Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Schaeffler India Ltd

Beneficiary of electrification and hybridization trend

Automobiles	Sharekhan code: SCHAEFFLER
Reco/View: Buy ↔	CMP: Rs. 9,288
	Price Target: Rs. 10,678 ↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- We retain our Buy recommendation on Schaeffler India Limited (SIL) with a revised PT of Rs. 10,678, led by a strong outlook for its automotive and industrial businesses, and better multiples.
- SIL is expected to perform strongly in Q4CY21E, with record sales and profitability growth, led by order wins and margin improvement.
- Exports is a high-growth area for SIL, given the pedigree of its parent company. Greater localisation and focus on market share gains would aid revenue and EBITDA growth going forward. We expect its earnings to report a 64% CAGR during CY2020-CY2022E.
- Stock trades at a P/E of 37.9x and EV/EBITDA of 22.4x its CY2022E estimates.

We remain positive on Schaeffler India Limited (SIL), driven by a strong outlook for its automotive and industrial businesses and improving content per vehicle. The company has a strong R&D and technology bandwidth, which makes it well placed to garner benefit from the electrification and hybridization trend in the domestic automobile sector. The company has strong support from its parent company and has access to latest technologies and relationships with global OEMs & Tier I suppliers. Also, the company would benefit from the industrial and automobile aftermarket segments, strong growth traction in export markets, and better prospects for the bearings business. Recovery in the domestic business, improving share of exports business, increase in content per vehicle and solid margin expansion are expected to drive earnings by robust 64% CAGR over CY2020-CY2022E. The company's board has approved stock split in 5:1 ratio and targets dividend payout ratio of 30-50% of the annual standalone net profit, which will benefit the shareholders' going forward. We reiterate our Buy rating on the stock with a revised price target (PT) of Rs. 10,678.

- **Well positioned to benefit from electrification and hybridization trend:** The company is likely to be a key beneficiary of electrification and hybridization trend for domestic business, as India is expected to witness faster growth in the electric and hybrid vehicles going forward. The company expects electrification to be at high single digit by 2030, while hybridization to be 25-35%. The company has a strong product portfolio and is well placed to benefit from this trend.
- **Multiple growth levers:** In the automotive OEM segment, SIL is witnessing increased content per vehicle in the petrol passenger vehicle (PV) segment post the implementation of BS-VI emission norms; while in the industrial OEM segment, the company is witnessing strong growth from the railways segment and wind power division. We expect SIL to continue its better-than-industry performance, given its strong pedigree of parent, which gives access to latest technologies and relationships with global OEMs & Tier I suppliers.
- **Strong earnings growth:** Given the robust outlook for SIL's business, we expect its earnings to post a 64% CAGR during CY2020-CY2022E, driven by a 36.7% revenue CAGR during CY2020-CY2022E and a 310 bps improvement in EBITDA margin from 14.3% in CY2020 to 17.4% in CY2022.

Our Call

Valuation – Maintain Buy with a revised PT of Rs. 10,678: SIL has been consistently outperforming industry growth rate, driven by its technological edge and established relationships with leading OEMs/clients in India and globally. After a dip in performance led by a COVID induced lockdown in Q2CY20, the company's performance have improved steadily, aided by strong recovery in the automotive segment and industrial segment. Exports continue to do well and contributed ~11% to revenue in Q3CY2021. We expect a robust performance by the company going forward, driven by normalisation of economic activity, improvement in content per vehicle, strong growth in the wind power and railways businesses, and launch of new products in the aftermarket segment. We expect its earnings to post a 64% CAGR from CY2020-CY2022E, driven by a 36.7% revenue CAGR during CY2020-CY2022E and a 310 bps improvement in EBITDA margin from 14.3% in CY2020 to 17.4% in CY2022. The stock is trading at P/E of 37.9x and EV/EBITDA of 22.4x its CY2022E estimates. The premium valuations are justified, given the pedigree of its parent company and its capability to outperform industry and peers. We reiterate our Buy rating on the stock with a revised PT of Rs. 10,678.

