Stock Update

Sharda Motor Industries Ltd.

Jan 8, 2024

RETAILRESEARCH

Sharda Motor Industries Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Auto Ancillaries	Rs 1394	Buy in Rs 1385-1410 band & add on dips in Rs 1245-1270 band	Rs 1547	Rs 1654	2-3 quarters

HDFC Scrip Code	SHAMOTEQNR
BSE Code	535602
NSE Code	SHARDAMOTR
Bloomberg	SHMO IN
CMP Jan 5 , 2024	1393.6
Equity Capital (Rs cr)	6.0
Face Value (Rs)	2.0
Equity Share O/S (cr)	3.0
Market Cap (Rs cr)	4143.3
Book Value (Rs)	283.3
Avg. 52 Wk Volumes	53,600
52 Week High (Rs)	1425.0
52 Week Low (Rs)	550.4

Share holding Pattern % (Sep, 2023)	
Promoters	73.2
Institutions	1.9
Non Institutions	24.9
Total	100.0

HDFCsec Retail research stock rating meter

for details about the ratings, refer at the end of the report

* Refer at the end for explanation on Risk Ratings

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Our Take:

Sharda Motor Industries Ltd. (SMIL) is a leading auto-ancillary company supplying exhaust and suspension systems to major OEMs. The company is benefitting from the BS-VI implementation and prepared with products to meet the next significant update in emission norms for CE (construction equipment vehicles) and tractors. It has entered in JV with Purem International to manufacture commercial vehicle exhaust systems in India which would make its addressable market equivalent/larger than the CV market. Even in the PV segment its content per vehicle is expected to increase by 10-15% with the implementation of Real Driving Emissions (RDE) norms.

Its foray into EV space through a JV with Kinetic Green for developing Battery Packs with Battery Management Systems (BMS) has reached the testing phase and the company expects to begin commercial production in the coming quarters. Sale of Kinetic Green vehicles bodes well for the JV company. SMIL aims to tie-up or acquire companies with power agnostic products.

Valuation & Recommendation:

We expect SMIL's Revenue/ PAT to grow at 12/19% CAGR over FY23-FY26, led by increased content per vehicle in both the PV and CV segment, improvement in JV profitability and operating leverage. The company is debt-free, holds substantial cash and cash equivalents with healthy return ratios and is available at attractive valuation considering the strong growth prospects. We believe investors can buy the stock in Rs 1385-1410 band and add on dips in Rs 1245-1270 band (11x Sep'25E EPS) for a base case fair value of Rs 1547 (13.5x Sep'25E EPS) and bull case fair value of Rs 1654 (14.5x Sep'25E EPS) over the next 2-3 quarters.

Financial Summary

Particulars (Rs cr)	Q2FY24	Q2FY23	YoY (%)	Q1FY24	QoQ (%)	FY23	FY24E	FY25E	FY26E
Operating Income	763	698	9.3	654	16.6	2,700	2,997	3,357	3,776
EBITDA	99	76	31.4	68	45.7	282	348	399	464
APAT	80	55	46.5	55	45.0	208	273	307	351
Diluted EPS (Rs)	26.9	18.4	46.5	18.6	45.0	70.1	91.7	103.4	118.1
RoE (%)						31.3	31.9	29.1	27.3
P/E (x)						19.9	15.2	13.5	11.8
EV/EBITDA (x)						12.7	9.6	7.7	6.1

(Source: Company, HDFC sec)

Q2FY24 Result Update

SMIL reported decent numbers for Q2FY24 with consolidated revenue growth of 9.3% YoY to Rs 763cr driven by increasing vehicle volumes. Gross margin improved ~260bps to 22.8% on better product mix. EBITDA increased by 31.5% YoY to Rs 99cr and EBITDA margin expanded 220bps led by higher capacity utilisation. PAT was up by 46.5% YoY to Rs 80cr. The management has guided for 10%+ EBITDA margins going forward.

Key Triggers

Stricter emission norms to drive higher content per vehicle

The TREM IV norms (for higher HP tractors) have been implemented from Jan’23 after multiple postponements and CEV V and TREM V norms for construction equipment vehicles and all tractors are scheduled to be implemented from Apr 24. With the applicability of new emission norms, the Off Highway addressable market for the company will become equivalent or larger than the current commercial vehicle market. The products of the company will be required for majority of the off highway segment. SMIL has already developed and validated export product equivalent to TREM V norms.

