Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Schaeffler India Ltd

Consistently exerting for upbeat

Automobiles	Sharekhan code: SCHAEFFLER
Reco/View: Buy ↔	CMP: Rs. 2,943	Price Target: Rs. 3,328 ↔

↑ 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 22.37

Updated Dec 08, 2022

Medium Risk

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

Source: Morningstar

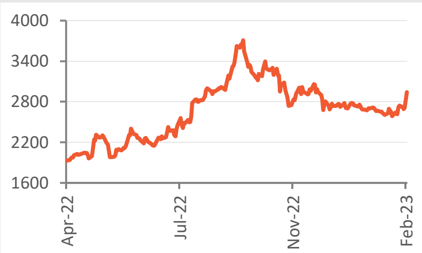
Company details

Market cap:	Rs. 46,000 cr
52-week high/low:	Rs. 3,969 / 1,600
NSE volume: (No of shares)	0.8 lakh
BSE code:	505790
NSE code:	SCHAEFFLER
Free float: (No of shares)	4.0 cr

Shareholding (%)

Promoters	74.1
FII	4.8
DII	15.1
Others	6.0

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	8.9	7.9	-6.9	50.9
Relative to Sensex	8.3	8.2	-13.7	46.7

Sharekhan Research, Bloomberg

Summary

- We maintain our Buy rating on Schaeffler India Limited (SIL) with an unchanged PT of Rs 3,328 due to rising export revenue, improvement in profitability, and focus on localisation.
- EV proliferation would double its content per vehicle due to focus on the supply of systems and assemblies.
- SIL has revised its capex guidance from Rs. 1,000 crores to Rs, 1,500 crore over CY2020-CY2024, indicating a higher focus on localisation for an operating excellence.
- Management is strategically looking to expand its export business on the group's relocation strategy, increased localisation, and cost-effective value-added production.

For Q4FY2022, Schaeffler India Limited (SIL) reported in-line results with estimates backed by healthy traction in exports, strong performance in the domestic aftermarket business, and sharp EBITDA margin expansion led by gross margin expansion. While revenue missed our estimates marginally by 1.6%, EBIDTA and PAT were 3.3% and 3.0% ahead of estimates, respectively. The key positive of the result was strong performance in the export business and EBITDA margin expansion on a q-o-q basis. Revenue increased by 2.2% q-o-q to Rs. 1,795 crores on account of strong performance in the export business, as the domestic business was marginally down sequentially. While exports revenue increased by 17.5% q-o-q and contributed 18.5% to the top line (vs. 16.1% in Q3CY2022), domestic revenue declined by 0.8% q-o-q and contributed 81.5% to the top line (vs. 83.9% in Q3CY2022). In the domestic market, the decline in auto OEM and industrial revenue was largely netted off by strong growth in the domestic after market. The domestic auto and industrial segment registered a 2.3% q-o-q and 2.2% q-o-q decline in revenue, respectively, while the domestic aftermarket registered a 12.3% q-o-q increase in revenue. With improved product mix and robust export volumes, gross margin expanded by 200 bps q-o-q and consequently EBITDA margin expanded by 110 bps q-o-q to 19.2%. The improvement in EBITDA margin translated in to a 7.2% q-o-q increase in PAT to Rs. 231 crore. Along with the result, the company has announced a dividend of Rs. 24/share. Management is continuously focussing on localization and is strategically looking to expand its export business, which in our view would improve its overall profitability in coming years. Along with ICs and railway business, SIL has been increasing its proficiency in the EV business and has guided that the EV business would offer it an opportunity to double its content per vehicle compared to the available content per vehicle in ICs space. We continue to maintain our Buy rating on the stock with a price target (PT) of Rs 3,328.

