Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Sundram Fasteners Ltd

Racing ahead of peers

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. 932**	
Price Target: **Rs. 1,100**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

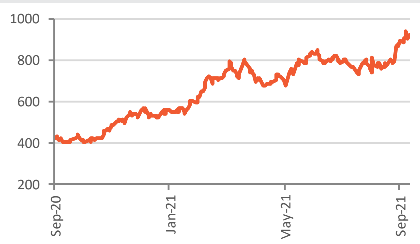
Company details

Market cap:	Rs. 19,584 cr
52-week high/low:	Rs. 948 / 392
NSE volume: (No of shares)	1.5 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	17.2	12.3	28.2	120.0
Relative to Sensex	12.3	0.6	13.6	69.0

Sharekhan Research, Bloomberg

Summary

- We retain our Buy rating on Sundram Fasteners Limited (SFL) with a revised PT of Rs. 1,100, 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 is well positioned to benefit from technology shift from BS-VI to electric vehicles, especially in emission-control products. Moreover, the company has capabilities to benefit from technological trends shifting towards lightweight and high strength products.
- We expect SFL's earnings CAGR to improve by 39.2% during FY2021E-FY2023E, driven by a 30.5% revenue CAGR and a 40 bps improvement in EBITDA margin to 18.6% in FY2023E from 18.2% in FY2021, with ROCE progressing to 24.5% in FY2023E.
- The stock trades at P/E multiple of 28x and EV/EBITDA multiple of 17.2x its FY2023E estimates.

Sundram Fasteners Limited (SFL) is expected to continue its outperformance over the automobile industry's growth through diversifying client and product portfolios, benefitting from its established client relationships and prudent capital allocation. The company is well positioned to benefit from the technological shift in the industry towards electric vehicles (EV), light weight and high strength components. The company has completed its major capacity expansion in FY2020 and is expected to increase in asset turnover with minimal investments. Focus on exports remains its prime focus area with robust market demand.

- **Well positioned to benefit from the technological shift:** The company is well positioned to benefit from the technology shift from BS-VI to EVs, especially in emission-control products. Though EV is in the nascent stage in India, there are good opportunities in the manufacture of shafts (rotor and intermediate assembly), gear blanks, differentials, electric oil, and water pumps. Moreover, the company has capabilities to benefit from technological trends shifting towards lightweight and high strength products.
- **Healthy order book:** SFL's order book remains at healthy levels with sectors such as farm implements, printed circuit boards, and industrial power generation growing rapidly. Domestic original equipment orders have improved more than 90% of pre-COVID levels across segments with commercial vehicle (CV) segments showing strong signs of recovery. The after-sales market (mainly for fasteners, caps, pumps, and sockets) is receiving strong traction. The company is witnessing robust demand from developed markets, and customers in the US and Europe are looking at India vis-à-vis traditional sources such as China and Taiwan. SFL is focusing on a diversified product range from EVs to non-autos, including aerospace, defence, wind, and solar and expects growth through new customers and new products.
- **Major capacity expansion over; Likely to improve asset turnover:** SFL 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 ~80% capacity utilisation. The recent capex programme has enabled the company to increase revenue by 25-30% without any major investments and will improve its turnover at minimal cost.

Our Call

Valuation - Maintain Buy with a revised PT of Rs.1,100: 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 FY2022E, driven by pent-up demand, post normalisation of the economy. 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. The company has a strong long-term revenue visibility, given its strong relationships with OEMs, both in India and globally. We expect SFL's earnings CAGR to improve by 39.2% during FY2021E-FY2023E, driven by a 30.5% revenue CAGR and a 40 bps improvement in EBITDA margin to 18.6% in FY2023E from 18.2% in FY2021, with ROCE progressing to 24.5% in FY2023E. We have introduced FY2024E estimates. The stock is trading at a P/E multiple of 28x and EV/EBITDA multiple of 17.2x its FY2023E estimates, which is trading at the higher end of its average multiples. The stock's premium valuation is justified given strong pedigree of its promoter, revenue visibility and ability to pass on costs to its customers. We retain our Buy rating on the stock with a revised PT of Rs. 1,100.

Key Risks

Any significant rise in COVID-19 cases can lead to slowdown in economic activities again and can impact the company's revenue growth. The company's performance can also be impacted by ongoing global chips shortage if the situation further worsens.