In the PV segment BS VI RDE norms have been implemented from Apr’23 requiring cars to achieve emission targets even in real world conditions, as opposed to just a laboratory environment. The applicability of RDE norms would increase the content per vehicle by 10-15% for SMIL.

Strong potential for JV performance to improve

The 50:50 JV of the company formed with Germany based Purem International GmbH (formerly known as Eberspaecher Exhaust Technology International) to manufacture commercial vehicle exhaust systems has strong growth potential as and when the stricter exhaust norms for CVs become mandatory. CV sales have picked up in the country and the JV has turned profitable in FY23 with SML’s share at Rs 2.8cr. The management is currently focusing on maintaining/improving the profitability of the JV and undertaking lot of business development activity and other initiatives to driver higher sales.

The Eberspächer Group of Companies is an international automotive supplier with 80 locations in 28 countries, having revenues of Euro 6.4bn in 2022. It brings in global know-how for the local market. The company is a segment leader in the developed economies with a 75% market share in Europe and 50% market share in the US.

Foray into EV space

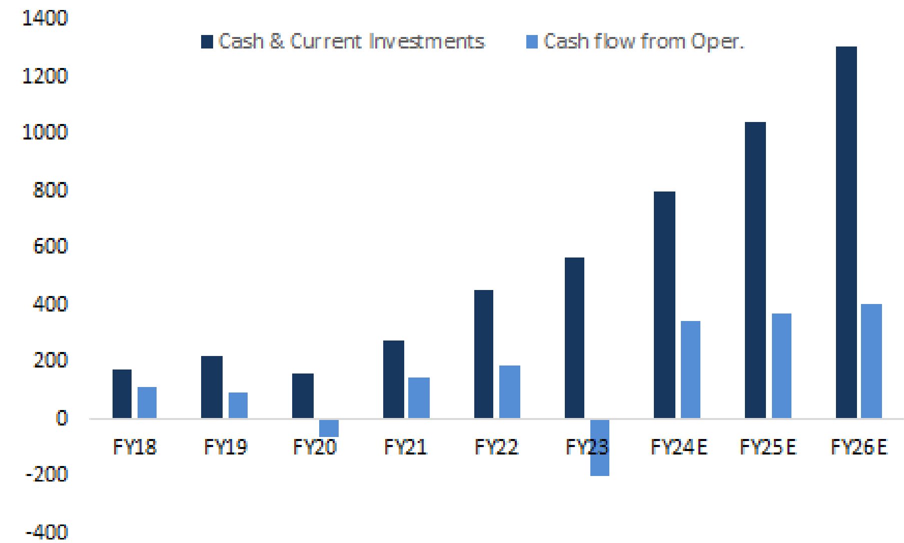
SMIL has also forayed into EV space by forming a 74:26 JV with Kinetic Green Energy for developing Battery Packs with Battery Management Systems (BMS) for electric vehicles and stationery applications. The prototype is ready and is under extensive field testing. Multiple regulatory changes and reduced subsidy for EV have delayed the launch. Additionally, the management intends to wait for full testing to be done before launching the products.

Kinetic Green expects a turnover to about Rs 1000cr in FY25 as traction for its two-wheelers continues to increase. The electric vehicle arm of the Kinetic Group is targeting sale of 100,000 units of 2/3W in FY25. With increasing penetration of EV in 2W and 3W, the JV can become profitable in short period of time.

Debt free company with strong cash generation

SMIL is debt free company with low capex requirement. It is an asset light company and higher customer demands can be met through minimal incremental capex. The capex can be funded through internal accruals as it has strong operating cash flow generation. The management intends to utilise cash generation for inorganic opportunities in powertrain agnostic product or return it to shareholders via higher dividend payouts. SMIL had cash and current investments of Rs 566cr at the end of H1FY24.

