Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Company Update

Sundram Fasteners Ltd

Shifting gears to revv up growth

Automobiles	Sharekhan code: SUNDRMFAST
Reco/View: Buy ↔	CMP: **Rs. 720**
Price Target: **Rs. 1,030** ↔	

↑ Upgrade ↔ Maintain ↓ Downgrade

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 25.48

Updated Feb 08, 2022

Medium Risk

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

Source: Morningstar

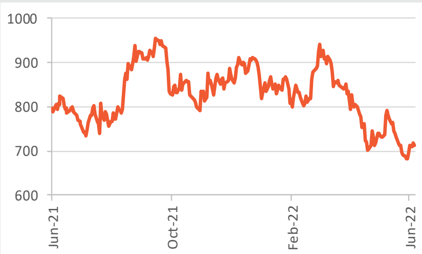
Company details

Market cap:	Rs. 15,129 cr
52-week high/low:	Rs. 993 / 675
NSE volume: (No of shares)	0.63 lakh
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	-3.4	-23.2	-17.1	-10.7
Relative to Sensex	1.7	-15.3	-11.3	-11.3

Sharekhan Research, Bloomberg

Summary

- We retain a Buy rating on Sundram Fasteners Limited (SFL) with a unchanged PT of Rs. 1,030, led by the company's strong performance outpacing the automobile industry's growth through diversifying client and product portfolios, benefiting from its established client relationships and prudent capital allocation.
- SFL is well positioned to benefit from technology shift from BS-VI to electric vehicles (EVs), 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 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 is trading below its historical valuations at P/E multiple of 17.2x and EV/EBITDA multiple of 10.8x its FY2024E estimates.

Sundram Fasteners Limited (SFL) is expected to continue outperforming the automobile industry's growth through diversifying client and product portfolios, benefiting 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 (EVs), lightweight and high weight components. 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 EVs are at a nascent stage, 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 are expected to remain robust across segments including passenger vehicles (PVs), commercial vehicle (CV), tractors and two-wheeler (2W) segments. 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's major capex plan is completed, which will enable 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 unchanged 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. OPM is set to 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, benefiting 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. The stock has corrected ~23% over the last three months due to weak market sentiments, geopolitical uncertainty raising risks on export growth and margin decline in the last two quarters. The stock is trading below its historical valuations at P/E multiple of 17.2x and EV/EBITDA multiple of 10.8x its FY2024E estimates. We reiterate our Buy rating on the stock with an unchanged PT of Rs. 1,030.

Key Risks

Geopolitical tensions can affect SFL's global business. The company's performance can also be affected by ongoing global chips shortage further aggravates.

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	22.0	33.5	41.9
P/E (x)	41.9	32.8	21.5	17.2
P/BV (x)	6.4	5.8	4.9	4.1
EV/EBITDA (x)	23.1	19.1	13.8	10.8
RoE (%)	15.4	17.6	19.4	20.4
RoCE (%)	18.4	21.4	22.0	24.0

Source: Company; Sharekhan estimates

Well-positioned to benefit from technology shift in the industry: 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. In terms of design changes in the engine segment, the company has developed more efficient products in the pump segment and variable valve transmission parts for engines.

Exports remain top focus area: Export continues to be the focus area with a strategy to de-risk business from the automobile industry's cyclicality. Exports are 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.

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-automobile segments, 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.

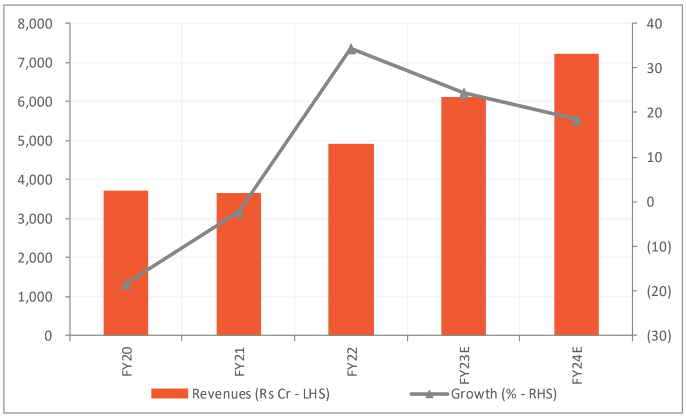
New businesses: SFL is planning to foray into new businesses. The company has plans to enter businesses such as EVs, aerospace, and defence. The company sees a huge potential in these emerging sectors and believes it will take time to have a strong foothold in new market segments. The strategy would 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.