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22E	FY23E	FY24E
Net sales	3,644	4,665	6,209	7,450
Growth (%)	(2.1)	28.0	32.0	20.0
EBIDTA	664	830	1,155	1,401
OPM (%)	18.2	17.8	18.6	18.8
PAT	361	465	700	875
Growth (%)	11.2	28.6	50.7	24.9
FD EPS	17.2	22.1	33.3	41.6
P/E (x)	54.2	42.1	28.0	22.4
P/BV (x)	8.7	7.6	6.4	5.3
EV/EBITDA (x)	30.2	24.1	17.2	13.9
RoE (%)	16.1	18.1	22.9	23.8
RoCE (%)	16.0	18.8	24.5	26.6

Source: Company; Sharekhan estimates

Well positioned to benefit from technology shift in the industry: The company is well positioned to benefit from technology shift from BS-VI to EV, especially in emission control products. Though the EV is in the nascent stage in India, there are good opportunities in the manufacture of shafts (rotor and intermediate assembly), gear blanks, differentials, electric oil, and water pumps. Moreover, the company has capabilities to benefit from technological trends shifting towards lightweight and high strength products. In terms of design changes in the engine segment, we have developed more efficient products in the pump segment and variable valve transmission parts for engines.

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 over the next 3-5 years. 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.

Healthy order book: SFL's order book remains at healthy levels with sectors such as farm implements, printed circuit boards, and industrial power generation growing rapidly. Domestic original equipment orders have improved more than 90% of pre-COVID levels across segments with CV segments showing strong sign of recovery. The after-sales market (mainly for fasteners, caps, pumps, and sockets) is receiving strong traction. The company is witnessing robust demand from developed markets, and customers in the US and Europe are looking at India vis-à-vis traditional sources such as China and Taiwan. SFL is focusing on a diversified product range from EVs to non-autos, including aerospace, defence, wind, and solar, and expects growth through new customers and new products. The company continues to move forward through its strategy of deepening engagement with existing customers and participating in new projects that its customers are foraying into. Moreover, SFL continues to increase its penetration into new territories and geographies.

New businesses: SFL is planning to foray into new businesses. The company has plans to enter businesses such as EV, 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 EV space, where it supplies radiator caps. The company expects to double its revenue in the e-mobility division.

Major capacity expansion over; Likely to improve asset turnover: 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 ~80% capacity utilisation. The recent capex programme has enabled the company to increase revenue by 25-30% without any major investments and will improve its turnover at minimal cost. The company expects capex to be Rs. 100 crore-150 crore every year.

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. Given the strong outlook, we have increased our earnings estimates by 5.2% for FY2022E and 10.7% for FY2023E. We expect SFL's earnings CAGR to improve by 39.2% during FY2021E-FY2023E, driven by a 30.5% revenue CAGR and a 40 bps improvement in EBITDA margin to 18.6% in FY2023E from 18.2% in FY2021, with ROCE progressing to 24.5% in FY2023E. We have introduced FY2024E estimates.

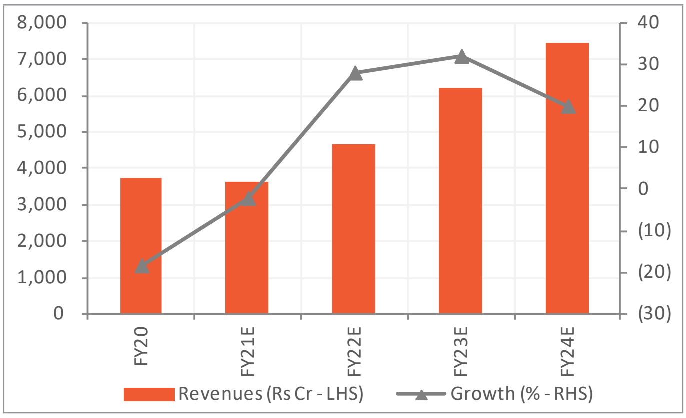
Change in estimates Rs cr

Particulars	Revised		Earlier		% Change	
	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
Revenue	4,665	6,209	4,519	5,784	3.2	7.3
EBITDA	830	1,155	800	1,064	3.8	8.5
EBITDA margin (%)	17.8	18.6	17.7	18.4	10 bps	20 bps
PAT	465	700	442	633	5.2	10.7
EPS	22.1	33.3	21.0	30.1	5.2	10.7