Operating cash generation has been strong



(Source: Company, HDFCsec)

Established market position and strong customer base

SMIL is a prominent player in the Indian automotive components industry with strong presence in both the spaces – exhaust systems and suspension systems. Experience of around three decades in manufacturing exhaust systems has enabled the promoters to develop healthy relationships with OEMs such as M&M, for which SMIL is the preferred supplier of independent front suspension systems. It also caters to various models of Hyundai Motor India Ltd and Tata Motors. Apart from exhaust systems, SMIL manufactures and supplies various suspension systems and also trades in catalytic convertors for its customers.

The JV with Purem has enabled the company to manufacture exhaust systems for CV which could result in incremental opportunity with companies where it is supplying exhaust system for PV.

Risk & Concern

Slowdown in automobile sales

The products of the company primarily cater to the automobile industry (PV and CV) and any slowdown in the industry could have a significant impact on the company's profitability.

Susceptibility to increase in raw material prices and pricing pressure from OEMs

The company has limited bargaining power with OEMs, which periodically revise prices based on their financial standing and willingness. As such, any benefit in operating margin comes with a lag.

Faster adoption of EV could render products obsolete

Large scale adoption of EV for passenger and commercial vehicles would take time in India. However, faster adoption could render many products of the company obsolete in a few years.

Postponement of emission norms

The implementation of TREM IV norms was postponed multiple times before Jan'23. Similar postponement for implementation of CEV V and TREM V norms could delay the company's growth by a few quarters.

Customer concentration

The top 3 customers account for ~75-80% of revenue. Loss of any of these customers could have a substantial impact on the company's financials.

Company Background:

SMIL is the market leader in manufacturing of Exhaust Systems. It also manufactures Catalytic Converter, Independent Suspension, Seat Frames, Seat Covers (Two Wheelers & Four Wheelers), Soft Top Canopies, and Pressed part- White goods products. Established in 1986, SMIL is fully backward integrated and has nine manufacturing units including the JV plants, three sales offices and one world class R&D center. Its plants are strategically located across the country near auto clusters. Capacity utilisation across the plants is close to 85% and higher output requires incrementally smaller capex.

SMIL has a market share of ~30% in exhaust systems in the domestic PV industry catering to almost all major OEMs except Maruti. Ex-Maruti its share is 60-65%. It also caters to major tractor manufacturers like Escorts, TAFE, Kubota, etc. and CV players like Tata Motors, Ashok Leyland, Force Motors, etc. In addition, the company also supplies to non-auto players (for genset applications) like Cummins, Carriers, and others. Apart from SMIL, the other key players in the Indian market are Tenneco, Faurecia, JBM and Mark Exhaust in the exhaust systems. In the CV segment SMIL has lower market share of 10-20% due to requirement of high technology, which post the JV with Purem, SMIL has and this could lead to higher market share going forward.

As a backward integration step, it also has 3 stamping plants managing all critical stamping in-house and two tube mills producing stainless steel and aluminium steel tubes for exhaust systems. In the suspension segment it has market share of ~10% with two manufacturing units at Nashik and Pune.

Financials

Income Statement

(Rs cr)	FY22	FY23	FY24E	FY25E	FY26E
Net Revenues	**2,255**	**2,700**	**2,997**	**3,357**	**3,776**
Growth (%)	***29.9***	***19.7***	***11.0***	***12.0***	***12.5***
Operating Expenses	2,028	2,418	2,649	2,957	3,312
EBITDA	**228**	**282**	**348**	**399**	**464**
Growth (%)	***76.2***	***23.7***	***23.4***	***14.9***	***16.3***
EBITDA Margin (%)	***10.1***	***10.4***	***11.6***	***11.9***	***12.3***
Depreciation	41	46	51	54	57
Other Income	30	42	66	64	60
EBIT	**217**	**277**	**363**	**409**	**467**
Interest expenses	1	2	2	3	3
PBT	**215**	**275**	**361**	**407**	**465**
Tax	54	70	91	103	118
PAT	**161**	**205**	**269**	**304**	**347**
Share of Asso./Minority Int.	-12	3	3	4	4
Adj. PAT	**149**	**208**	**273**	**307**	**351**
Growth (%)	***123.8***	***39.6***	***30.8***	***12.8***	***14.2***
EPS	50.2	70.1	91.7	103.4	118.1

