Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Sundram Fasteners Ltd

Margins decline in Q2; new businesses to drive growth ahead

Automobiles	Sharekhan code: SUNDRMFAST
Reco/View: Buy ↔	CMP: **Rs. 954**
Price Target: **Rs. 1,110** ↑	

↑ 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 Aug 08, 2022

Medium Risk

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

Source: Morningstar

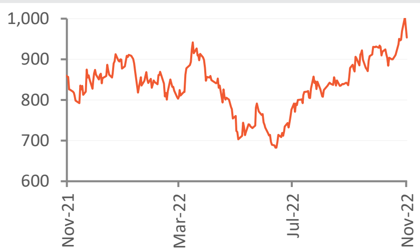
Company details

Market cap:	Rs. 20,046 cr
52-week high/low:	Rs. 1,010 / 675
NSE volume: (No of shares)	1.16 lakh
BSE code:	500403
NSE code:	SUNDRMFAST
Free float: (No of shares)	10.6 cr

Shareholding (%)

Promoters	48.5
FII	11.8
DII	18.7
Others	21.0

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	2.6	12.8	19.1	9.2
Relative to Sensex	-2.2	8.2	12.0	7.5

Sharekhan Research, Bloomberg

Summary

- We maintain a Buy on Sundram Fasteners Ltd.'s (SFL's) with a revised PT of Rs. 1,110, led by the company's dominant position in the fasteners segment, diverse client base and product portfolios, established client relationships, and prudent capital allocation.
- Q2FY23 results missed estimates, driven by lower-than-expected EBITDA margin and higher other operating costs and staff costs.
- SFL maintains its capex program of Rs. 350 crores for EVs and select ICE vehicles over the next five years and additional Rs. 300 crores for wind energy business over the next two years. However, it defers its capex of Rs100 crore to FY24E.
- The stock trades at P/E multiple of 23.1x and EV/EBITDA multiple of 14.8x its FY2024E estimates.

Q2FY23 results missed estimates, driven by lower-than-expected EBITDA margin led by higher other operating costs and staff costs. Consolidated revenue improved by 12.8% y-o-y to Rs. 1,402 crore, led by improved offtake from OEMs. Consolidated EBITDA margin contracted 140bps q-o-q in Q2, led by higher other expenses and staff costs, partially offset by softening raw material costs. As a result, standalone net profit declined 7% y-o-y to Rs. 111.8 crore in Q2FY23, while consolidated PAT declined 5.8% y-o-y to Rs. 116.8. SFL continues its efforts to de-risk its business model from dependency on one-customer or one-products. We expect strong earnings growth going forward, driven by new client acquisitions and expansion of product portfolio. Exports will also be a key driver as the company is committed to expand its export portfolio to 50% of overall revenues (from 33% currently) in 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

- Consolidated revenue improved by 12.8% y-o-y to Rs. 1,402 crores, led by improved offtake from OEMs.
- The EV business prospects remain robust going forward. The company 3% share of revenues from the EV portfolio, while the EV business share in the order book is above 10%.
- The company's board has announced an interim dividend of Rs3.57/share (357%) and an additional special dividend of Rs2/share (200%).

Key negatives

- The exports suffered a slowdown during the Q2FY23 on a sequential basis, led by chips supply constraints in the passenger vehicle segment. Thus, the management has reduced its export revenue guidance for FY23E by 10% to build in the slowdown.
- Consolidated EBITDA margin contracted 140bps q-o-q in Q2, led by higher other expenses and staff costs, partially offset by softening raw material costs. Higher other operating expenses were mainly due to inventory built-up and a small contribution of the increase in component costs.
- The company has deferred its Capex of Rs100 crore to FY24E from earlier planned for FY23E. However, the management reaffirmed its Capex for EV, select ICE vehicle segment and wind energy business.