Key Risks

Delayed approval from industrial customers and late launches by automotive players can impact growth. Moreover, growth momentum might get derailed if the third wave (Omicron) of COVID hits as severely as the second wave.

Valuation (Standalone) Rs cr

Particulars	CY20	CY21E	CY22E	CY23E
Net Sales	3,762	5,492	7,030	8,296
Growth (%)	(13.7)	46.0	28.0	18.0
EBIDTA	536	906	1,223	1,460
OPM (%)	14.3	16.5	17.4	17.6
Recurring PAT	291	562	782	940
Growth (%)	(20.9)	93.2	39.1	20.2
EPS (Rs)	93.1	179.9	250.3	300.8
PE (x)	99.8	51.6	37.1	30.9
P/BV (x)	9.8	9.2	8.3	6.8
EV/EBIDTA (x)	51.8	30.7	22.4	18.4
RoE (%)	9.3	16.1	18.3	18.4
RoCE (%)	12.4	20.9	23.8	23.9

Source: Company; Sharekhan estimates

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		↔	

ESG Disclosure Score NEW

ESG RISK RATING 22.37

Updated Nov 08, 2021

Medium Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

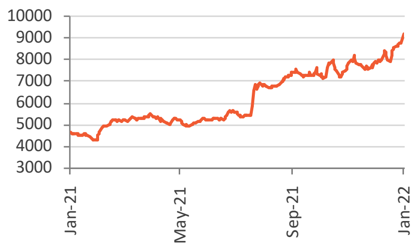
Company details

Market cap:	Rs. 29,035 cr
52-week high/low:	Rs. 9,382/ 4,260
NSE volume: (No of shares)	24,176
BSE code:	505790
NSE code:	SCHAEFFLER
Free float: (No of shares)	0.8 cr

Shareholding (%)

Promoters	74.1
FII	5.0
DII	15.6
Others	5.3

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	16.9	20.5	63.7	106.7
Relative to Sensex	15.7	20.4	51.9	81.8