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. SFL's major capex plan is completed, which will enable 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. 100-150 crore every year.

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.

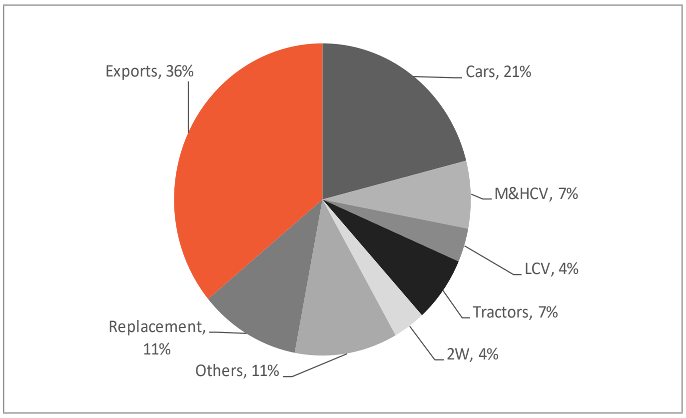
Financials in charts

Revenue and Growth Trend



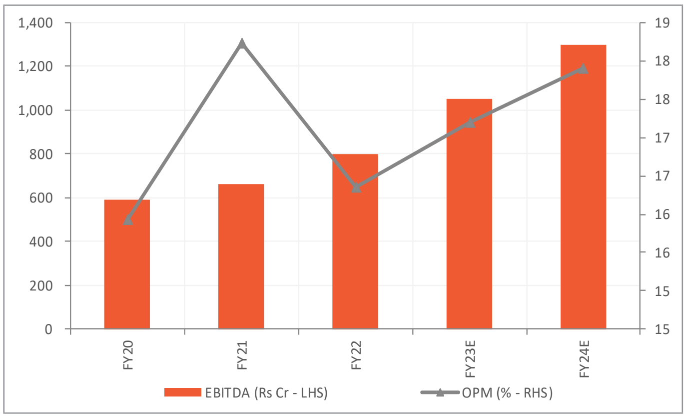
Source: Company, Sharekhan Research

Revenue Mix (%)



