfolio. In FY2000, SFL had revenue concentration of ~80% through sales of fasteners, which it has brought down to 30% in FY2020.

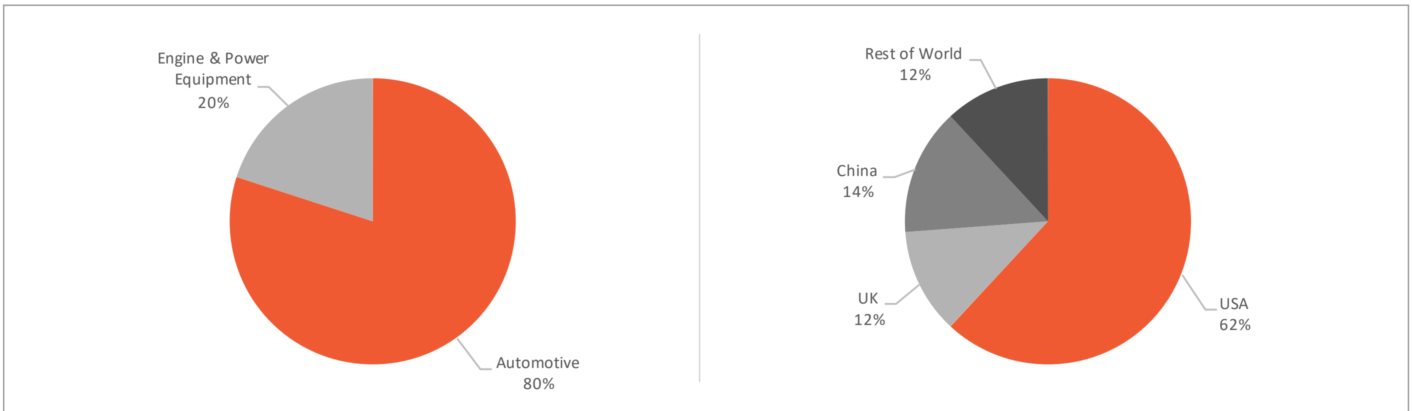
Product mix diversified over the year on strong OEM relationships



Source: Company, 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 the overall revenue. The company's long-term goal is to make exports contribution to be more than 50% of revenue from 33% currently. The company's key export clientele includes 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.

Product mix diversified over the year on strong OEM relationships



Source: Company, 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 a huge potential in these emerging sectors and believes 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.

Looking opportunities in e-mobility business: The company is also seeing traction from the electric vehicle space where it supplies radiator caps. The company expects to double its revenues in e-mobility division. The current base is low around Rs 25 crore in FY20, which it expects to reach around Rs 50-55 crore in FY21E. SFL is in discussion with its key clients to increase its business in e-mobility business.

Capex plans: SFL has completed a major three-year capex plan in FY2020. The company had invested to the tune Rs 1,000 crore during FY2017-20 and had expanded capacity across the segments. Currently, SFL is operating at 65-70% capacity utilisation, crossing the 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 100-150 crore every year. The next phase of expansion would be planned when the company will be operating at around an 80% capacity utilisation.

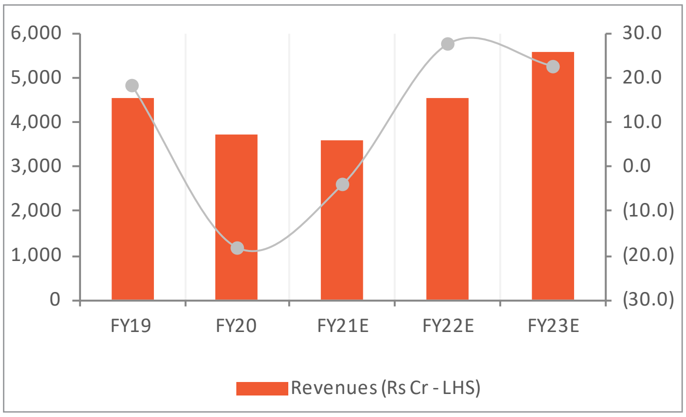
Management guidance: The company is witnessing recovery in sales and is optimistic for growth in FY2022, near its FY2019 levels. The company expects volumes to remain robust in the coming quarters, given the normalisation of economic activities. Key areas of growth would arise from OEMs in the defence, aerospace, M&HCVs, four-wheelers and the tractor segments. The company focuses on business projects that has capability to give 25% return on the capital employed.

Latest quarterly results surprised positively: SFL's Q3FY21 results were ahead of expectations driven by higher-than-expected demand and slightly higher margin expansion. Standalone net revenue grew by 36% y-o-y at Rs 942 crores, led by strong demand recovery, both in India and globally. SFL also benefited from the improved automotive business scenario in USA, UK and China, which together contributes ~88% of its exports. The operating profit margin for the Q3FY21 stood at 21.5% showing a strong improvement of 475 bps y-o-y and 52 bps q-o-q, aided by price hikes, cost reductions and operating leverage benefits. The Company's consolidated revenue grew by 34.8% y-o-y at Rs. 1,109 crores as against Rs. 822 crores in Q3FY20. The consolidated net profit for Q3FY21 grew strongly by 37.1% y-o-y at Rs. 144 crore.