Key positives

- Exports revenue increased by 17.5% q-o-q and contributed 18.5% to the topline (vs. 16.1% in Q3CY2022).
- Gross margin expanded by 200 bps q-o-q and resulted into 110 bps q-o-q expansion in EBITDA margin.
- The domestic aaftermarket segment registered 12.3% q-o-q growth and contributed 9.4% to the total revenue (vs. 8.6% in Q3CY2022).
- The company has incurred capex of Rs. 182.7 crore in Q4CY2022 and Rs. 499 crore in CY2022 (vs. Rs. 337 crore in CY2021). The rising trend of capex indicates that the company is focussing on localisation to reduce outsourcing of products.
- The company has completed a few of the projects and begins revenue generation from them.

Key negatives

- The domestic automotive business declined by 2.3% q-o-q and domestic industrial business fell by 2.2% q-o-q. Performance of the industrial segment was impacted by muted performance in the wind energy segment.
- Other expenses as a percentage of sales rose by 120 bps q-o-q.

Management Commentary

- Capex over CY2022 to CY2024 has been revised upward from Rs. 1,000-1,200 crore to Rs. 1,500 crore on account of visibility in the overseas business, and setting up of plants for futuristic products in the automotive segment and for the industrial segment. Iincreased capex would reduce the need of outsourcing and, hence, profitability would improve on the completion of the projects.
- The aftermarket segment has been performing well on the introduction of new launches, including BSVI products.
- Revenue contribution from wind energy came down in H2CY2022 compared to H1CY2022 due to geopolitical issues. In H1CY2022, the wind energy segment contributed 10-12% to the topline.

Our Call

Valuation – Upgrade to Buy with an unchanged PT of Rs. 3,328: Post reporting the decent performance in Q3FY2023, the company has increased its capex programme and guided for a capex of Rs. 1,500 crore over CY2022-CY2024E compared to the earlier plan of Rs. 1,000 crore to Rs. 1,200 crore. Increased capex would improve the localisation and, hence, profitability on the shift in opex (outsourced products) to capex. Though export markets are facing headwinds, the company indicates for a healthy traction in export on account of its strategic initiatives, localisation, and relocation strategy in overall group. Schaeffler is assumed to be one of the key beneficiaries of China Plus 1 theme, followed by global players. Along with a strong position in railway and IC business, the company is focusing on the EV business and guided for a doubling of content per vehicle on the shift in business from ICs to EVs. While the company is facing headwinds in the overseas wind energy segment, it foresees a rising opportunity in the domestic wind energy segment. We continue to remain positive on SIL due to consistent performance, rising export, increasing localisation, positive outlook on the domestic PV segment, traction in the railway business, and strong presence in the aftermarket segment. We maintain our Buy rating on the stock with a TP of Rs. 3,328. The stock trades at a P/E multiple of 38.9x and EV/EBITDA multiple of 24.4x its FY2025 estimates.

Key Risks

A weakening global outlook and uncertainties can disrupt the supply chain and increase costs, which may affect our future estimates.

Valuation (Consolidated) Rs cr

Particulars	CY20	CY21	CY22E	CY23E	CY24E
Net Sales	3762	5561	6867	7983	9120
Growth (%)	-13.7	47.8	23.5	16.2	14.2
EBIDTA	536	972	1294	1557	1797
OPM (%)	14.3	17.5	18.8	19.5	19.7
Recurring PAT	291	629	879	1026	1183
Growth (%)	-20.9	116.2	39.8	16.6	15.4
EPS (Rs.)	18.6	40.3	56.3	65.6	75.7
PE (x)	158.1	73.1	52.3	44.9	38.9
P/BV (x)	15.5	14.6	12.6	10.7	9.3
EV/EBIDTA (x)	83.5	45.9	34.3	28.4	24.4
RoE (%)	9.4	18.4	21.8	22.2	22.2
RoCE (%)	9.7	18.6	21.9	22.3	22.3

Source: Company; Sharekhan estimates

Infra capex drives order book: The introduction of Vande Bharat trains would augur well for SIL's railway segment as content per vehicle rises on the introduction of new locomotives on the adoption of advanced technologies. While business from the overseas wind energy segment has been tapering off, the domestic wind energy segment is appearing promising. Similarly, the Indian government's focus on the wind energy segment would enhance SIL's order book as it is a leading player in the wind energy segment. The overseas wind energy business is impacting due to geopolitical issues.

