Sharekhan by BNP PARIBAS

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Stock Update

Result Update

Sundram Fasteners Ltd

Mixed quarter, Hoping for better Q4

Automobiles	Sharekhan code: SUNDRMFAST
Reco/View: Buy ↔	CMP: **Rs. 972**
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 20.59

Updated Dec 08, 2022

Medium Risk

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

Source: Morningstar

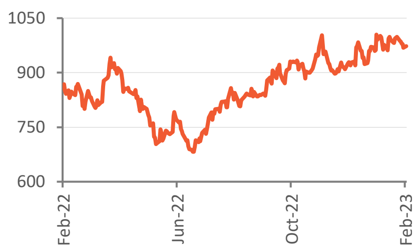
Company details

Market cap:	Rs. 20,424 cr
52-week high/low:	Rs. 1,029 / 675
NSE volume: (No of shares)	0.4 lakh
BSE code:	500403
NSE code:	SUNDRMFAST
Free float: (No of shares)	10.8 cr

Shareholding (%)

Promoters	48.5
FII	11.7
DII	18.8
Others	21.0

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	1.1	0.4	20.9	13.3
Relative to Sensex	1.5	1.2	14.6	10.7

Sharekhan Research, Bloomberg

Summary

- We maintain a Buy on Sundram Fasteners Ltd.'s (SFL's) with an unchanged 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.
- Though SFL missed our expectations in Q3FY2023, but the operating performance is expected to be better in Q4FY2023 on a sequential basis, led by improvement in export revenue and soft RM cost benefit with a lag.
- The increase in revenue from non-auto business, export business and EV business would translate into improvement in its performance as SFL has embarked a Rs 1000 cr capex over FY2023-2025.
- The stock trades at P/E multiple of 23.2x and EV/EBITDA multiple of 13.9x its FY2025E estimates.

Standalone revenue increased by 0.7% q-o-q to Rs 1,226cr, led by 1.4% q-o-q increase in domestic revenue and 3.5% q-o-q decline in export revenue. The decline in export revenue is attributed to production constraints at OEMs end due to shortage in the supply of semiconductor chips. Standalone EBITDA margin contracted by 70 bps q-o-q to 14.6% (against our estimate of 15.0%) due to the absence of gross margin expansion. The company has yet to benefit from a correction in commodity cost as the changes in raw material cost reflects in its financials with a lag of a quarter and based on its negotiations with the OEMs for price hikes. Gross margin contracted by 240 bps q-o-q. However, better cost control management halted the deterioration in the EBITDA margin. With this operating performance, the standalone PAT declined by 5.0% q-o-q. Though the operating performance was impacted in Q3FY2023 due to RM cost pressure, the operating performance is expected to be better in Q4FY2023 on a q-o-q basis in expectation of (1) improvement in export revenue on account of better production cycle on a q-o-q basis (2) benefit of softening in commodity cost and recovery of past hikes from customers and its ongoing cost control management. SFL is continuously de-risking its business via diversifying its customer and geography base. The EBITDA margin is expected to improve from current levels due to increased revenue contribution from the non-auto segment, EV segment and exports but substantial uptick would be led by a significant correction in raw material prices. The company has 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

- Other expenses (standalone) as a percentage of sales improved by 190 bps q-o-q to 31.5% and arrested the contraction in EBITDA margin.
- SFL has received a multiyear order of USD 250 mn (Rs 2050 cr) from global OEMs for its EV projects.

Key negatives

- The exports suffered a slowdown during the Q3FY23 on a sequential basis, led by chip supply constraints. Export revenue declined by 3.5% q-o-q
- Continued under recovery and delay in reimbursements from OEMs translated into gross margin contraction. The gross margin contracted by 240 bps q-o-q. Consequently, EBIDTA margin contracted by 70 bps on q-o-q basis.

