

Initiating Coverage Sterling Tools Ltd.

February 8, 2023





Sterling Tools Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Auto Ancillaries	Rs 357	Buy in Rs 355-360 band & add more on dips in Rs 317-322 band	Rs 401	Rs 425	2-3 quarters

HDFC Scrip Code	STETOOEQNR
BSE Code	530759
NSE Code	STERTOOLS
Bloomberg	STRT IN
CMP Feb 7, 2023	357.3
Equity Capital (Rs cr)	7.2
Face Value (Rs)	2
Equity Share O/S (cr)	3.6
Market Cap (Rs cr)	1287
Book Value (Rs)	107.2
Avg. 52 Wk Volumes	145,500
52 Week High (Rs)	390.6
52 Week Low (Rs)	116.1

Share holding Pattern % (Dec 2022)	
Promoters	65.8
Institutions	5.3
Non Institutions	28.9
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:

Sterling Tools Ltd. (STL) is the 2nd largest automotive fastener manufacturer in India, in existence since last 4 decades with a well-diversified presence across all automotive segments and customers. It entered the EV space in 2020 and has become one of the largest e-2W MCU (Motor Control Unit) supplier in India. It has also started supplying MCUs for LCVs. EV penetration in 2W and 3W is expected to increase at a fast rate over the next few years which augurs well for the company's growth. The collaboration with Meidoh for high tension fasteners could lead to higher orders from Japanese manufacturers. STL has also invested in 3W cargo EV manufacturer which is showing rapid growth and could lead to a valuation uptick.

With minimum capex requirement and strong cash flows, the management has guided for a growth of 15-18% in FY24. Margins were impacted in FY22 due to company's limited ability to pass on inflationary pressures. However, softening of raw material costs should lead to higher margins in the coming quarters.

Valuation & Recommendation:

STL maintains a conservative capital structure with low gearing levels and comfortable coverage indicators. We expect STL's Revenue/EBITDA/PAT to grow at 26/31/51% CAGR over FY22-FY25E, led by strong growth in EV business, higher share of specialised fasteners, improved realisations, and strict control on cost overheads. We believe investors can buy the stock in Rs 355-360 band and add on dips in Rs 317-322 band (13.5x Dec'24E EPS) for a base case fair value of Rs 401 (17x Dec'24E EPS) and bull case fair value of Rs 425 (18x Dec'24E EPS) over the next 2-3 quarters.

Financial Summary

(Rs cr)	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)	FY22	FY23E	FY24E	FY25E
Operating Income	208	122	70.4	179	16.4	510	755	892	1,017
EBITDA	28	16	76.5	25	12.2	67	102	126	151
APAT	14	5	155.4	17	-16.2	26	54	71	90
Diluted EPS (Rs)	3.9	1.5	155.2	4.6	-16.3	7.3	15.0	19.7	24.9
RoE-%						7.6	14.3	16.4	17.9
P/E (x)						49.2	23.8	18.2	14.3
EV/EBITDA (x)						20.5	13.4	10.7	8.6

(Source: Company, HDFC sec)



Q3FY23 Result Review

STL reported strong numbers for Q3FY23 with highest ever quarterly consolidated revenue of Rs 208cr, up by 70% YoY led by increased offtake for MCU. The turnover in EV business has increased to Rs 119cr in 9MFY23 as compared to just Rs 7cr in the corresponding period previous year. Ola which is the major customer for MCU reported monthly wholesale sales of 20000+ units in October-December period. EBITDA increased by 76% YoY to Rs 28cr and EBITDA margin expanded 40bps to 13.5% on account of higher capacity utilisation. However, sequentially EBITDA margin declined 13.5%. PAT for the quarter came in at Rs 14cr, up 155% YoY while PAT margin expanded 220bps to 6.7%. New capacity utilisation was to the tune of 70%.

Key updates

Auto sales to improve going forward

According to Crisil Research, growth across the automobile sector segments could level off next fiscal as the base effect of last fiscal wanes. Commercial vehicle sales are expected to drive past pre-pandemic levels next fiscal along with passenger vehicles, which did so this fiscal, and tractors, which recorded an all-time high in pandemic-impacted fiscal 2021. Two-wheelers will continue to lag as the hike in their total cost of ownership (TCO) has been much sharper than for passenger vehicles.