Rising opportunity in export markets: Though the export market has been facing challenges, SIL has been registering healthy improvement in the export business owing to (1) strategic relocation of a part of business in the overall group to India due to low-cost production and technical expertise on Indian unit, (2) China Plus One strategy following by global players, and (3) Indian unit has been incurring capex to develop relevant products for export markets. Management assumes the traction in export revenue will continue due to its long-term strategic initiatives. The export revenue mix is broadly the same among Asia, Europe, and U.S.

Increased localisation would expand profitability: The company has been continuously investing on capacity addition and has ended CY2022 with capex of Rs. 499 crore against Rs. 347 crore in CY2021. Further, the company has revised its capex upward for CY2022-CY2024 to Rs. 1,500 crore from its earlier plan of Rs. 1,000-Rs. 1,200 crore, as the company is setting up new plants for futuristic products in the automotive segment and another plant for the industrial division. The increase in capex indicates that the company is increasing localisation, which would improve its profitability on shift of opex (outsourcing) to capex.

Growing opportunities with railway: The railway segment contributes 4-5% to the topline. SIL has been strongly present in the metro segment and provided bearings, traction motors as well as sub-assemblies. The company is looking to expand its capacities for railway-related supplies. Currently, it has been importing some of the components from Europe. However, going forward, it plans to localise them in India due to visibility of volumes. The company is also looking to boost its presence in the cost-sensitive freight segment.

Content per vehicle would double in EVs: Scheffler has won a new system order in e-mobility segment. It is a 3-in-one e-axle system, which comprises an electric motor, gear box, and electronic parts. While the gear box and motor would be an in-house design, the company would outsource the electronic parts from its business partners. The company believes the EV business would be much superior to the ICs business, as it indicates that content per vehicle would double on shift in the business from ICs to EVs.

Results (Standalone) Rs cr

Particulars	Q4CY22	Q4CY21	Y-o-Y %	Q3CY22	Q-o-Q %
Net revenue	**1,795**	**1,523**	**17.8**	**1,756**	**2.2**
Operating expenses	**1,449**	**1,236**	**17.3**	**1,437**	**0.8**
EBIDTA	**345**	**287**	**20.2**	**319**	**8.2**
Depreciation	53	51	3.6	52	2.5
Interest	1	1	6.9	1	9.4
Other Income	18	22	(16.2)	23	(21.1)
PBT	310	257	20.5	290	6.9
Tax	79	66	18.6	74	5.9
Reported PAT	231	191	21.1	215	7.2
Adjusted PAT	**231**	**191**	**21.1**	**215**	**7.2**
EPS	**14.8**	**12.2**	**21.1**	**13.8**	**7.2**

Source: Company; Sharekhan Research

Key ratios

Particulars	Q4CY22	Q4CY21	Y-o-Y (bps)	Q3CY22	Q-o-Q (bps)
Gross margin (%)	39.0	38.9	10	37.0	200
EBIDTA margin (%)	19.2	18.9	40	18.2	110
Net profit margin (%)	12.9	12.5	40	12.3	60
Effective tax rate (%)	25.4	25.8	(40)	25.6	(20)

