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Stock Update

Sundram Fasteners Ltd

Strong performance

Automobiles	Sharekhan code: SUNDRMFAST	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. 753**	
Price Target: **Rs. 994**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

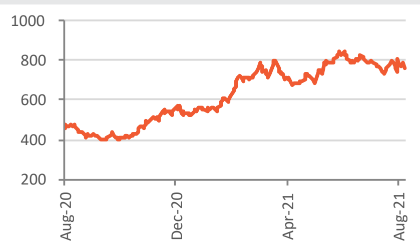
Company details

Market cap:	Rs. 15,823 cr
52-week high/low:	Rs. 867 / 392
NSE volume: (No of shares)	1.4 lakh
BSE code:	500403
NSE code:	SUNDRMFAST
Free float: (No of shares)	10.6 cr

Shareholding (%)

Promoters	49.5
FII	11.1
DII	17.4
Others	22.0

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-2.9	2.4	27.6	66.1
Relative to Sensex	-8.2	-9.2	19.8	20.7

Sharekhan Research, Bloomberg

Summary

- We continue to retain our Buy rating on Sundram Fasteners Limited (SFL) with an unchanged PT of Rs. 994, led by the company's strong performance outpacing the automobile industry's growth through diversifying client and product portfolios, benefitting from its established client relationships, and prudent capital allocation.
- SFL displayed strong performance in Q1FY2022, beating street expectations, led by robust operational performance, despite tough environment. Export and non-automotive segments remain the top focus areas for the management to de-risk business from cyclicality.
- We expect SFL's earnings CAGR to improve by 32.3% during FY2021E-FY2023E, driven by a 26% revenue CAGR during FY2021E-FY2023E and a 20 bps improvement in EBITDA margin to 18.4% in FY2023E from 18.2% in FY2021, with ROCE progressing to 22.6% in FY2023E.
- The stock trades at P/E multiple of 25x and EV/EBITDA multiple of 15.1x its FY2023E estimates.

Sundram Fasteners Limited (SFL) reported strong performance in Q1FY2022, beating street expectations, led by robust operational performance, despite tough environment. Standalone revenue declined by 13% q-o-q to Rs. 938.8 crore, while consolidated revenue declined by 12.6% q-o-q to Rs. 1,112 crore in Q1FY2022. Standalone revenue was driven by a 21% q-o-q decline in domestic sales, partially mitigated by 5.6% growth in exports. The company benefitted from higher exports, led by opening up of western geographies. EBITDA margin of the standalone business remained flat at 19.5% q-o-q. Gross margin for the company stood at 59.8% in Q1FY2022, showing an improvement of 150 bps q-o-q. As a result, standalone net profit declined 13.4% q-o-q to Rs. 112.6 crore in Q1FY2022. Consolidated PAT declined by 14.4% q-o-q to Rs. 120.5 crore in Q1FY2022, led by a 12.6% q-o-q decline in revenue and 60 bps q-o-q decline to 18%. Revenue from subsidiaries declined 10% q-o-q during Q1. Standalone exports contributed 38% to the revenue in Q1FY22 as compared to 31% in Q4FY2022. The company is also seeing traction from the electric vehicle space, where it supplies radiator caps. The company has a well-diversified customer and product portfolio. SFL continues its efforts to de-risk 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 over the next 3-5 years. The company has a strong long-term revenue visibility, given its strong relationships with original equipment manufacturers (OEMs), both in India and globally. We retain our Buy rating on the stock.

Key positives

- Increasing business traction from its global clients helped the company to perform better than expectations during Q1FY2022.
- Consolidated gross margin improved 140 bps q-o-q to 61% in Q1FY2022.

Key negatives

- Consolidated EBITDA margin declined 60 bps q-o-q to 18% in Q1FY2022, led by impact of negative operating leverage.