Management Commentary

- Management expects to grow faster than the industry and is expected to be a beneficiary of increasing demand in automotive and non-automotive segments.
- The management remains positive of the domestic demand and continues to maintain its long-term goals of achieving quarterly revenue run rate of Rs2,000 crore by FY25E. T
- The company expects subsidiaries to do well, with the UK subsidicontinuingnued to improve its revenue and profitability on back of improvements in capacity utilisation, a buoyant truck market, and upward price revisions with some clients

Our Call

Valuation - Maintain Buy with a revised PT of Rs. 1,110: SFL is witnessing strong traction from its domestic and global OEMs, driven by a 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 increase in cost 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 robust 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 margins to normalise around 18% going forward. We have fine-tuned our earnings estimates to build the impact of increasing raw material costs and included FY25E estimates. The stock is trading at a P/E multiple of 23.1x and EV/EBITDA multiple of 14.8x its FY2024E estimates, which is trading below its average multiples. We retain our Buy rating on the stock with a revised PT of Rs. 1,110.

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	FY25E
Net sales	3,644	4,902	6,103	7,324	8,203
Growth (%)	(2.1)	34.5	24.5	20.0	12.0
EBIDTA	664	801	1,025	1,282	1,517
OPM (%)	18.2	16.3	16.8	17.5	18.5
PAT	361	462	686	867	1,035
Growth (%)	11.2	27.8	48.5	26.4	19.4
FD EPS	17.2	22.0	32.6	41.3	49.3
P/E (x)	55.5	43.4	29.2	23.1	19.4
P/BV (x)	8.5	7.6	6.5	5.4	4.5
EV/EBITDA (x)	30.5	25.3	18.9	14.8	12.1
RoE (%)	15.4	17.6	18.9	20.2	20.1
RoCE (%)	18.4	21.4	21.4	23.5	23.9

Source: Company; Sharekhan estimates

Missed expectations in Q2: Q2FY23 results missed estimates, driven by lower-than-expected EBITDA margin led by higher other operating costs and staff costs. Consolidated revenue improved by 12.8% y-o-y to Rs. 1,402 crore, led by improved offtake from OEMs. The company's standalone revenue was 14.6% y-o-y in Q2, led by 21% growth in domestic business and a 4.1% growth in exports. Consolidated EBITDA margin contracted 140bps q-o-q in Q2, led by higher other expenses and staff costs, partially offset by softening raw material costs. Higher other operating expenses was largely due to inventory built-up and small contribution of the increase in component costs. As a result, standalone net profit declined 7% y-o-y to Rs. 111.8 crore in Q2FY23. In comparison, consolidated PAT declined 5.8% y-o-y to Rs. 116.8. Export and non-automotive segments remain the top focus areas for the management to de-risk business from cyclicality. The company's board has announced an interim dividend of Rs3.57/share (357%) and an additional special dividend of Rs2/share (200%).

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 enormously, almost near to pre-COVID levels across segments with commercial vehicle (CV) and passenger vehicle (PV) segments showing strong signs of recovery. The aftersales 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 by 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.

Management outlook: The management remains positive of the domestic demand and continues to maintain its long-term goals of achieving a quarterly revenue run rate of Rs2,000 crore by FY25E. The company expects subsidiaries to do well, with UK subsidiary continued to improve its revenue and profitability on the back of improvements in capacity utilisation, a buoyant truck market, and upward price revisions with some clients. Q2 exports were impacted by COVID-induced restrictions in China, which is expected to recover in Q3FY23.

Export remains the top focus area, despite witnessing a slowdown in Q2: The exports suffered a slowdown during Q2FY23 on a sequential basis, led by chip supply constraints in passenger vehicle segment, while the commercial vehicle segment continues to grow. The company has reduced its export revenue guidance for FY23E by 10% to build in the slowdown. However, it has maintained its FY24E export estimates and long-term goals. Export is one of the 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 an export 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 focusing on non-automotive segments. The company has substantial exposure to US, UK, and China, where demand has witnessed a strong response, aided by big stimulus packages by respective governments.

New businesses and increased capex allocation: The company has maintained its capex program as announced earlier. A capex of Rs100 crore has been deferred to FY24E, on the back of order book situations. Thus, the company has now revised its FY23E capex to Rs300 crore.SFL is witnessing strong traction in EVs and new businesses. The company plans to build capacities to meet the rising demand in the new segments. The company has allocated to invest ~Rs. 350 crores over the next five years for manufacturing advanced automotive technology components such as powertrain assemblies for EV and select ICE vehicles. The company focuses on different shafts (e.g. input, output and intermediate shafts) for EVs. Also, the company has announced a further capex of Rs. 300 crores over the next two years to meet increasing demand in wind energy business. The company is focusing on new products such 4as tower fasteners, valve body housing and swash plate for hydraulic power system, electric water pumps for a passenger utility vehicle, and sintered pulleys for electric scooter application. The management will meet capex through internal accruals largely but can look for external borrowing options, if the demand outpaces the company's expectations and the company decides to expedite the capex plans. With the planned capex, the company is well poised to outpace industry growth rates. Historically, the company has grown at least 5-6% faster than the industry.