Source: Company; Sharekhan Research

Segment-wise Performance

Rs cr

Segment Revenue	Q4CY22	Q4CY21	Y-o-Y %	Q3CY22	Q-o-Q %
(a) Mobility components and related solutions	**1,430.9**	**1,276.8**	**12.1**	**1,410.9**	**1.4**
- Automotive Technologies	700.5	567.2	23.5	717.1	(2.3)
- Automotive Aftermarket	169.1	152.2	11.1	150.6	12.3
- Industrial	320.7	375.8	(14.7)	335.3	(4.4)
- Exports & Others	240.6	181.6	32.5	208.0	15.7
(b) Others	**363.8**	**246.4**	**47.6**	**345.5**	**5.3**
- Industrial	271.9	213.8	27.1	270.5	0.5
- Exports & Others	91.9	32.6	182.1	75.0	22.6
Net revenue	**1,794.7**	**1,523.2**	**17.8**	**1,756.4**	**2.2**
EBIT (Rs cr)	**Q4CY22**	**Q4CY21**	**%YoY**	**Q3CY22**	**%QoQ**
(a) Mobility components and related solutions	222.9	198.4	12.4	202.0	10.4
(b) Others	69.3	37.6	84.4	65.3	6.2
Total	**292.2**	**236.0**	**23.8**	**267.3**	**9.3**
EBIT Margin (%)	**Q4CY22**	**Q4CY21**	**YoY (bps)**	**Q3CY22**	**QoQ (bps)**
(a) Mobility components and related solutions	15.6	15.5	4	14.3	126
(b) Others	19.1	15.3	380	18.9	16
Total	**16.3**	**15.5**	**79**	**15.2**	**107**
Geography wise revenue	**Q4CY22**	**Q4CY21**	**%YoY**	**Q3CY22**	**%QoQ**
Domestic	1462.1	1309.1	11.7	1473.5	(0.8)
Exports	332.5	214.1	55.3	282.9	17.5
Total	1794.7	1523.2	17.8	1756.4	2.2
Domestic / export mix	**Q4CY22**	**Q4CY21**	**%YoY**	**Q3CY22**	**%QoQ**
Domestic	81.5%	85.9%		83.9%	
Exports	18.5%	14.1%		16.1%	
Total	100%	100%		100%	