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. The EBITDA margins are expected to remain firm on a sequential basis in Q4FY21, though the margins would be marginally impacted due to rise in raw materials and an increase in employee expenses due to rise in salary levels. However, the company can pass on rise in raw material prices with some lag period of 3-6 months. Considering the positive outlook, we have raised our earnings estimates to factor in the impact of a better business outlook. We expect SFL's earnings to improve by 60.1% during FY21E-23E, driven by a 25% CAGR during FY2021E-23E and a 360-bps improvement in EBITDA margin.

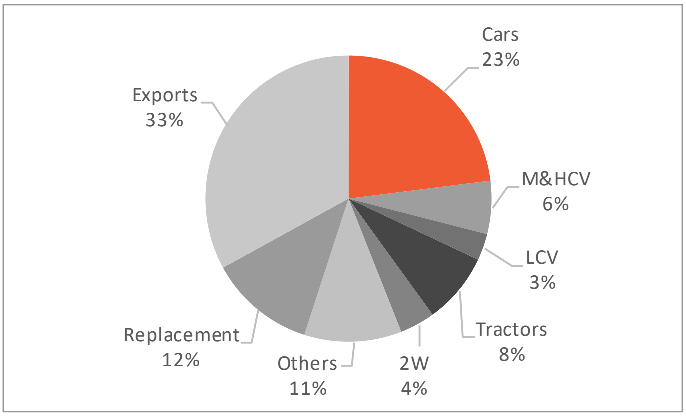
Financials in charts

Revenue and Growth Trend



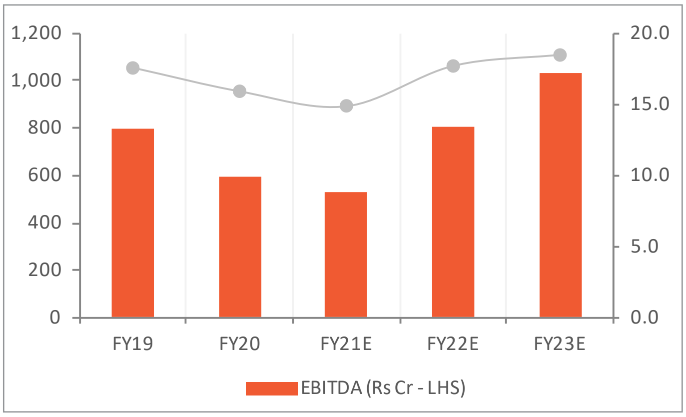
Source: Company, Sharekhan Research

Revenue Mix (%)