Our Call

Valuation - Maintain Buy with an unchanged PT of Rs. 994: SFL is witnessing strong traction from its domestic and global OEMs, driven by recovery in automotive and non-automotive demand. The outlook remains positive with recovery expected in FY2022, driven by pent-up demand, post normalisation of COVID wave-2. Operating profit margin (OPM) would expand on account of operating leverage benefits, cost-control measures, and its ability to pass on cost increase to customers. We are positive on SIL's growth prospects, led by its strong performance outpacing the automobile industry's growth through diversifying its client portfolio, expanding product portfolios, benefitting from its established client relationships, and prudent capital allocation. We expect SFL's earnings CAGR to improve by 32.3% during FY2021E-FY2023E, driven by a 26% revenue CAGR during FY2021E-FY2023E and a 20 bps improvement in EBITDA margin to 18.4% in FY2023E from 18.2% in FY2021, with ROCE progressing to 22.6% in FY2023E. The stock is trading at a P/E multiple of 25x and EV/EBITDA multiple of 15.1x its FY2023 estimates. We retain our Buy rating on the stock with an unchanged PT of Rs. 994.

Key Risks

The spread of COVID-19 can lead to slowdown in economic activities again and can impact revenue growth of the company. Moreover, pricing pressures from automotive OEM customers can impact profitability.

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22E	FY23E	FY24E
Net sales	3,644	4,519	5,784	6,652
Growth (%)	(2.1)	24.0	32.0	15.0
EBIDTA	664	800	1,064	1,237
OPM (%)	18.2	17.7	18.4	18.6
PAT	361	442	633	752
Growth (%)	11.2	22.3	43.1	18.9
FD EPS	17.2	21.0	30.1	35.8
P/E (x)	43.8	35.8	25.0	21.0
P/BV (x)	7.0	6.2	5.3	4.5
EV/EBITDA (x)	24.5	20.3	15.1	12.7
RoE (%)	16.1	17.3	21.1	21.3
RoCE (%)	16.0	18.1	22.6	23.7

Source: Company; Sharekhan estimates

Strong performance continues in Q1FY2022: SFL reported strong performance in Q1FY2022, beating street expectations, led by robust operational performance, despite tough environment. Standalone revenue declined by 13% q-o-q to Rs. 938.8 crore, while consolidated revenue declined 12.6% q-o-q to Rs. 1,112 crore in Q1FY2022. Standalone revenue was driven by a 21% q-o-q decline in domestic sales, partially mitigated by 5.6% growth in exports. The company benefitted from higher exports, led by the opening up of western geographies. EBITDA margin of standalone business remained flat at 19.5% q-o-q. Gross margin for the company stood at 59.8% in Q1FY2022, showing an improvement of 150 bps q-o-q. As a result, standalone net profit declined by 13.4% q-o-q to Rs. 112.6 crore in Q1FY2022. Consolidated PAT declined by 14.4% q-o-q to Rs. 120.5 crore in Q1FY2022, led by a 12.6% q-o-q decline in revenue and 60 bps q-o-q decline to 18%. Revenue from subsidiaries declined by 10% q-o-q during Q1.

Export remains the top focus area: Standalone exports contributed 38% to revenue in Q1FY2022 as compared to 31% in Q4FY2022. Export continues to be the focus area with a strategy to de-risk business from the automobile industry's cyclicality. Export 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 33% currently. The company's key export clientele includes General Motors, Cummins, American Axles, Navistar, among others, but General Motors and Cummins fetch a huge chunk of overseas revenue. The automotive business continues to be dominant in the export portfolio. SFL is working towards diversifying export revenue through new client acquisition and focusing on non-automotive segments. The company has substantial exposure to US, UK, and China markets, where demand has witnessed strong response, aided by big stimulus packages by respective governments and faster rollout of COVID-19 vaccination programmes. Overseas demand is expected to continue its growth momentum going forward, as the company's new plant is commissioned, which will enable it to increase its focus on western markets.

New businesses: SFL is planning to foray into new businesses. The company has plans to enter businesses such as electric vehicles, aerospace, and defence. The company sees huge potential in these emerging sectors and believes it will take time to have a strong foothold in new market segments. The strategy would be to first establish markets in India and then expand globally. The company is also seeing traction from the electric vehicle space, where it supplies radiator caps. The company expects to double its revenue in the e-mobility division.

