Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Sundram Fasteners Ltd

Q4 missed expectations, while outlook remains positive

Automobiles	Sharekhan code: SUNDRMFAST

Reco/View: Buy	↔	CMP: Rs. 835	Price Target: Rs. 1,030	↓

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- We maintain Buy on Sundram Fasteners Limited (SFL) with a revised PT of Rs. 1,030, led by the company's dominant position in the fasteners segment, diverse client base and product portfolios, established client relationships, and prudent capital allocation.
- Q4FY2022 results missed estimates, driven by lower-than-expected EBITDA margin due to increased raw-material and logistics costs. 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 38% during FY2022-FY2024E, driven by a 21.5% revenue CAGR and a 160-bps improvement in EBITDA margin to 17.9% in FY2024E from 16.3% in FY2022, with ROCE progressing to 24% in FY2024E.
- The stock trades at P/E multiple of 19.9x and EV/EBITDA multiple of 12.7x its FY2024E estimates.

Sundram Fasteners Limited (SFL) reported lower-than expected EBITDA margin in Q4FY2022, driven by increased raw-material and logistics costs. Standalone revenue improved by 11.9% q-o-q to Rs. 1,146 crore, while consolidated revenue declined by 11% q-o-q to Rs. 1,339.8 crore in Q4FY2022. Export continues to drive revenue with 8.7% y-o-y and 40.7% y-o-y growth in Q4FY2022 and full-year FY2022, respectively. The company benefitted from higher exports, led by opening up of western geographies. EBITDA margin declined by 260 bps q-o-q for the standalone business, while that of the consolidated business declined by 150 bps q-o-q, marred by rise in raw-material and logistics costs. As a result, standalone net profit declined 22% y-o-y to Rs. 101.4 crore in Q4FY2022, while consolidated PAT declined 23.7% y-o-y to Rs. 107.4. 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 the product portfolio. Exports will also be a key driver as the company is committed towards expanding 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 as well as domestic clients helped the company maintain its revenue growth.
- Exports continue to drive robust 40.7% y-o-y growth in FY2022.

Key negatives

- Consolidated EBITDA margin missed street expectations in Q4FY2022 and declined by 150 bps q-o-q to 14.3% due to increased raw-material and logistics costs.

Our Call

Valuation – Maintain Buy with a revised PT of Rs. 1,030: SFL is witnessing strong traction from its domestic and global OEMs, driven by recovery in automotive and non-automotive demand. The outlook remains positive going forward, 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 the cost increase to customers. We are positive on SFL'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. Given the company's revenue visibility and its ability to pass on cost increases to clients, we expect EBITDA margin to normalise around 18% going forward. We have fine-tuned our earnings estimates to build the impact of increasing raw-material costs. The stock is trading at a P/E multiple of 18.3x and EV/EBITDA multiple of 11.7x its FY2024E estimates, which is trading below its average multiples. We retain our Buy rating on the stock with a revised price target (PT) of Rs. 1,030.

Key Risks

Rising commodity prices and pricing pressures from automotive OEM customers can impact its profitability.

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Net sales	3,644	4,902	6,103	7,232
Growth (%)	-2.1	34.5	24.5	18.5
EBIDTA	664	801	1,050	1,295
OPM (%)	18.2	16.3	17.2	17.9
PAT	361	462	704	879
Growth (%)	11.2	27.8	52.5	24.9
FD EPS	17.2	22	33.5	41.9
P/E (x)	48.5	38	24.9	19.9
P/BV (x)	7.5	6.7	5.6	4.7
EV/EBITDA (x)	26.8	22.1	16.1	12.7
RoE (%)	15.4	17.6	19.4	20.4
RoCE (%)	18.4	21.4	22.0	24.0

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		↑	

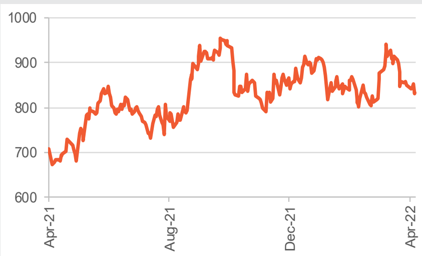
Company details

Market cap:	Rs. 17,546 cr
52-week high/low:	Rs. 993 / 655
NSE volume: (No of shares)	68,351
BSE code:	500403
NSE code:	SUNDRMFAST
Free float: (No of shares)	10.6 cr

Shareholding (%)

Promoters	49.7
FII	11.7
DII	17.7
Others	20.9

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-5.7	-8.1	-11.2	17.9
Relative to Sensex	-5.5	-1.4	-6.1	0.8