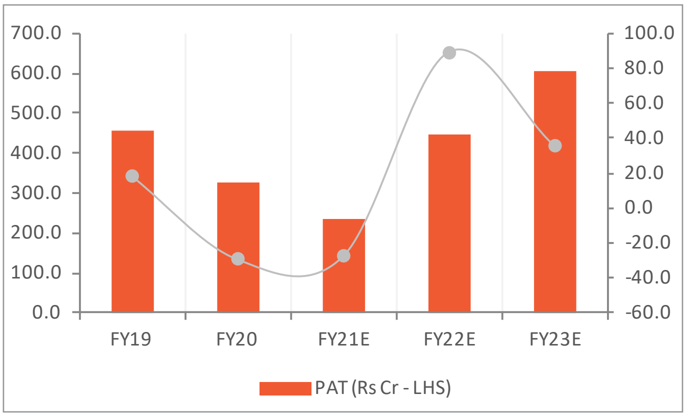
Source: Company, Sharekhan Research

EBITDA and OPM Trend



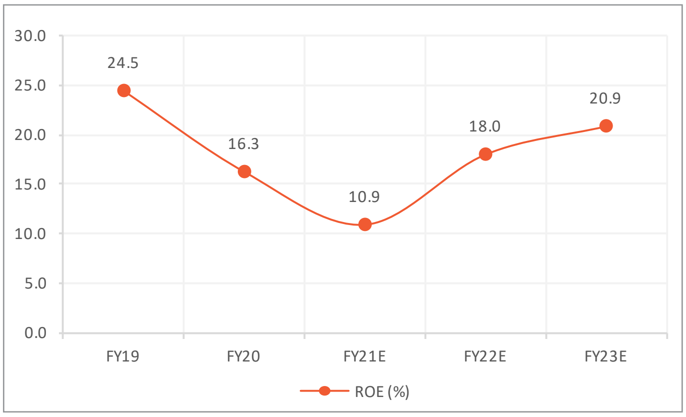
Source: Company, Sharekhan Research

Net profit and Growth Trend



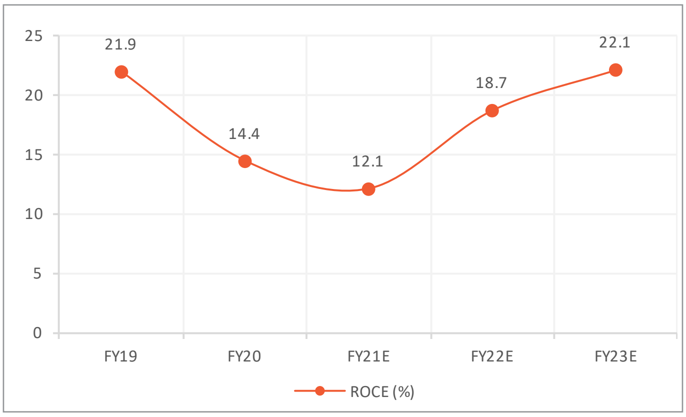
Source: Company, Sharekhan Research

RoE trend



Source: Company, Sharekhan Research

RoCE trend



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector View – 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, an increase in personal mobility transport. The tractor segment remains buoyant on robust farm income this year. The recovery in export destinations augurs well for the sector.

■ Company Outlook – Strong earnings growth

SFL's latest results in Q3FY21 were ahead of expectations driven by higher-than-expected demand and slightly higher margin expansion. We expect SFL to be a 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 SFL to benefit from strong growth traction in automotive industry with its clients well diversified across segments. 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 improve by 60.1% during FY21E-23E, driven by a 25% CAGR during FY2021E-23E and a 360-bps improvement in EBITDA margin. We remain positive on SFL's business prospects going forward.

■ Valuation – Maintain Buy with a revised PT of Rs. 850

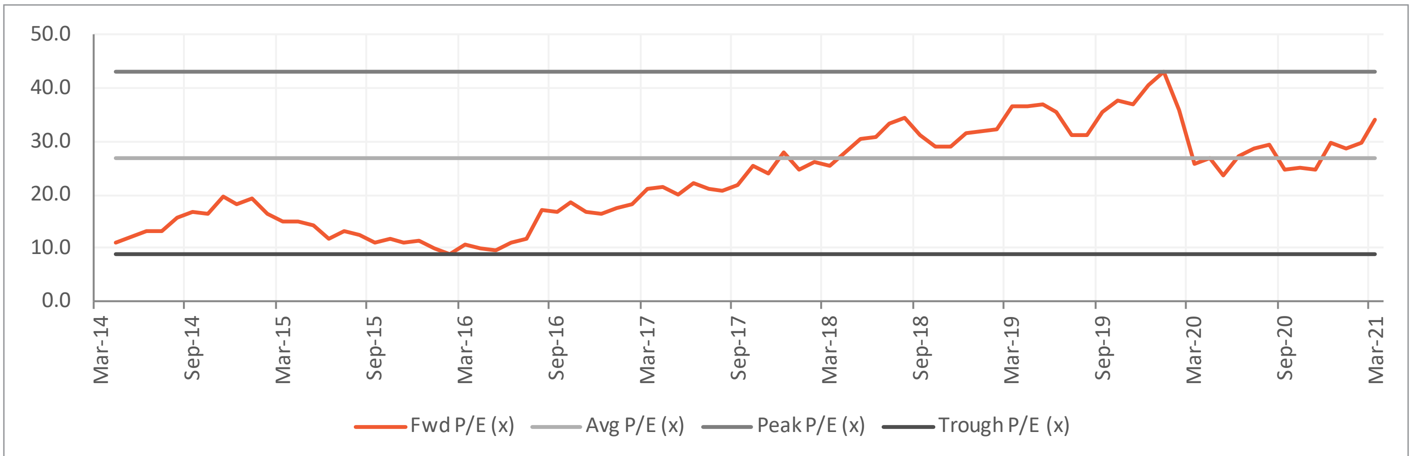
SFL is witnessing a strong traction from the domestic and global OEMs, driven by a recovery in automotive and non-automotive demand. The outlook remains positive with strong recovery expected from FY2022, driven by normalisation of economic activities. Operating profit margins would expand on the back 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 a 10% premium to its historical P/E multiples. We believe the premium is justified given the company strong promoters pedigree and improved business prospects. The stock is trading at a P/E multiple of 25.2x and EV/EBITDA multiple of 15.1x its FY2023 estimates. We retain our Buy rating on the stock with a revised PT of Rs. 850.

Price target arrived at Rs 850

Price Target Calculation	Rs/Share
FY2023E EPS (Rs. per share)	28.8
Target P/E Multiple (x)	29.5
Target Price (Rs.)	850
Upside (%)	17%

Source: Company; Sharekhan estimates

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	P/E (x)			EV/EBITDA (x)			RoE (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Sundram Fasteners	64.7	34.3	25.2	29.7	19.5	15.1	12.1	18.7	22.1
Suprajit Engineering	31.7	22.5	18.2	19.0	14.3	11.7	15.0	18.4	20.0
Schaeffler India	56.8	38.8	29.6	30.1	22.1	17.0	12.6	16.9	19.0

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 is expected to be a 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. 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. Also, the renewed focus on non-automotive segment is expected to grow faster than other segments. We remain positive on SFL's business prospects going forward. Aerospace and defence would be emerging growth areas and company has earmarked Rs 100 crore 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
Mr. R Dilip Kumar	VP - Finance & Company Secretary

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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