Our Call

Valuation – Maintain Buy with an unchanged PT of Rs. 1,110: While Q3FY2023 performance was impacted due to raw material cost pressure, the operating performance is expected to improve in Q4FY2023 due to probable recovery of higher input cost from customers and increase in export volumes, given SFL is expected to continue to outperform in the domestic market. Going forward, SFL is expected to build up a strong EV portfolio as it has started receiving prestigious export orders in the EV space. The profitability in EV space is assumed to be better than that of legacy business. The increase in revenue contribution from EV segment, exports and non-auto segment would improve its profitability from current level, however substantial improvement in its operating performance would be visible once the benefit of soft raw material cost would filter into its financials. SFL is witnessing strong traction from its domestic and global OEMs, driven by a recovery in automotive and non-automotive demand. 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. 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 23.2x and EV/EBITDA multiple of 13.9x its FY2025E estimates. Though the stock is trading at premium valuation compared to peers and close to its 7-year average P/E multiple, we believe that its renewed focus on EV business and export-oriented business model justifies the premium valuations. We retain our Buy rating on the stock with an unchanged 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	5,758	6,622	7,416
Growth (%)	-2.1	34.5	17.5	15.0	12.0
EBIDTA	664	801	858	1126	1372
OPM (%)	18.2	16.3	14.9	17.0	18.5
PAT	361	462	506	695	879
Growth (%)	11.2	27.8	9.6	37.4	26.4
FD EPS	17.2	22.0	24.1	33.1	41.8
P/E (x)	56.5	44.2	40.4	29.4	23.2
P/BV (x)	8.7	7.8	6.9	5.9	5.0
EV/EBITDA (x)	31.1	25.7	23.1	17.4	13.9
RoE (%)	15.4	17.6	13.8	16.9	18.4
RoCE (%)	18.4	21.4	16.1	20.0	21.7

Source: Company; Sharekhan estimates

Q4FY2023 would be better on q-o-q basis

The Q3Fy23 performance was impacted due to a chip shortage issue in export markets and under recoveries, however the performance is expected to improve in Q4 on account of expectation of improvement in export markets and recoveries pertain to raw material cost from OEMs. CV OEMs in US markets are indicating for an improvement in business in CY23 compared to Cy22. In domestic market the company continue to aim to outperform the industry growth due to its diversified customer and segment portfolio. CV, PV and tractor segment contributes 30%, 30-35%, and 10-15% to its top line, respectively. Further, the wind energy segment, which is currently contributing 5% to the top line, would likely witness an acceleration in revenue in FY24. Though currently export revenue growth is facing headwinds due to the external market situation but company continue to endeavour to generate 50% of its revenue from export markets in medium term. With increased revenue contribution from EV, non-auto and export business, the EBITDA margin would improve. Still, substantial improvement in EBITDA margin would be driven by the significant correction in raw material costs.

Scheduled capex of Rs 1000 cr over next 3 years

The company has scheduled a Rs 1,000 cr capex program over Fy2023 to 2025. In order to build its legacy business, the company is aiming to develop new products and new technologies to cater to diversified set of customers and industry segments. Out of Rs 1000 cr SFL has earmarked Rs 350cr for EV related capex as it is expected to gain traction in the EV business in coming years.

Export business likely to be better in FY2024

The company has substantial exposure in USA, China and Europe. Though the Chinese market was weak in Q3FY2023 due to covid related headwinds the Chinese market is expected to perform better in Q4 on sequential basis due to opening of markets. SFL caters to the auto as well as construction segment in Chinese market. The CV segment is doing relatively better in European market due to increase in e commerce activities and need of last mile delivery. Despite macro concerns the CV segment in US is expected to do better in Cy23 compared to CY22 due to delay in replacement cycle as chip shortage impacted the production in recent past.