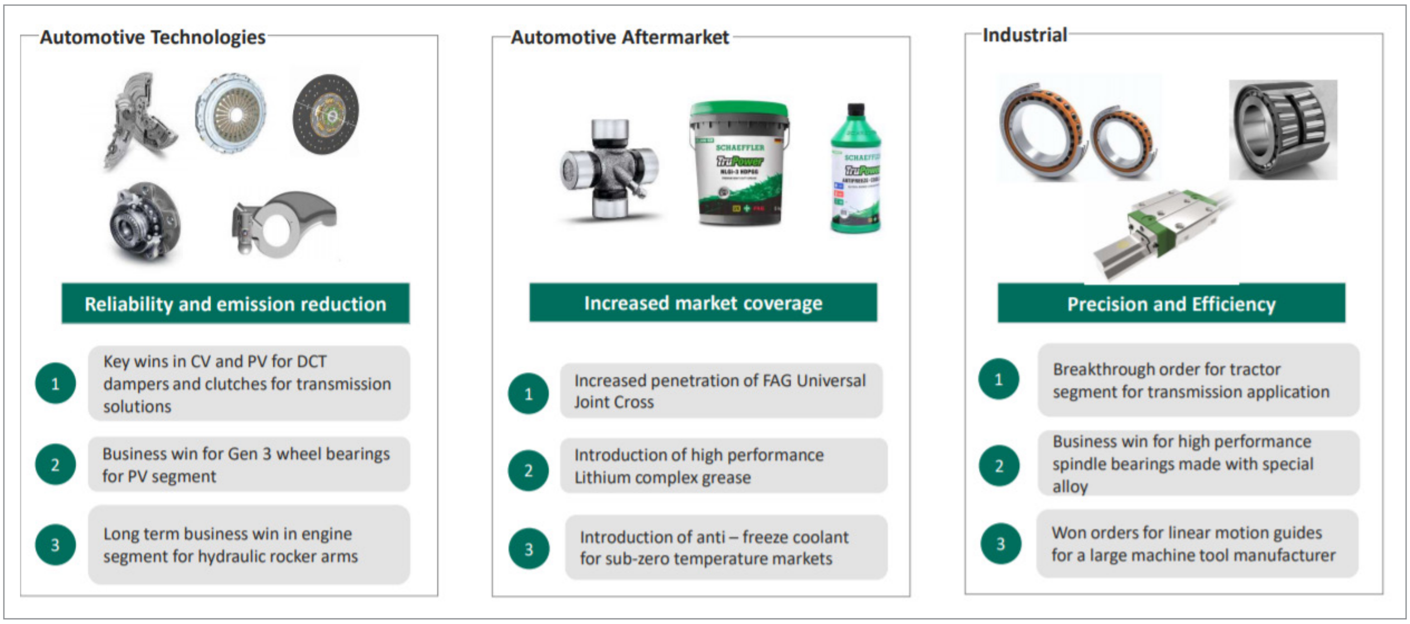
Sharekhan Research, Bloomberg

Well positioned to benefit from electrification and hybridization trend: The company is likely to be a key beneficiary of electrification and hybridization trend for the domestic business, as India is expected to witness faster growth in the electric and hybrid vehicles going forward. The company expects electrification to be at high single digit by 2030, while hybridization is expected to be at 25-35%. The company has a strong product portfolio and is well placed to benefit from this trend. The internal combustion engine (ICE) technology is expected to remain a significant driver for industry going forward. The company will continue to benefit from its existing product portfolio. Since all hybrids will also have an ICE, there will be continuous improvement in the technology of internal combustion engines, which will drive content per car for the company, given its technological edge over peers and established relationships with OEMs. Also, the company has exposure to all the key markets, viz. North America, Europe, China and Indian markets. The company is well positioned to benefit from the electrification trend in the mass markets of these geographies. Also, the management expects to the two-wheeler and three-wheeler markets to witness faster electrification compared to other segments.

New greenfield facility: SIL has announced investments of Rs300 crore for setting up a new manufacturing facility in Hosur, Tamil Nadu over the next four years. The proposed plant will manufacture transmission components and systems for automotive and tractor segments.

Positive management guidance: The company's management has given a cautious positive outlook, as the company expects volumes to recover, as COVID-19 wave subsides and consumer sentiments improve. Management sees CY2021 to be a strong year and expects its businesses to perform well this year, driven by an expected normalisation of economic activity with the rollout of vaccines in the country. The company has a robust order book outlook, led by strong customer engagement. The company has won significant business orders in both automotive and industrial businesses and has consolidated its leadership position during Q3CY2021. We expect SIL to perform strongly in Q4CY21E, with record sales and profitability growth, led by order wins and margin improvement. The management expects sustained operational performance across its plants and normal capacity utilisation. Further, the company's board has approved stock split in 5:1 ratio and targets dividend payout ratio of 30-50% of the annual standalone net profit.

Key business wins across segments



Source: Company Investor Presentation; Sharekhan Research

Increased market coverage: SIL continues to focus on increasing its market coverage through new launches, expansion of new product range, and improvement in service levels. The company increased FAG universal joint cross and introduced Lithium complex grease and anti-freeze coolant for sub-zero temperature markets. The company continues to focus on service-level improvement and range extension in Schaeffler TruPower.