Source: Company; Sharekhan Research

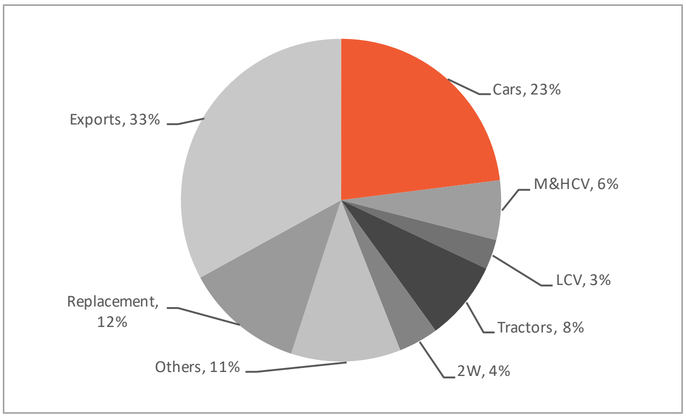
Financials in charts

Revenue and Growth Trend



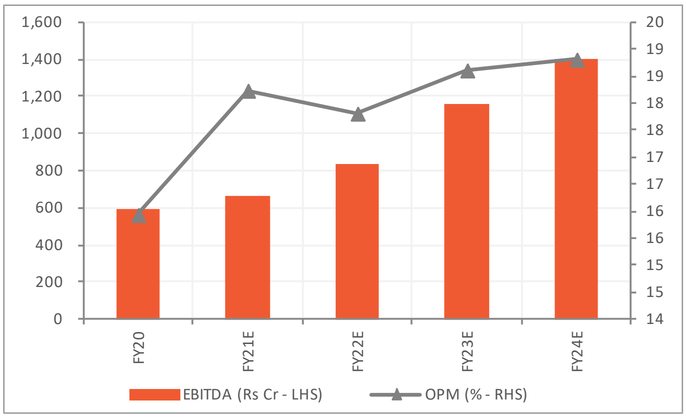
Source: Company, Sharekhan Research

Revenue Mix (%)