EV projects would more profitable

SFL is aiming to build up strong product portfolio for EV business in next 4- 5 years as it has already planned to invest Rs 350 cr for EV related projects. EV projects are expected to be more profitable than that of the legacy business as EV projects are expected to deliver EBIDTA margin around at 20% and ROCE at 25% compared to its EBITDA margin (excluding the benefits of PLI scheme) at 16.3% and ROCE at 21.4% (in FY22). Recently SFL has received an order of USD 250 mn (ct Rs 2050 cr) over six years from a leading global OEM. This project is expected to deliver a peak revenue of USD 52 mn (ct Rs 426 cr) in FY2026. SFL is expected incur a capex of Rs 200 cr for this project, which would be fungible as well as the part of its Rs 350 cr investment plan for EV projects.

Results (Consolidated) Rs cr

Particulars	Q3FY23	Q3FY22	Y-o-Y %	Q2FY23	Q-o-Q %
Revenues	1,403.0	1,207.5	16.2	1,401.7	0.1
Total operating expenses	1,206.8	1,016.6	18.7	1,197.0	0.8
EBITDA	196.3	191.0	2.8	204.7	(4.1)
Depreciation	49.9	47.4	5.2	49.3	1.1
Interest	10.0	6.9	43.7	8.1	23.1
Other income	20.0	10.4	92.7	9.7	106.2
PBT	156.5	147.1	6.4	157.0	(0.3)
Tax	38.4	37.1	3.7	40.2	(4.4)
Adjusted PAT	118.1	110.0	7.3	116.8	1.1
Reported PAT	118.1	110.0	7.3	116.8	1.1
Adjusted EPS	5.6	5.2	7.3	5.6	1.1

Source: Company; Sharekhan Research

Key ratios (Consolidated)

Particulars	Q3FY23	Q3FY22	Y-o-Y (bps)	Q2FY23	Q-o-Q (bps)
Gross margin (%)	55.3	57.5	(220)	56.8	(150)
EBIDTA margin (%)	14.0	15.8	(180)	14.6	(60)
EBIT margin (%)	10.4	11.9	(150)	11.1	(60)
Net profit margin (%)	8.4	9.1	(70)	8.3	10
Effective tax rate (%)	24.6	25.2	(60)	25.6	(110)

Source: Company; Sharekhan Research

Results (Standalone) Rs cr

Particulars	Q3FY23	Q3FY22	Y-o-Y %	Q2FY23	Q-o-Q %
Revenues	1,226.9	1,024.3	19.8	1,218.2	0.7
Total operating expenses	1,048.0	848.2	23.6	1,032.6	1.5
EBITDA	178.9	176.1	1.6	185.6	(3.6)
Depreciation	39.9	38.3	4.1	39.4	1.1
Interest	6.3	3.2	94.1	4.3	44.8
Other income	9.3	4.0	134.5	7.7	21.5
PBT	142.1	138.5	2.6	149.5	(5.0)
Tax	35.9	35.1	2.2	37.7	(4.7)
Adjusted PAT	106.1	103.3	2.7	111.8	(5.0)
Reported PAT	106.1	103.3	2.7	111.8	(5.0)
Adjusted EPS	5.1	4.9	2.7	5.3	(5.0)

Source: Company; Sharekhan Research

Key ratios (Standalone)

Particulars	Q3FY23	Q3FY22	Y-o-Y (bps)	Q2FY23	Q-o-Q (bps)
Gross margin (%)	53.0	55.9	(280)	55.4	(240)
EBIDTA margin (%)	14.6	17.2	(260)	15.2	(70)
EBIT margin (%)	11.3	13.4	(210)	12.0	(70)
Net profit margin (%)	8.7	10.1	(140)	9.2	(50)
Effective tax rate (%)	25.3	25.4	(10)	25.2	10