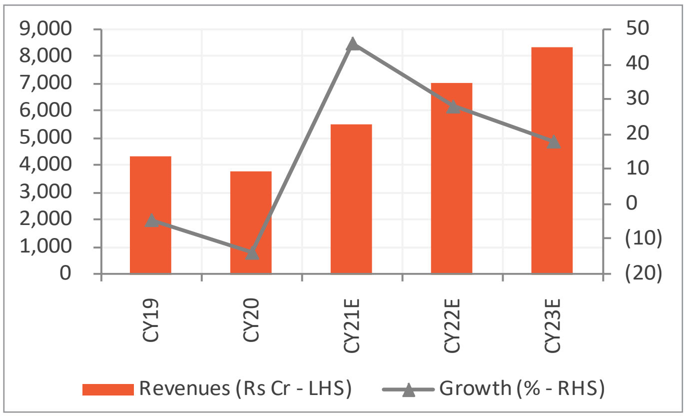
Multiple growth levers: In the automotive OEM segment, SIL is witnessing increased content per vehicle in the petrol passenger vehicle (PV) segment post the implementation of BS-VI emission norms; while in the industrial OEM segment, the company is witnessing strong growth from the railways segment and wind power division. The railway division's business is driven by introduction of new products and supplies to metro railways, while the wind power business is aided by new client acquisitions. Besides the OEM segment, aftermarket is also poised for healthy growth, driven by new product introductions. SIL has launched the lubricant business under the 'True Value' brand, which is receiving positive feedback. The company aims to introduce more products in the segment. Moreover, SIL's parent has identified it as a manufacturing base for supply to Asia-Pacific region. This provides a huge growth potential for the company in the long run. The company has a strong access to e-mobility technology through its parent company, which has a strong presence in Europe. The company is developing technology for two-wheelers, working jointly with the parent company.

Strong growth prospects: SIL would benefit from industrial and automobile aftermarket segments, strong growth traction in export markets, and better prospects for the bearings business. The company is focusing on introducing new products in the industrial and automotive aftermarkets by bringing in localisation and boosting its market share. SIL will be the key beneficiary of this trend, as it focuses on increasing content per vehicle. In the industrial OEM segment, the company is witnessing strong growth in the railways segment with the introduction of new products and supplies to Metro Rail projects. With new additions of customers in the wind power business, we expect SIL to report strong growth in this space. Exports is a high-growth area for SIL, given the pedigree of its parent company. We expect SIL to benefit from industrial and automobile aftermarkets, strong growth traction in railways and export segments, and better prospects for the bearings business amid stricter norms. We are positive on the automobile sector and expect the industry to post double-digit growth in FY2022.

Strong earnings growth: Given the robust outlook for SIL's business, we expect its earnings to post a 64% CAGR during CY2020-CY2022E, driven by a 36.7% revenue CAGR during CY2020-CY2022E and a 310 bps improvement in EBITDA margin from 14.3% in CY2020 to 17.4% in CY2022.

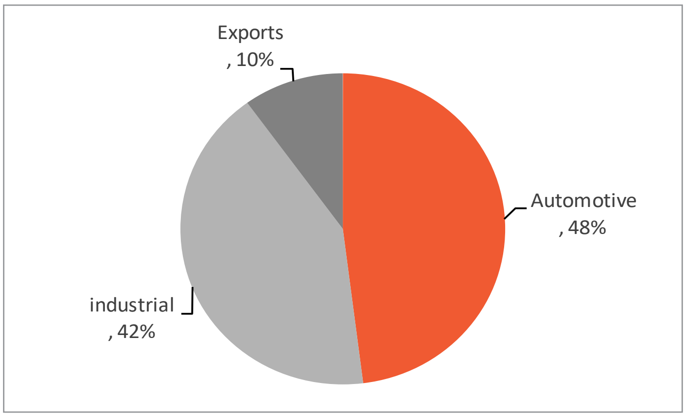
Financials in charts

Revenue and Growth Trend



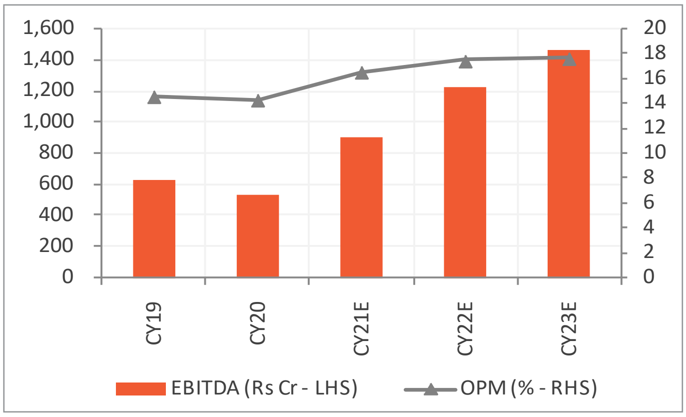
Source: Company, Sharekhan Research

Revenue Mix (%)