Capex plans: SFL has completed a major three-year capex plan in FY2020. The company had invested Rs. 1,000 crore during FY2017-FY2020 and had expanded capacity across segments. Currently, SFL is operating at 70-75% capacity utilisation. The recent capex programme has enabled the company to increase revenue by 25-30% without any major investments. The company expects capex to be around Rs. 100-150 crore every year. The company plans the next phase of extension when it operates at 80-85% capacity utilisation.

Strong broad-based growth; Expect double-digit growth in FY2022: SFL has a strong long-term revenue visibility, given its strong relationships with OEMs, both in India and globally. EBITDA margin is expected to remain firm, driven by improved product mix and operating leverage benefits. We expect SFL's earnings CAGR to improve by 32.3% during FY2021E-FY2023E, driven by a 26% revenue CAGR during FY2021E-FY2023E and a 20 bps improvement in EBITDA margin to 18.4% in FY2023E from 18.2% in FY2021, with ROCE progressing to 22.6% in FY2023E.

Results (Standalone) Rs cr

Particulars	Q1FY22	Q1FY21	Y-o-Y %	Q4FY21	Q-o-Q %
Revenues	938.8	276.7	239.3	1,079.3	(13.0)
Total operating expenses	755.5	271.4	178.4	869.1	(13.1)
EBITDA	183.3	5.4	3,326.9	210.1	(12.7)
Depreciation	37.6	36.5	3.0	36.2	3.8
Interest	4.2	7.9	(47.3)	3.4	22.3
Other income	9.5	7.6	24.9	2.4	304.2
PBT	151.1	(31.4)	NA	172.9	(12.6)
Tax	38.6	(7.9)	NA	42.8	(9.9)
Adjusted PAT	112.6	(23.5)	NA	130.0	(13.4)
Reported PAT	112.6	(23.5)	NA	130.0	(13.4)
Adjusted EPS	5.4	(1.1)	NA	6.2	(13.4)

Source: Company; Sharekhan Research

Key ratios(Standalone)

Particulars	Q1FY22	Q1FY21	Y-o-Y (bps)	Q4FY21	Q-o-Q (bps)
Gross margin (%)	59.8	57.3	250	58.3	150
EBIDTA margin (%)	19.5	1.9	1,760	19.5	10
EBIT margin (%)	15.5	(11.2)	NA	16.1	(60)
Net profit margin (%)	12.0	(8.5)	NA	12.0	(10)
Effective tax rate (%)	25.5	25.2	NA	24.8	70

Source: Company; Sharekhan Research

Results (Consolidated) Rs cr

Particulars	Q1FY22	Q1FY21	Y-o-Y %	Q4FY21	Q-o-Q %
Revenues	1,112.4	373.2	198.1	1,273.1	(12.6)
Total operating expenses	912.0	358.0	154.7	1,036.3	(12.0)
EBITDA	200.5	15.1	-	236.8	(15.3)
Depreciation	46.6	44.3	5.2	45.2	3.2
Interest	7.8	11.4	(32.1)	6.9	11.7
Other income	17.1	8.6	98.5	4.3	302.1
PBT	163.2	(32.0)	NA	188.9	(13.6)
Tax	42.7	(6.5)	NA	48.1	(11.2)
Adjusted PAT	120.5	(26.7)	NA	140.8	(14.4)
Reported PAT	120.5	(26.7)	NA	140.8	(14.4)
Adjusted EPS	5.7	(1.3)	NA	6.7	(14.4)

Source: Company; Sharekhan Research

Key ratios(Consolidated)

Particulars	Q1FY22	Q1FY21	Y-o-Y (bps)	Q4FY21	Q-o-Q (bps)
Gross margin (%)	61.0	58.4	260	59.5	140
EBIDTA margin (%)	18.0	4.1	1,400	18.6	(60)
EBIT margin (%)	13.8	(7.8)	NA	15.1	(120)
Net profit margin (%)	10.8	(7.2)	NA	11.1	(20)
Effective tax rate (%)	26.2	20.4	NA	25.5	70