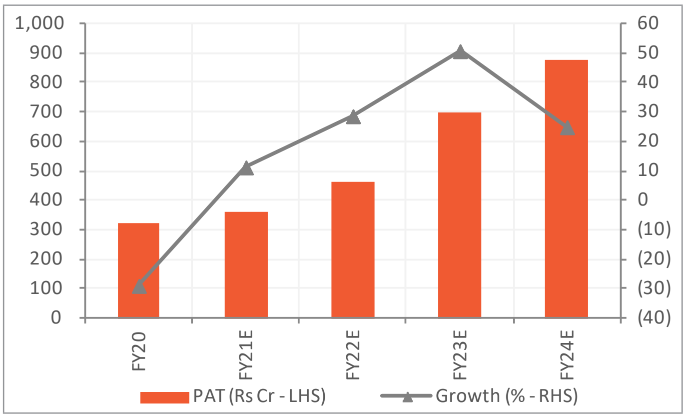
Source: Company, Sharekhan Research

EBITDA and OPM Trend



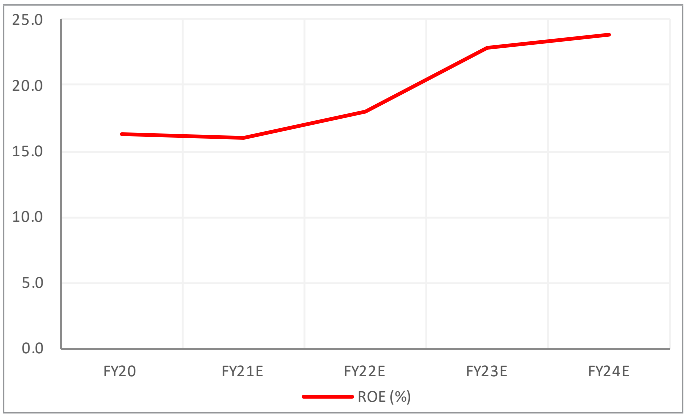
Source: Company, Sharekhan Research

Net Profit and Growth Trend



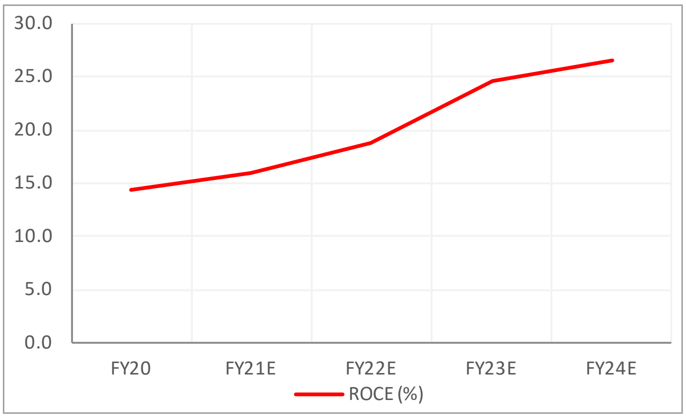
Source: Company, Sharekhan Research

RoE Trend



Source: Company, Sharekhan Research

RoCE trend



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector outlook – 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 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 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 FY2022E and FY2023E, 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 are showing initial signs of recovery, as schools, colleges, offices, and use of public transport are opening up gradually in the country.

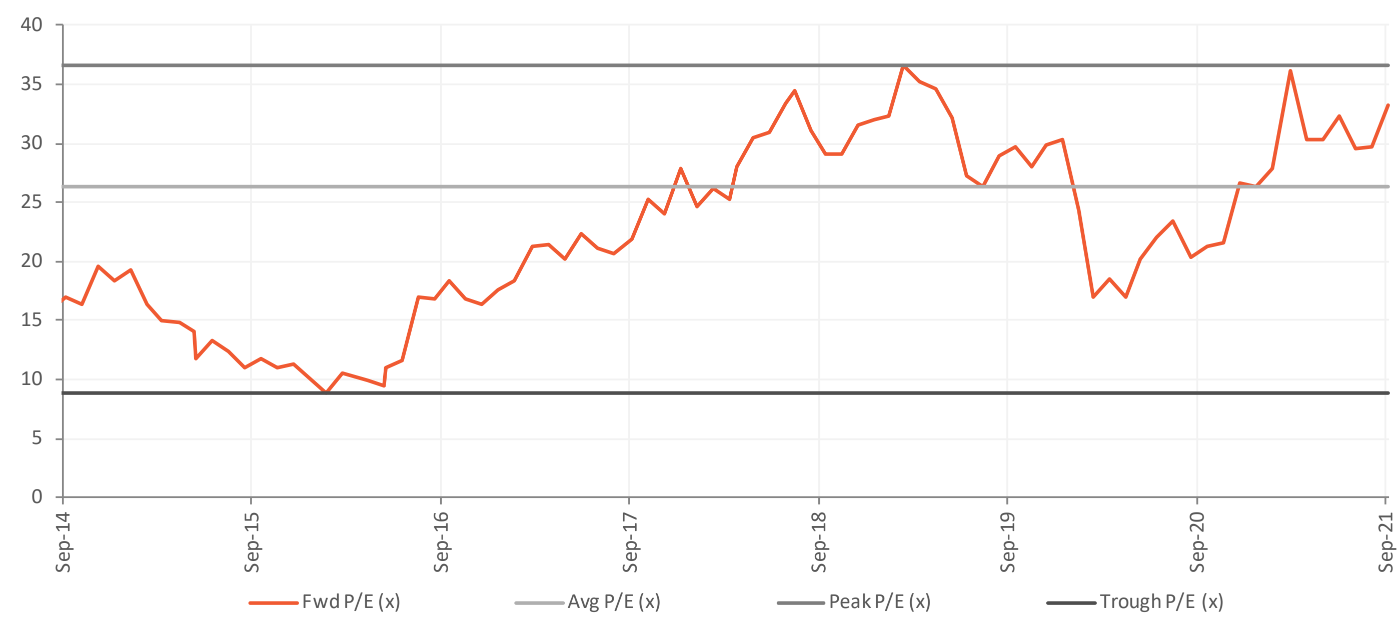
■ Company outlook – Strong earnings growth

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 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 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 remain positive on SFL's business prospects going forward.