The passenger vehicle sector was the hardest hit in fiscal 2022 due to semiconductor shortages on account of rising semiconductor intensity per vehicle. CRISIL Research expects domestic volumes in FY24 to rise 27-29% on-year to ~3.9 million vehicles, surpassing the pre-pandemic high of 3.4 million vehicles. The volumes would be supported by strong pent-up demand, a healthy order book across original equipment manufacturers (OEMs), improving model availability, new model launches and the loan-to-value (LTV) inching towards near 100% of on-road financing.

CV domestic sales volumes are expected to rise 31-33% on a low base of fiscal 2022 and grow 9-11% on a strong base of fiscal 2023 driven by improving fleet utilisation and transporter profitability levels, higher replacement demand and expectations of robust economic growth. Implementation of scrappage policy could also help. In 2W space, reopening of educational institutions and offices and positive rural sentiments backed by a regular monsoon and increased minimum support prices (MSPs) across crops, coupled with improved model availability and demand for electric vehicles (EVs), are expected to drive two-wheeler sales by 21-23% in fiscal 2023. Sales in fiscal 2024 are likely to be driven by expectations of a normal monsoon, coupled with improved model availability and demand for EVs.

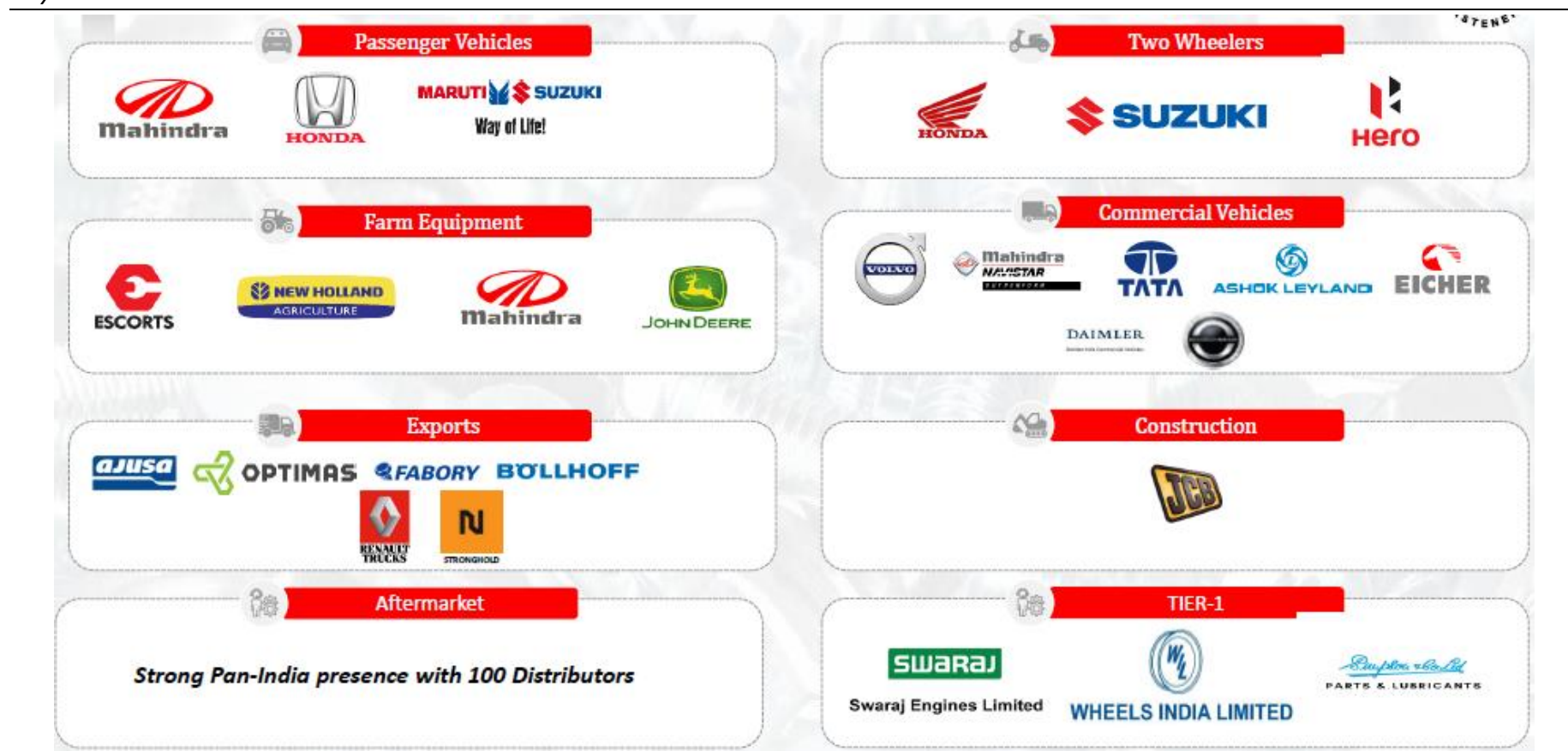
Growing demand and the resultant rise in operating leverage is likely to boost profitability of auto ancillary companies like STL.