Source: Company; Sharekhan Research

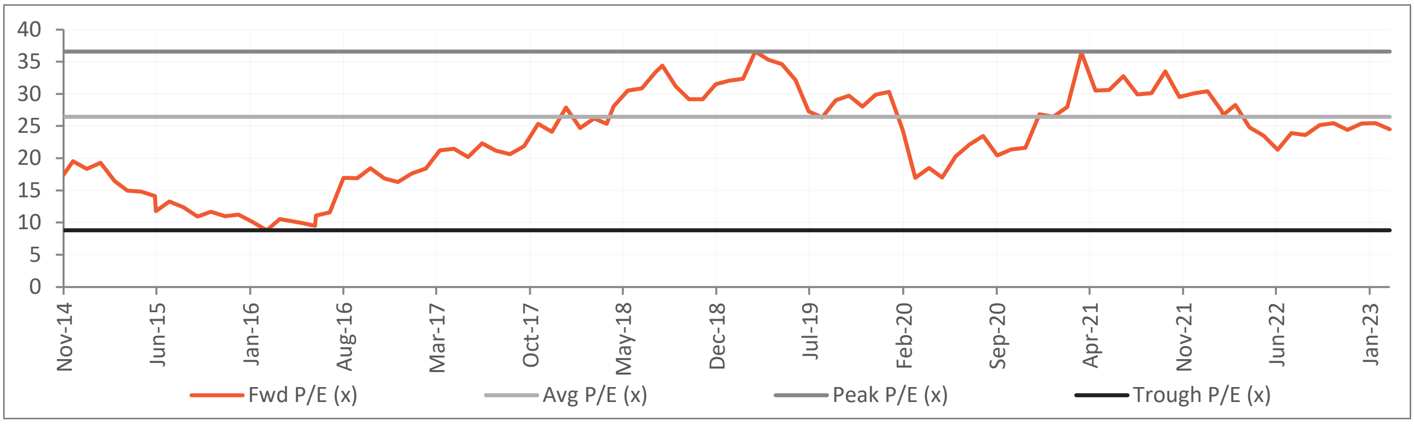
Outlook and Valuation

■ **Sector Outlook – 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. The 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 a stable performance, despite a tough environment. We expect SFL to benefit from improved automotive business outlook and a diversified portfolio. Export markets are also expected 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 remain positive on SFL's business prospects in the future.

■ **Valuation – Maintain Buy with an unchanged PT of Rs. 1,110:** While Q3FY2023 performance was impacted due to raw material cost pressure the operating performance is expected to improve in Q4FY2023 due to probable recovery of higher input cost from customers and increase in export volumes, given SFL is expected to continue to outperform in the domestic market. Going forward, SFL is expected to build up strong EV portfolio as it has started receiving prestigious export orders in EV space. The profitability in EV space is assumed to be better than that of legacy business. The increase in revenue contribution from EV segment, exports and non-auto segment would improve its profitability from current level, however substantial improvement in its operating performance would be visible once the benefit of soft raw material cost would filter into its financials. SFL is witnessing strong traction from its domestic and global OEMs, driven by a recovery in automotive and non-automotive demand. 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. 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 23.2x and EV/EBITDA multiple of 13.9x its FY2025E estimates. Though the stock is trading at premium valuation compared to peers and close to its 7-year average P/E multiple we believe that its renewed focus on EV business and export-oriented business model justifies the premium valuations. We retain our Buy rating on the stock with an unchanged PT of Rs. 1,110.

One-year forward P/E (x) band



Source: 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	972	44.2	40.4	29.4	25.7	23.1	17.4	21.4	16.1	20.0
Suprajit Engineering	328	26.2	23.0	17.0	18.1	15.3	11.5	16.2	17.6	20.9
Schaeffler India	2,630	65.3	45.9	35.8	42.0	29.5	22.9	30.9	32.9	32.0

*Source: Company, Sharekhan estimates; *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	Executive Director
Mr. R Dilip Kumar	Chief Financial Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	TVS Sundram Fastners	48.4%
2	Hdfc Trustee Company Ltd	6.4%
3	Amansa Holdings Pvt Ltd	6.0%
4	Parikh Govindlal	2.0%
5	Vanguard Group	1.9%
6	ICICI Pru AMC	1.5%
7	TATA AMC	1.3%
8	GIC	1.3%
9	UTI AMC	1.2%
10	HDFC Life Insurance	1.0%

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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For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com.

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