■ Valuation – Maintain Buy with a revised PT of Rs. 1,100:

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 FY2022E, driven by pent-up demand, post normalisation of the economy. 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. The company has a strong long-term revenue visibility, given its strong relationships with OEMs, both in India and globally. We expect SFL's earnings CAGR to improve by 39.2% during FY2021E-FY2023E, driven by a 30.5% revenue CAGR and a 40 bps improvement in EBITDA margin to 18.6% in FY2023E from 18.2% in FY2021, with ROCE progressing to 24.5% in FY2023E. We have introduced FY2024E estimates. The stock is trading at a P/E multiple of 28x and EV/EBITDA multiple of 17.2x its FY2023E estimates, which is trading at the higher end of its long-term average multiples. The stock's premium valuation is justified given strong pedigree of its promoter, revenue visibility, and ability to pass on costs to its customers. We retain our Buy rating on the stock with a revised PT of Rs. 1,100.

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	932	54.2	42.1	28.0	30.2	24.1	17.2	16.0	18.8	24.5
Suprajit Engineering	321	31.1	23.5	18.4	19.9	15.4	12.3	16.0	18.9	21.1
Schaeffler India	7,279	78.2	44.3	33.7	40.1	25.6	19.6	12.4	19.2	21.2

Source: Company, Sharekhan estimates

About company

SFL, incorporated in 1966, is 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 EV 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. 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

- Any significant rise in COVID-19 cases can lead to slowdown in economic activities again and can impact the company revenue growth.
- The company's performance can also be impacted by ongoing global chips shortage if the situation further worsens.
- 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 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

Sharekhan

by BNP PARIBAS

Know more about our products and services

For Private Circulation only

Disclaimer: This document has been prepared by Sharekhan Ltd. (SHAREKHAN) and is intended for use only by the person or entity to which it is addressed to. This Document may contain confidential and/or privileged material and is not for any type of circulation and any review, retransmission, or any other use is strictly prohibited. This Document is subject to changes without prior notice. This document does not constitute an offer to sell or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction. Though disseminated to all customers who are due to receive the same, not all customers may receive this report at the same time. SHAREKHAN will not treat recipients as customers by virtue of their receiving this report.

The information contained herein is obtained from publicly available data or other sources believed to be reliable and SHAREKHAN has not independently verified the accuracy and completeness of the said data and hence it should not be relied upon as such. While we would endeavour to update the information herein on reasonable basis, SHAREKHAN, its subsidiaries and associated companies, their directors and employees ("SHAREKHAN and affiliates") are under no obligation to update or keep the information current. Also, there may be regulatory, compliance, or other reasons that may prevent SHAREKHAN and affiliates from doing so. This document is prepared for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. Recipients of this report should also be aware that past performance is not necessarily a guide to future performance and value of investments can go down as well. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved), and should consult its own advisors to determine the merits and risks of such an investment. The investment discussed or views expressed may not be suitable for all investors. We do not undertake to advise you as to any change of our views. Affiliates of Sharekhan may have issued other reports that are inconsistent with and reach different conclusions from the information presented in this report.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject SHAREKHAN and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

The analyst certifies that the analyst has not dealt or traded directly or indirectly in securities of the company and that all of the views expressed in this document accurately reflect his or her personal views about the subject company or companies and its or their securities and do not necessarily reflect those of SHAREKHAN. The analyst and SHAREKHAN further certifies that neither he or his relatives or Sharekhan associates has any direct or indirect financial interest nor have actual or beneficial ownership of 1% or more in the securities of the company at the end of the month immediately preceding the date of publication of the research report nor have any material conflict of interest nor has served as officer, director or employee or engaged in market making activity of the company. Further, the analyst has also not been a part of the team which has managed or co-managed the public offerings of the company and no part of the analyst's compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this document. Sharekhan Limited or its associates or analysts have not received any compensation for investment banking, merchant banking, brokerage services or any compensation or other benefits from the subject company or from third party in the past twelve months in connection with the research report.

Either, SHAREKHAN or its affiliates or its directors or employees / representatives / clients or their relatives may have position(s), make market, act as principal or engage in transactions of purchase or sell of securities, from time to time or may be materially interested in any of the securities or related securities referred to in this report and they may have used the information set forth herein before publication. SHAREKHAN may from time to time solicit from, or perform investment banking, or other services for, any company mentioned herein. Without limiting any of the foregoing, in no event shall SHAREKHAN, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind.

Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

Registered Office: Sharekhan Limited, 10th Floor, Beta Building, Lodha iThink Techno Campus, Off. JVLR, Opp. Kanjurmarg Railway Station, Kanjurmarg (East), Mumbai – 400042, Maharashtra. Tel: 022 - 61150000. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183;