Diversified revenue profile across automotive segments

STL's revenue profile is well-diversified, catering to all major automotive segments, as well as some non-automotive segments. Furthermore, its dependence on each segment is limited, with commercial vehicles accounting for only 28% of its OEM revenues (FY2022), followed by passenger vehicles (PVs) (~27%), two-wheelers (~21%), and tractors (~15%). STL's diversified presence protects its revenues and earnings to some extent from demand downturns that impact specific automotive segments. The company caters to multiple OEMs across the automotive spectrum, with healthy share of business (SOB) with most leading OEMs and limited dependence on a single customer.

Key Clientele - Fasteners



(Source: Company)

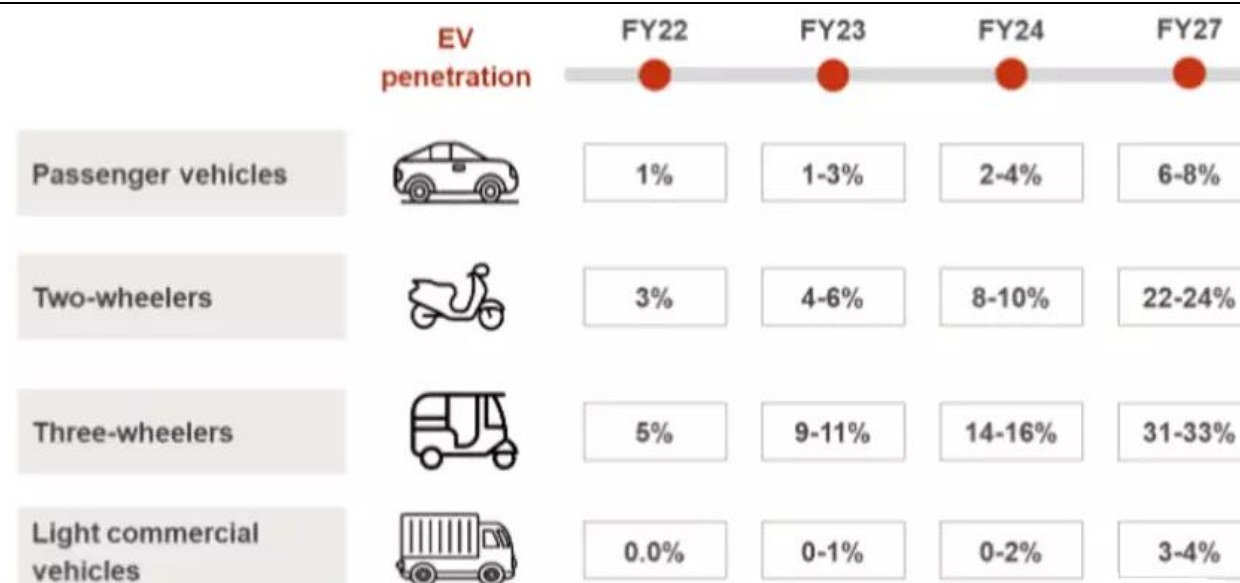


Increasing e-2W penetration

Two wheelers and three wheelers account for over 80% of vehicle sales in India and domestic EV penetration is expected to be led by two-wheeler and three-wheeler segments. The favourable total cost of ownership (TCO), vehicle uptake from the delivery segment, and continued national and state-level subsidies are likely to boost sales.