Strong broad-based growth; Expect double-digit growth in the medium term: SFL has a solid 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 37% during FY2022-FY2024E, driven by a 22.2% revenue CAGR during and a 120- bps improvement in EBITDA margin to 17.5% in FY2024E from 16.3% in FY2022, with ROCE progressing to 24% in FY2024E.

Results (Consolidated) Rs cr

Particulars	Q2FY23	Q2FY22	YoY %	Q1FY23	QoQ %
Revenues	1,401.7	1,242.3	12.8	1,410.1	(0.6)
Total operating expenses	1,197.0	1,023.8	16.9	1,184.6	1.0
EBITDA	204.7	218.4	(6.3)	225.5	(9.2)
Depreciation	49.3	47.3	4.4	48.6	1.4
Interest	8.1	5.8	38.8	8.9	(9.2)
Other income	9.7	1.8	452.3	11.6	(16.1)
PBT	157.0	167.1	(6.0)	179.6	(12.6)
Tax	40.2	43.2	(6.9)	41.5	(3.2)
Adjusted PAT	116.8	123.9	(5.8)	138.0	(15.4)
Reported PAT	116.8	123.9	(5.8)	138.0	(15.4)
Adjusted EPS	5.6	5.9	(5.8)	6.6	(15.4)

Source: Company, Sharekhan Research

Key ratios (Consolidated)

Particulars	Q2FY23	Q2FY22	YoY (bps)	Q1FY23	QoQ (bps)
Gross margin (%)	56.8	59.3	(250)	55.2	160
EBIDTA margin (%)	14.6	17.6	(300)	16.0	(140)
EBIT margin (%)	11.1	13.8	(270)	12.5	(150)
Net profit margin (%)	8.3	10.0	(160)	9.8	(150)
Effective tax rate (%)	25.6	25.8	(20)	23.1	250

Source: Company, Sharekhan Research

Results (Standalone) Rs cr

Particulars	Q2FY23	Q2FY22	YoY %	Q1FY23	QoQ %
Revenues	1,218.2	1,063.1	14.6	1,239.6	(1.7)
Total operating expenses	1,032.6	863.3	19.6	1,031.4	0.1
EBITDA	185.6	199.7	(7.1)	208.3	(10.9)
Depreciation	39.4	38.0	3.7	38.8	1.7
Interest	4.3	2.1	109.2	5.0	(13.6)
Other income	7.7	1.2	527.9	6.6	16.4
PBT	149.5	160.9	(7.1)	171.1	(12.6)
Tax	37.7	40.7	(7.3)	41.0	(8.0)
Adjusted PAT	111.8	120.2	(7.0)	130.1	(14.1)
Reported PAT	111.8	120.2	(7.0)	130.1	(14.1)
Adjusted EPS	5.3	5.7	(7.0)	6.2	(14.1)

Source: Company, Sharekhan Research

Key ratios (Standalone)

Particulars	Q2FY23	Q2FY22	YoY (bps)	Q1FY23	QoQ (bps)
Gross margin (%)	55.4	57.9	(250)	54.2	120
EBIDTA margin (%)	15.2	18.8	(360)	16.8	(160)
EBIT margin (%)	12.0	15.2	(320)	13.7	(170)
Net profit margin (%)	9.2	11.3	(210)	10.5	(130)
Effective tax rate (%)	25.2	25.3	(10)	24.0	130

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector View – Positive led by pent-up demand

We stay positive on the structural demand for automobiles in the medium term. We 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 and four-wheelers, is expected to remain strong amid COVID-19, as a 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 a recovery in the CV segment to continue in FY2023E and FY2024E, driven by improved economic activities and better financing availability.