Sharekhan Research, Bloomberg

Q4FY2022 results missed expectations: Q4FY2022 results missed estimates, driven by lower-than-expected EBITDA margin due to higher raw-material and logistics costs. Standalone revenue improved by 11.9% q-o-q to Rs. 1,146 crore, while consolidated revenue declined by 11% q-o-q to Rs. 1,339.8 crore in Q4FY2022. Export continues to drive revenue with 8.7% y-o-y and 40.7% y-o-y growth in Q4FY2022 and full year FY2022, respectively. The company benefitted from higher exports, led by opening up of western geographies. EBITDA margin declined by 260 bps q-o-q for the standalone business, while that of the consolidated business declined by 150 bps q-o-q, marred by rise in raw-material and logistics costs. As a result, standalone net profit declined by 22% y-o-y to Rs. 101.4 crore in Q4FY2022, while consolidated PAT declined by 23.7% y-o-y to Rs. 107.4.

Export remains the top focus area: 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, and Navistar, among others, but General Motors and Cummins fetch a huge chunk of overseas revenue. The automotive business continues to be a dominant player in the export portfolio. SFL is working towards diversifying its export revenue through new client acquisitions and focus 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.

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 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 EVs, aerospace, and defence. The company sees a 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.

Strong broad-based growth; Expect double-digit growth in the medium term: 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 38% during FY2022-FY2024E, driven by a 21.5% revenue CAGR during and a 160-bps improvement in EBITDA margin to 17.9% in FY2024E from 16.3% in FY2022, with ROCE progressing to 24% in FY2024E.

Results (Standalone) Rs cr

Particulars	Q4FY22	Q4FY21	Y-o-Y %	Q3FY22	Q-o-Q %
Revenues	1,339.8	1,273.1	5.2	1,207.5	11.0
Total operating expenses	1,148.3	1,036.3	10.8	1,016.6	13.0
EBITDA	191.5	236.8	(19.1)	191.0	0.3
Depreciation	49.5	45.2	9.7	47.4	4.5
Interest	8.2	6.9	18.3	6.9	18.5
Other income	10.1	4.3	135.9	10.4	(3.4)
PBT	143.9	188.9	(23.9)	147.1	(2.2)
Tax	36.4	48.1	(24.3)	37.1	(1.7)
Adjusted PAT	107.4	140.8	(23.7)	110.0	(2.3)
Reported PAT	107.4	140.8	(23.7)	110.0	(2.3)
Adjusted EPS	5.1	6.7	(23.7)	5.2	(2.3)

Source: Company; Sharekhan Research

Key ratios (Standalone)

Particulars	Q4FY22	Q4FY21	Y-o-Y (bps)	Q3FY22	Q-o-Q (bps)
Gross margin (%)	53.8	58.3	(450)	55.9	(210)
EBIDTA margin (%)	14.6	19.5	(490)	17.2	(260)
EBIT margin (%)	11.2	16.1	(490)	13.4	(220)
Net profit margin (%)	8.8	12.0	(320)	10.1	(120)
Effective tax rate (%)	25.2	24.8	40	25.4	(20)

Source: Company; Sharekhan Research

Results (Consolidated) Rs cr

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Adjusted EPS	5.1	6.7	(23.7)	5.2	(2.3)

Source: Company; Sharekhan Research

Key ratios (Consolidated)

Particulars	Q4FY22	Q4FY21	Y-o-Y (bps)	Q3FY22	Q-o-Q (bps)
Gross margin (%)	54.7	59.5	(490)	57.5	(280)
EBIDTA margin (%)	14.3	18.6	(430)	15.8	(150)
EBIT margin (%)	10.6	15.1	(450)	11.9	(130)
Net profit margin (%)	8.0	11.1	(300)	9.1	(110)
Effective tax rate (%)	25.3	25.5	(20)	25.2	10

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. 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 recovery in the CV segment to continue in FY2023E and FY2024E, driven by improved economic activities, low interest rate regime, and better financing availability.