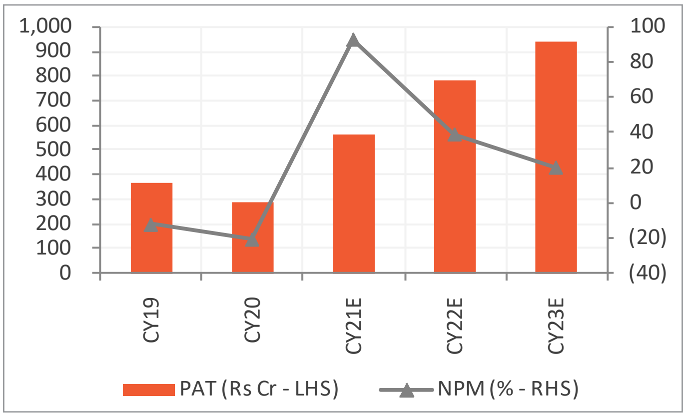
Source: Company, Sharekhan Research

EBITDA and OPM Trend



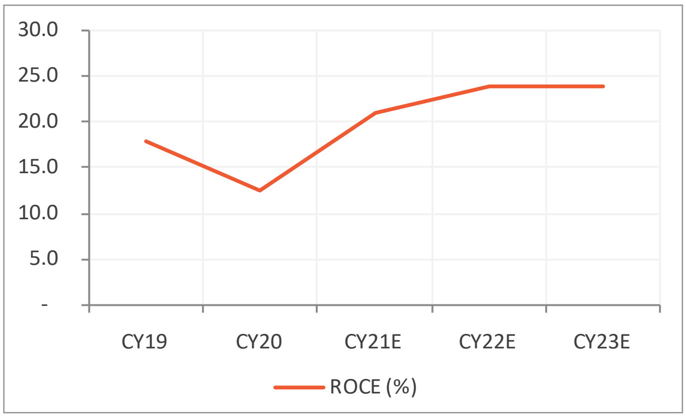
Source: Company, Sharekhan Research

Net Profit and NPM Trend



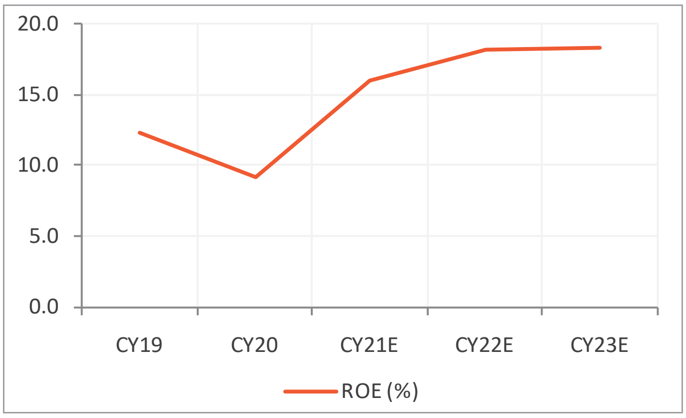
Source: Company, Sharekhan Research

RoCE Trend



Source: Company, Sharekhan Research

RoE Trend



Source: Company, Sharekhan Research

Outlook and Valuation

Sector view - Demand picking up in the automotive and industrial sector

The passenger segment, both for two-wheelers and four-wheelers, is expected to remain strong amid COVID-19, as a preference for personal transport. Rural demand is expected to recover given positive rural sentiments. We expect a 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 commercial vehicle (CV) segment in FY2022E and FY2023E, driven by an improvement in economic activities, low interest rate regime, and better financing availability. We expect M&HCVs to outpace other automobile segments in FY2022 and FY2023, followed by growth in the tractor, PV, and two-wheeler segments. Moreover, exports provide a huge growth potential, given India's cost-effective manufacturing, being geographically closer to key markets of Middle East and Europe, and being the second-largest producer of key raw-material – steel. Auto component exports are expected to grow from $15 billion to $80 billion by FY2027.