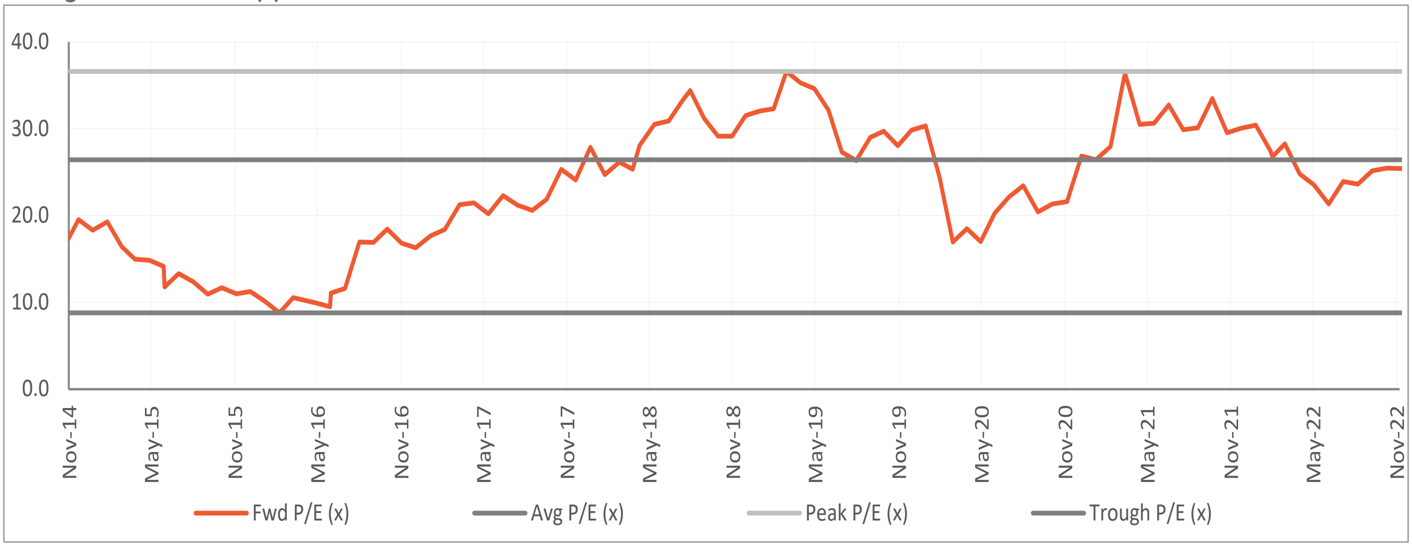
■ Company Outlook – Strong earnings growth potential

SFL continues to deliver strong sales in Q2FY23, despite a tough environment. We expect SFL to benefit from 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 solid 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 37% during FY2022-FY2024E, driven by a 22.2% revenue CAGR during and a 120- bps improvement in EBITDA margin to 17.5% in FY2024E from 16.3% in FY2022, with ROCE progressing to 24% in FY2024E. We remain positive on SFL's business prospects in the future.

■ Valuation – Maintain Buy with a revised PT of Rs. 1,110

SFL is witnessing strong traction from domestic and global OEMs, driven by a recovery in automotive and non-automotive demand. 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 increase in cost 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 margins to normalise around 18% going forward. We have fine-tuned our earnings estimates to build the impact of increasing raw material costs and included FY25E estimates. The stock is trading at a P/E multiple of 23.1x and EV/EBITDA multiple of 14.8x its FY2024E estimates, which is trading below its average multiples. We retain our Buy rating on the stock with a revised PT of Rs. 1,110.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Companies	CMP (Rs/ Share)	P/E (x)			EV/EBITDA (x)			ROCE (%)		
		FY22*	FY23E*	FY24E*	FY22*	FY23E*	FY24E*	FY22*	FY23E*	FY24E*
Sundram Fasteners	954	43.4	29.2	23.1	25.3	18.9	14.8	21.4	21.4	23.5
Suprajit Engineering	331	26.5	23.3	17.1	18.3	15.5	11.6	16.2	17.6	20.9
Schaeffler India	2,911	72.3	50.8	39.6	46.5	32.8	25.4	30.9	32.9	32.0

Source: Company; Sharekhan Research
**Note: For Schaeffler the years are CY21, CY22E and CY23E*

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 an 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 done 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 expanding 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

- Global exposure can bear impact of fluctuating forex currency.
- 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 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

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