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector outlook – Positive led by pent up demand

We remain positive on the structural demand for automobiles in the medium term and expect recovery across segments post normalisation of economic activities, led by pent-up demand from rural, semi-urban, and urban demand along with a favourable macro outlook. The passenger vehicle (PV) segment, both for two-wheelers (2W) and four-wheelers (4W), is expected to remain strong amid COVID-19, as preference for personal transport. Rural demand is expected to be strong in southern and western India, given higher kharif sowing and a copious monsoon, both of which are crucial for these regions. Tractor sales are likely to pick up, ahead of the summer crop. We expect a strong sequential improvement in M&HCV sales to continue, driven by rise in e-commerce, agriculture, infrastructure, and mining activities. We expect the strongest recovery in the CV segment in FY2022 and FY2023, driven by improved economic activities, low interest rate regime, and better financing availability. We expect M&HCVs to outpace the other segments in FY2022, followed by growth in the tractor, PV, and 2W segments. The bus and three-wheeler (3W) segments continue to remain under pressure due to the closure of schools, colleges, offices, and lower use of public transport.

■ Company outlook – Strong earnings growth

SFL continues to deliver strong performance during Q1FY2022, despite a tough environment, led by robust growth from domestic as well as export markets. We expect SFL to be a beneficiary of improved automotive business outlook and a 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 the automotive industry with its clients well diversified across segments. Export and non-automotive segments continue to be the focus areas with a strategy to de-risk business from cyclicality. We expect SFL's earnings CAGR to improve by 29.4% during FY2021E-FY2023E, driven by a 24% revenue CAGR during FY2021E-FY2023E and a 30 bps improvement in EBITDA margin to 18.5% in FY2023E from 18.2% in FY2021, with ROCE progressing to 21.6% in FY2023E. We remain positive on SFL's business prospects going forward.