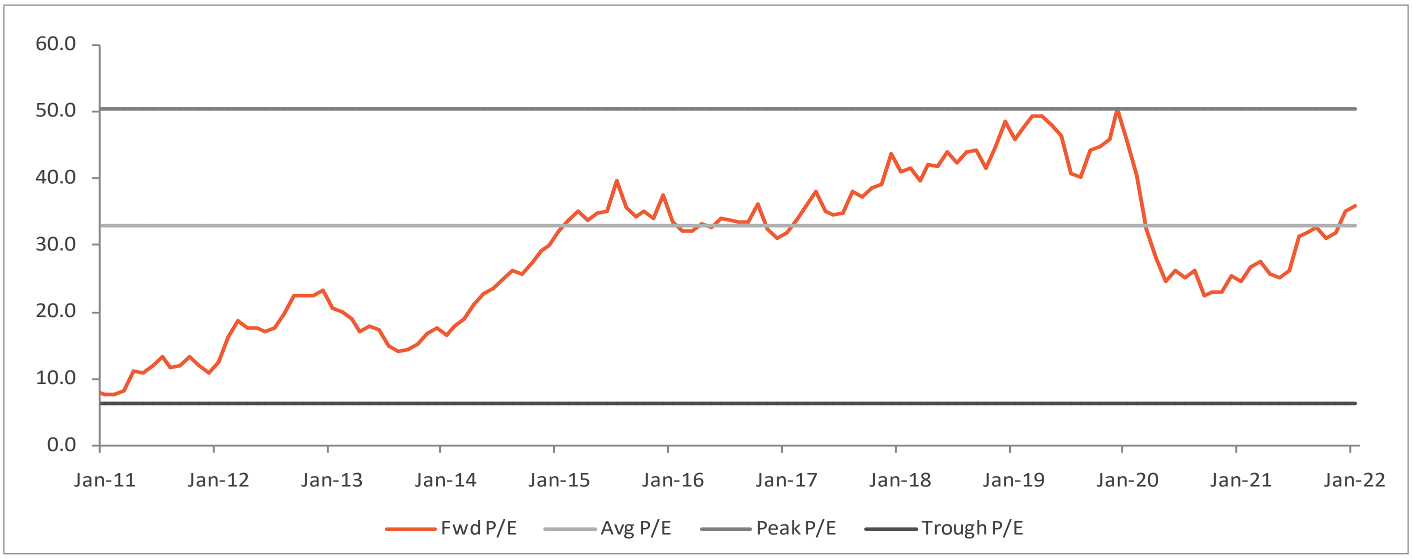
Company outlook - MNC company with strong technological parentage and robust balance sheet

SIL is part of the German Schaeffler Group. The Schaeffler Group has a strong research and development (R&D) DNA. In CY2019, the group filed 2,400 patents, making it the second most innovative company in Germany. The company has established strong relationships with global OEMs worldwide. SIL would benefit from its strong parentage and is expected to receive new businesses going forward. Moreover, SIL's parent has identified it as a manufacturing base for supply to Asia-Pacific region. This provides a huge growth potential for the company. SIL is a debt-free company with RoCE and ROIC expected to improve to 21.2% and 31.1%, respectively, in CY2022E. The company is expected to generate strong free cash flow (FCF) of Rs. 1,200 crore over the next three years. We remain positive on the company's growth prospects.