Balance Sheet

As at March (Rs cr)	FY22	FY23	FY24E	FY25E	FY26E
SOURCE OF FUNDS					
Share Capital	6	6	6	6	6
Reserves & Surplus	567	752	943	1158	1404
Shareholders' Funds	**573**	**758**	**949**	**1164**	**1410**
Borrowings	0	0	0	0	0
Net Deferred Taxes	-5	-7	-7	-7	-7
Other Non-curr. Liab.	12	24	21	24	29
Total Source of Funds	**580**	**775**	**963**	**1181**	**1432**
APPLICATION OF FUNDS					
Net Block & Goodwill	156	221	200	176	154
CWIP	0	0	0	0	0
Investments	78	30	130	255	405
Other Non-Curr. Assets	11	17	18	19	23
Total Non-Current Assets	**245**	**268**	**348**	**450**	**581**
Inventories	131	204	213	229	271
Trade Receivables	276	331	345	377	414
Cash & Equivalents	398	560	694	818	927
Other Current Assets	11	19	18	20	24
Total Current Assets	**816**	**1114**	**1270**	**1444**	**1636**
Trade Payables	415	516	558	607	662
Other Current Liab & Provisions	65	92	97	106	123
Total Current Liabilities	**481**	**607**	**655**	**713**	**785**
Net Current Assets	335	507	615	731	851
Total Application of Funds	**580**	**775**	**963**	**1181**	**1432**

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Cash Flow Statement

(Rs cr)	FY22	FY23	FY24E	FY25E	FY26E
PBT	215	278	364	410	469
Non-operating & EO items	-9	-40	-4	1	2
Interest Expenses	-12	2	2	3	3
Depreciation	41	46	51	54	57
Working Capital Change	13	-413	25	9	-10
Tax Paid	-57	-73	-91	-103	-118
OPERATING CASH FLOW (a)	**192**	**-201**	**347**	**374**	**402**
Capex	-14	-88	-30	-30	-35
Free Cash Flow	178	-289	317	344	367
Investments	-50	54	-100	-125	-150
Non-operating income	1	225	0	0	0
INVESTING CASH FLOW (b)	**-62**	**190**	**-130**	**-155**	**-185**
Debt Issuance / (Repaid)	0	0	0	0	0
Interest Expenses	-1	-2	-2	-3	-3
FCFE	128	-12	215	216	215
Share Capital Issuance	0	0	0	0	0
Dividend	-8	-24	-81	-92	-105
FINANCING CASH FLOW (c)	**-9**	**-26**	**-84**	**-95**	**-108**
NET CASH FLOW (a+b+c)	**120**	**-36**	**134**	**124**	**110**

Key Ratios

	FY22	FY23	FY24E	FY25E	FY26E
Profitability Ratios (%)					
EBITDA Margin	10.1	10.4	11.6	11.9	12.3
EBIT Margin	9.6	10.3	12.1	12.2	12.4
APAT Margin	6.6	7.7	9.1	9.2	9.3
RoE	29.7	31.3	31.9	29.1	27.3
RoCE	43.2	41.7	42.5	38.7	36.3
Solvency Ratio (x)					
Net Debt/EBITDA	-1.7	-2.0	-2.0	-2.0	-2.0
Net D/E	-0.7	-0.7	-0.7	-0.7	-0.7
PER SHARE DATA (Rs)					
EPS	50.2	70.1	91.7	103.4	118.1
CEPS	63.8	85.6	108.8	121.5	137.4
BV	192.6	254.9	319.2	391.5	474.2
Dividend	8.2	17.3	27.4	31.0	35.4
Turnover Ratios (days)					
Inventory	49	41	41	39	38
Debtor	22	23	25	24	24
Creditors	72	63	65	63	61
VALUATION (x)					
P/E	27.8	19.9	15.2	13.5	11.8
P/BV	7.2	5.5	4.4	3.6	2.9
EV/EBITDA	16.2	12.7	9.6	7.7	6.1
EV/Revenues	1.6	1.3	1.1	0.9	0.8
Dividend Yield (%)	0.6	1.2	2.0	2.2	2.5
Dividend Payout (%)	16.2	24.6	29.9	30.0	30.0

(Source: Company, HDFC sec)

Price chart

HDFC Sec Retail Research Rating description

Green Rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. This stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Yellow Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicality of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.

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Disclosure:

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