■ Valuation – Maintain Buy with an unchanged PT of Rs. 994

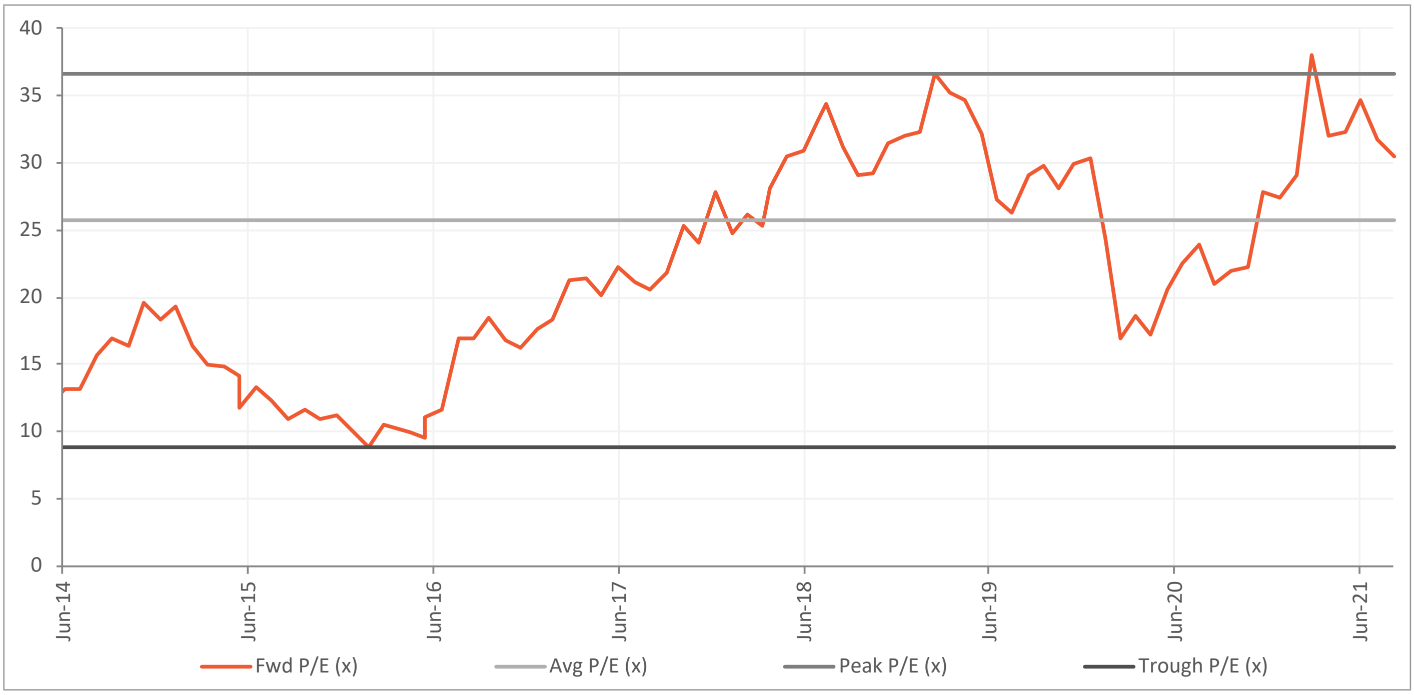
SFL is witnessing strong traction from its domestic and global OEMs, driven by recovery in automotive and non-automotive demand. The outlook remains positive with recovery expected in FY2022, driven by pent-up demand, post normalisation of COVID wave-2. Operating profit margin (OPM) would expand on account of operating leverage benefits, cost-control measures, and its ability to pass on cost increase to customers. We are positive on SIL's growth prospects, led by its strong performance outpacing the automobile industry's growth through diversifying its client portfolio, expanding product portfolios, benefitting from its established client relationships, and prudent capital allocation. We expect SFL's earnings CAGR to improve by 32.3% during FY2021E-FY2023E, driven by a 26% revenue CAGR during FY2021E-FY2023E and a 20 bps improvement in EBITDA margin to 18.4% in FY2023E from 18.2% in FY2021, with ROCE progressing to 22.6% in FY2023E. The stock is trading at a P/E multiple of 25x and EV/EBITDA multiple of 15.1x its FY2023 estimates. We retain our Buy rating on the stock with an unchanged PT of Rs. 994.

Target Price Calculation

	Rs/Share
FY2023E EPS (Rs. per share)	30.1
Target P/E Multiple (x)	33
Target Price (Rs.)	994
Upside (%)	32

Source: Company; Sharekhan Research

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	CMP	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
	Rs/Share	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
Sundram Fasteners	753	43.8	35.8	25.0	24.5	20.3	15.1	16.0	18.1	22.6
Suprajit Engineering	327	31.7	23.9	18.7	20.2	15.7	12.6	16.0	18.9	21.1
Schaeffler India	6,841	73.5	42.4	33.7	37.6	24.3	19.3	12.4	18.9	20.2

Source: Company, Sharekhan estimates

About company

SFL, incorporated in 1966, is a part of TVS Group, headquartered in Chennai. The company 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's customer portfolio includes domestic and international clients. The revenue mix comprises 52% domestic OEMs, 13% aftermarket, and 35% exports.

Investment theme

SFL is expected to be a beneficiary of improved automotive business outlook and diversified portfolio. Export markets have also witnessed 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 its 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 working on hybrid electric vehicle products, which would boost revenue 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. The renewed focus on the 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 for the company.

Key Risks

- The spread of COVID-19 can lead to slowdown in 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 Trustee Company Ltd	6.7%
4	Amansa Holdings Pvt Ltd	5.6%
5	Parikh Govindlal	2.0%
6	General Insurance Corp of India	1.8%
7	Life Insurance Corp of India	1.5%
8	New India Assurance	1.2%
9	L&T Mutual Fund Trustee 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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