Valuation - Maintain Buy with a revised PT of Rs. 10,678

Valuation – Maintain Buy with a revised PT of Rs. 10,678: SIL has been consistently outperforming industry growth rate, driven by its technological edge and established relationships with leading OEMs/clients in India and globally. After a dip in performance led by COVID induced lockdown in Q2CY20, the company's performances have improved steadily, aided by strong recovery in the automotive segment and industrial segment. Exports continue to do well and contributed ~11% to revenue in Q3CY2021. We expect a robust performance by the company going forward, driven by normalisation of economic activity, improvement in content per vehicle, strong growth in the wind power and railways businesses, and launch of new products in the aftermarket segment. We expect its earnings to post a 64% CAGR from CY2020-CY2022E, driven by a 36.7% revenue CAGR during CY2020-CY2022E and a 310 bps improvement in EBITDA margin from 14.3% in CY2020 to 17.4% in CY2022. The stock is trading at P/E of 37.9x and EV/EBITDA of 22.4x its CY2022E estimates. The premium valuations are justified, given the pedigree of its parent company and its capability to outperform industry and peers. We reiterate our Buy rating on the stock with a revised PT of Rs. 10,678.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Company	CMP (Rs)	P/E (x)			EV/EBITDA (x)			ROCE (%)		
		FY21*	FY22E*	FY23E*	FY21*	FY22E*	FY23E*	FY21*	FY22E*	FY23E*
Schaeffler India	9,288	99.8	51.6	37.1	51.8	30.7	22.4	12.4	20.9	23.8
Sundram Fasteners	893	51.9	40.4	26.8	28.9	23.1	16.5	16.0	18.8	24.5
Suprajit Engineering	449	43.5	32.8	24.4	27.4	21.3	16.4	16.0	18.9	22.1

**Note: For Schaeffler the years are CY20, CY21E and CY22E*
Source: Company, Sharekhan Research

About company

SIL (erstwhile FAG Bearings), with four plants and 11 sales offices, has a significant presence in India with three major widely known product brands – FAG, INA, and LuK. SIL produces a vast range of ball bearings, cylindrical roller bearings, deep groove balls, spherical roller bearings, and wheel bearings sold under the brand name of FAG. The company manufactures engine and transmission components for front accessory drive systems, chain drive systems, valve train, shift systems, and a range of needle roller bearings and elements under the brand, INA. SIL also produces clutch systems and dual mass flywheels for passenger cars, LCVs, heavy commercial vehicles, and tractors, which are sold under the brand of LuK. In addition to this, SIL has dedicated engineering and R&D support based in India to augment its product teams. SIL also has one of the largest aftermarket networks serving industrial and automotive markets. SIL derives 47% of its revenue from the automotive segment, 42% from the industrial segment, and 11% revenue from exports.

Investment theme

SIL is among the largest automotive and industrial suppliers with a strong parentage of the Schaeffler Group. The company is present in India since the past 50 years and has established strong relationships with leading OEMs in India and globally. Having strong manufacturing capability and R&D, SIL's parent company has identified it as a manufacturing base for supply to Asia-Pacific region. This provides a strong opportunity to the company to expand its export business. With the Indian Government focussing on 'Make in India,' 'Atma-Nirbhar,' and PLI programmes, SIL is well positioned to benefit from these programmes. Moreover, the company has a diversified portfolio – with automotive, industrial, and export businesses contributing 48%, 42%, and 10%, respectively, to revenue. The company's strategies to increase content per vehicle through product innovation and launches, while identifying new business divisions in the industrial sector, are likely to keep growth traction intact. The company's strong technological parentage and established relationships with global OEM clients would continue to provide growth opportunities. We remain positive on SIL and expect strong earnings growth, driven by revenue growth and margin expansion.

Key Risks

- Delayed approval from industrial customers and late launches by automotive players can impact growth.
- Pricing pressures from automotive OEM clients can impact profitability.
- Growth momentum might get derailed if the third wave (Omicron) of COVID-19 hits as severely as the second wave.

Additional Data

Key management personnel

Avinash Gandhi	Chairman
Harsha Kadam	Managing Director and CEO
Satish Patel	Director Finance and CFO
Ashish Tiwari	Company Secretary

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Fag Kugelfischer Gmbh	27.3
2	Schaeffler Buhl Verwaltungs Gmbh	20.6
3	Schaeffler Verwaltungsholding Sechs Gmbh	15.0
4	Industriewerk Schaeffler Ina-ingenieurdienst Gmbh	11.3
5	Kotak Emerging Equity Scheme	4.1
6	UTI Flexi Cap Fund	2.7
7	SBI Magnum Global Fund	2.2
8	Sundaram Mutual Fund	1.4
9	HDFC Life Insurance Co. Ltd.	1.3
10	HDFC Trustee Company Ltd. - A/c HDFC Mid - Capopportunities Fund	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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by BNP PARIBAS

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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

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