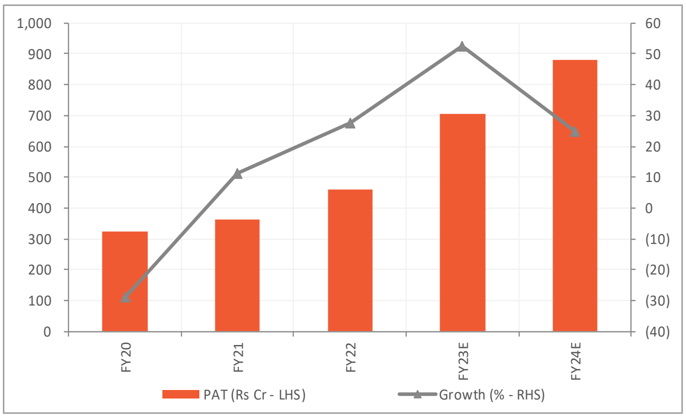
Source: Company, Sharekhan Research

EBITDA and OPM Trend



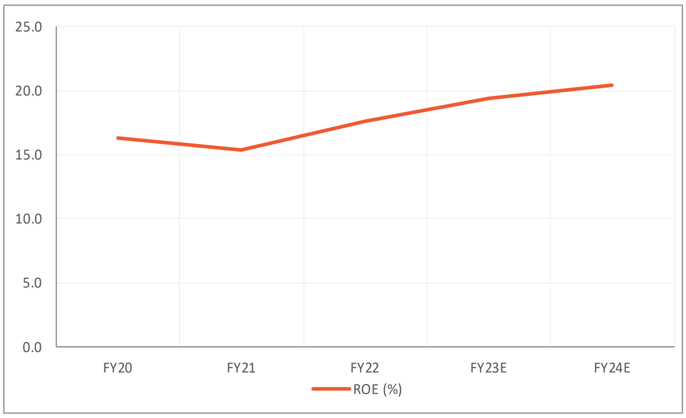
Source: Company, Sharekhan Research

Net Profit and Growth Trend



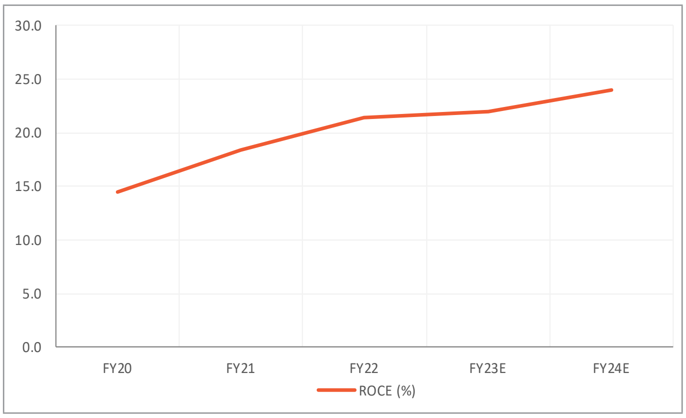
Source: Company, Sharekhan Research

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 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 and better financing availability.

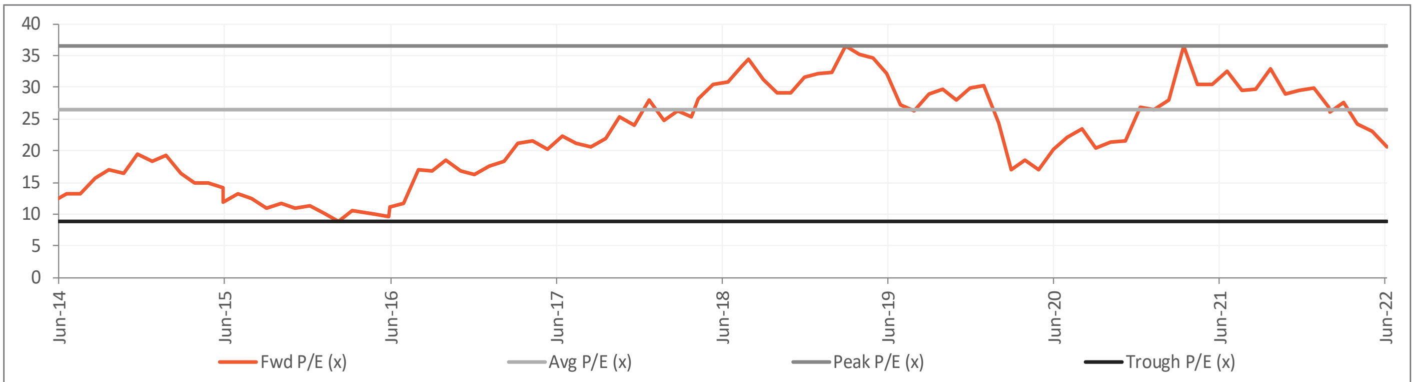
■ Company Outlook – Strong earnings growth

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 an unchanged 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. OPM is set to 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. The stock has corrected ~23% over the last three months due to weak market sentiments, geopolitical uncertainty raising risks on export growth and margin decline in the last two quarters. The stock is trading below its historical valuations at P/E multiple of 17.2x and EV/EBITDA multiple of 10.8x its FY2024E estimates. We reiterate our Buy rating on the stock with an unchanged PT of Rs. 1,030.

One-year forward P/E (x) band



Source: Company Data; Sharekhan Research

Peer Comparison

Particulars	CMP	P/E (x)			EV/EBITDA (x)			RoCE (%)		
	Rs/Share	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Sundram Fasteners	720	32.8	21.5	17.2	19.1	13.8	10.8	21.4	22.0	24.0
Suprajit Engineering	332	26.5	21.3	17.0	18.3	14.3	11.5	16.2	19.0	20.9
Schaeffler India	2,291	56.9	40.9	32.0	36.5	26.1	20.3	30.7	32.2	31.3

Source: Company Data; Sharekhan Research

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

- Geopolitical tensions can impact SFL's global business
- The company's performance can also be impacted by ongoing global chips shortage if the situation further aggravates.
- 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

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Registered Office: Sharekhan Limited, The Ruby, 18th Floor, 29 Senapati Bapat Marg, Dadar (West), Mumbai–400028, Maharashtra, INDIA, Tel: 022–67502000 / Fax: 022–24327343. 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.