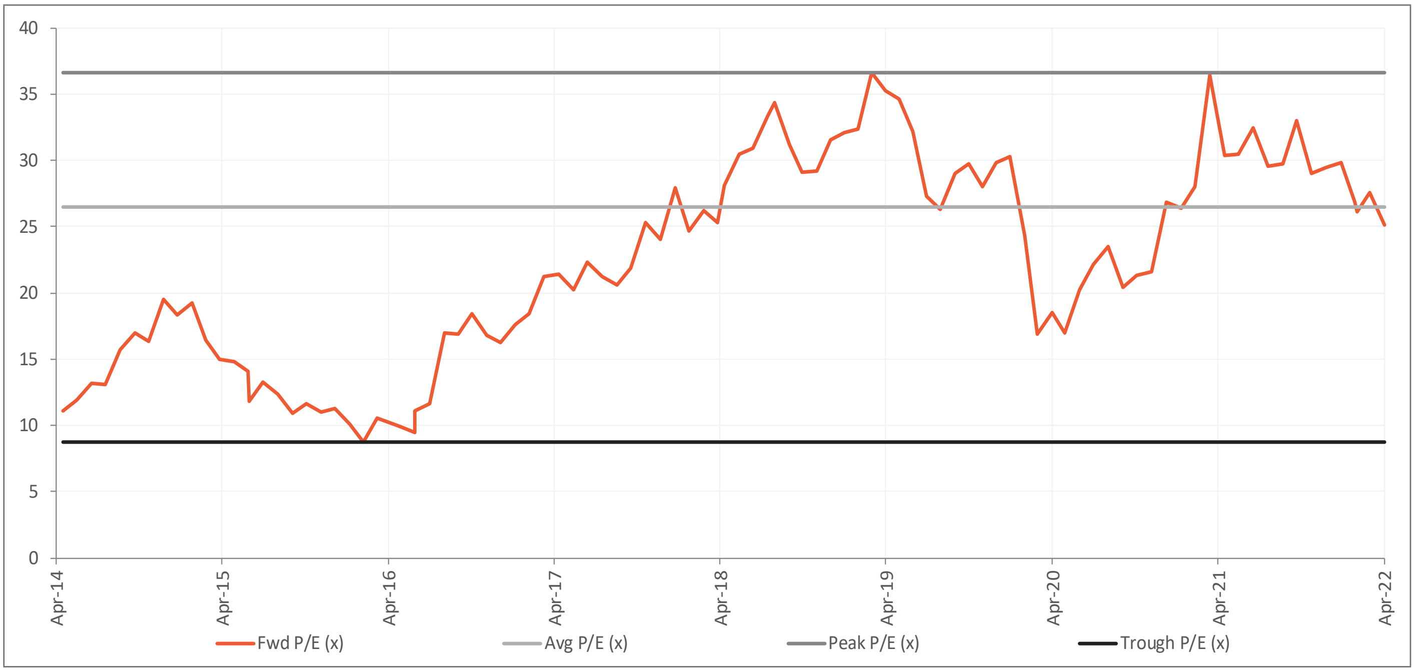
■ Company Outlook – Strong earnings growth

SFL continues to deliver strong sales in Q4FY2022, despite a tough environment. 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 expect SFL's earnings CAGR to improve by 38% during FY2022-FY2024E, driven by a 21.5% revenue CAGR and a 160-bps improvement in EBITDA margin to 17.9% in FY2024E from 16.3% in FY2022, with ROCE progressing to 24% in FY2024E. We remain positive on SFL's business prospects going forward.

■ Valuation – Maintain Buy with a revised PT of Rs.1,030:

SFL is witnessing strong traction from its domestic and global OEMs, driven by recovery in automotive and non-automotive demand. The outlook remains positive going forward, 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 the cost increase to customers. We are positive on SFL'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. Given the company's revenue visibility and its ability to pass on cost increases to clients, we expect EBITDA margin to normalise around 18% going forward. We have fine-tuned our earnings estimates to build the impact of increasing raw-material costs. The stock is trading at a P/E multiple of 18.3x and EV/EBITDA multiple of 11.7x its FY2024E estimates, which is trading below its average multiples. We retain our Buy rating on the stock with a revised price target (PT) of Rs. 1,030.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	CMP	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
	Rs/Share	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Sundram Fasteners	835	38	24.9	19.9	22.1	16.1	12.7	21.4	22	24
Suprajit Engineering	368	26.9	20	16.4	17.6	13.5	11.1	18.9	22.1	23.4
Schaeffler India	1,963	54.6	39.2	32.6	33.4	24.4	20.1	26.8	29.1	27.6

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 components 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 the 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. R Dilip Kumar	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	6.3%
4	Amansa Holdings Pvt Ltd	6.0%
5	Parikh Govindlal	2.0%
6	General Insurance Corp of India	1.7%
7	Life Insurance Corp of India	1.5%
8	New India Assurance	1.1%
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

Sharekhan

by BNP PARIBAS

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