Source: Company; Sharekhan Research

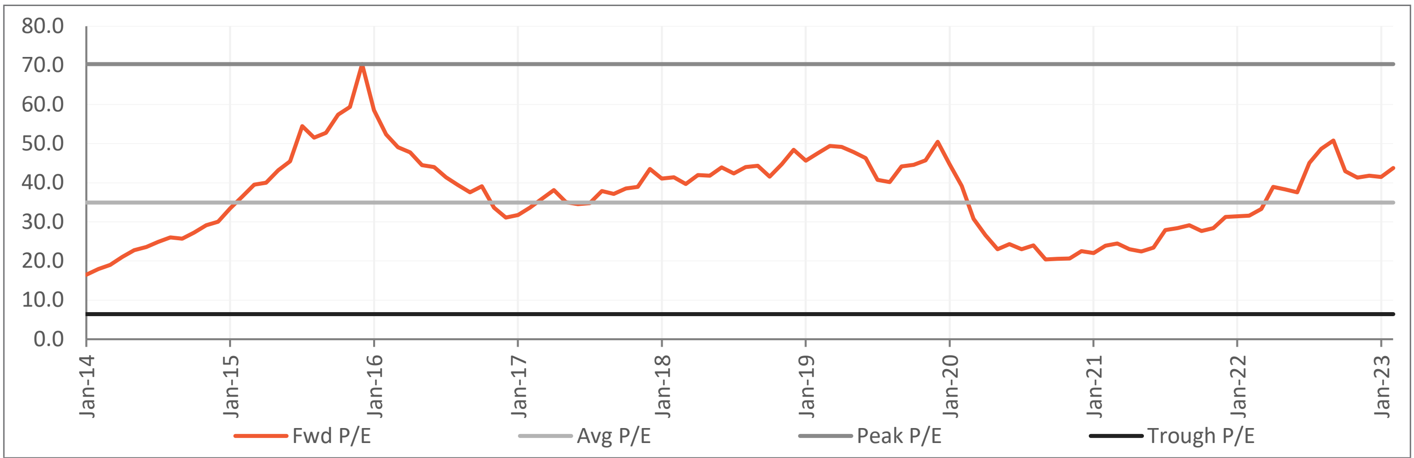
Outlook and Valuation

■ **Sector Outlook – Demand picking up in the automotive and industrial sector:** The passenger segment, both for two-wheelers and four-wheelers, is expected to remain strong, as the preference for personal transport rises. Rural demand is expected to improve on positive sentiments. We expect sequential improvement in M&HCV sales to continue, driven by the rise in e-commerce, agriculture, infrastructure, and mining activities. We expect a multi-year upcycle in the CV segment, driven by improved economic activities, low-interest rate regime, and better financing availability. We expect M&HCVs to outpace other automobile segments in the medium term, followed by growth in the tractor, PV, and 2W 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 with strong technological parentage and robust balance sheet:** SIL is part of Germany's Schaeffler Group. The Schaeffler Group has a strong research and development (R&D) DNA. In CY2021, the group filed 1,784 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 the Asia-Pacific region. This provides a huge growth potential for the company. SIL is a debt-free company with a strong return-ratio profile. The company is expected to generate strong FCF of Rs. 1,200 crore over the next three years. We remain positive on the company's growth prospects.

■ **Valuation – Maintain Buy with unchanged PT of Rs. 3,328:** Post reporting the decent performance in Q3FY2023, the company has increased its capex programme and guided for a capex of Rs. 1,500 crore over CY2022-CY2024E compared to the earlier plan of Rs. 1,000 crore to Rs. 1,200 crore. Increased capex would improve the localisation and, hence, profitability on the shift in opex (outsourced products) to capex. Though export markets are facing headwinds, the company indicates for a healthy traction in export on account of its strategic initiatives, localisation, and relocation strategy in overall group. Schaeffler is assumed to be one of the key beneficiaries of China Plus 1 theme, followed by global players. Along with a strong position in railway and IC business, the company is focusing on the EV business and guided for a doubling of content per vehicle on the shift in business from ICs to EVs. While the company is facing headwinds in the overseas wind energy segment, it foresees a rising opportunity in the domestic wind energy segment. We continue to remain positive on SIL due to consistent performance, rising export, increasing localisation, positive outlook on the domestic PV segment, traction in the railway business, and strong presence in the aftermarket segment. We maintain our Buy rating on the stock with a TP of Rs. 3,328. The stock trades at a P/E multiple of 38.9x and EV/EBITDA multiple of 24.4x its FY2025 estimates.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer valuation

Particulars	CMP (Rs / Share)	P/E (x)			EV/EBITDA (x)			ROCE (%)		
		FY22*	FY23E*	FY24E*	FY22*	FY23E*	FY24E*	FY22*	FY23E*	FY24E*
Schaeffler India	2,943	73.1	52.3	44.9	45.9	34.3	28.4	18.6	21.9	22.3
Sundram Fasteners	994	45.2	41.3	30.0	26.3	23.7	17.9	21.4	16.1	20.0
Suprajit Engineering	359	28.7	31.6	24.8	19.8	17.6	13.7	16.2	15.7	17.1
Bosch	18,010	43.6	36.7	27.9	33.1	25.9	19.1	13.9	15.6	18.2

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

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 wide 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 capabilities 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. 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.
- Weakening global outlook and uncertainties can disrupt supply chain and increase costs, which may affect our future estimates.

Additional Data

Key management personnel

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

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Fag Kugelfischer Gmbh	27.30
2	Schaeffler Buhl Verwaltungs Gmbh	20.60
3	Schaeffler Verwaltungsholding Sechs Gmbh	15.00
4	Industriewerk Schaeffler Ina-ingenieurdienst Gmbh	11.30
5	Kotak Mahindra AMC	3.50
6	SBI AMC	2.18
7	UTI AMC	1.59
8	Sundaram Mutual Fund	1.03
9	Axis AMC	0.95
10	Canara Robeco AMC	0.90

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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