STL forayed into the electric vehicle (EV) segment in Jan'20 through its partnership with Jiangsu Gtake of Shenzhen (China) called Sterling Gtake E-mobility Ltd (SGEM), through which it is manufacturing motor control units (MCUs) in India. It has become one of the largest e-2W MCU suppliers in India with a market share of 50% in high speed scooter segment, about 33% in overall 2W segment. It has an installed capacity of 300,000 MCUs and planning further expansion. SGEM received its first order worth Rs 60cr in July 2021 from an electric two-wheeler (e-2W) OEM, which was followed up by an additional order of Rs 100cr from the same OEM.

EV penetration across vehicle segments over the medium term



(Source: CRISIL, MI&A Research)



A Motor Control Unit (MCU) is an electronic module that interfaces with the Motor as well as the Battery Pack to control the electric vehicle's speed, acceleration and range based on the throttle input. MCUs make upto 10% of electric 2W cost. SGEM has production orders from 11 EV OEMs and is in advanced stages of discussions with more than 30 automobile EV OEMs for their MCU requirements for different vehicle segments, including two wheelers, three wheelers, passenger vehicles and commercial vehicles.

Recently it acquired business from 2 of the top 4 LCV players for MCU. Realization from MCU for a LCV is ~6x as compared to a 2W and it increases further as the power rating increases. With increasing penetration of EVs, STL expects revenue of ~Rs 150cr from MCU in FY23.

Collaboration with Meidoh opens market to Japanese manufacturers in India

In 2017, STL entered into a technical collaboration with Japan based Meidoh Co. Ltd., a technology leader and leading player in high tension fasteners. Meidoh invested Rs 44cr for 5% stake in STL in 2018 (@Rs.246.6 per share). It is among the largest suppliers to Toyota and the collaboration has helped the company to improve its product development capabilities for specialised fasteners. Partnering with a Japanese company has also led to increased orders from Japanese manufacturers like Toyota and Maruti Suzuki.

Invested in 3W Cargo manufacturer

STL invested Rs 4cr in 3W EV cargo manufacturer Altigreen in FY19. The company is making vehicles as per Indian roads and Indian weather conditions to give riders the best possible experience. In Feb'22, Altigreen raised Rs 300 crore (USD 40 million) in a funding round for capacity expansion, new products launch and to develop a pan-India network. The Series A investment is led by Sixth Sense Ventures, along with Reliance New Energy, Xponentia Capital, Accurant International, USA and Momentum Venture Capital, Singapore. The freshly raised capital will be utilized to ramp up production capabilities, accelerate R&D, fast-paced EV adoption and develop a robust pan-India network to offer the best and cleanest last-mile transportation solutions in the country. Post this fund raising, STL's investment reflects large upside potential.

Risks & Concerns

Slowdown in automobile industry

STL supplies mainly to automobile manufacturers across segments. Any slowdown in the automobile industry could impact its growth.

Raw material price volatility

Sharp increase in raw material prices could hurt its performance as there is a lag effect in passing on the increase to its clients.

Susceptibility to pricing pressure from OEMs and peers

STL may not be able to pass on the increase in costs easily to OEMs and remains susceptible to increasing competition in the auto component segment, and pricing pressures from auto OEMs.



Limited product diversification with fasteners constituting bulk of revenues

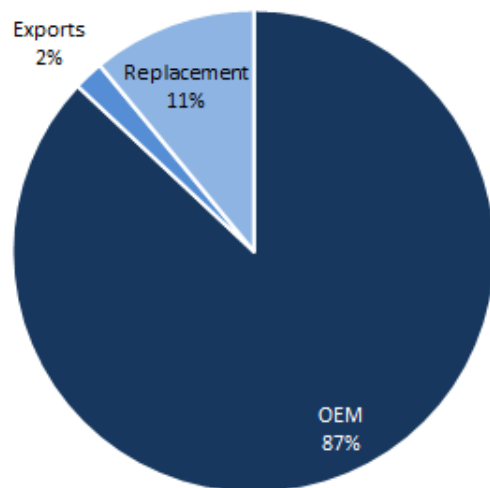
STL has historically operated in a single product category of fasteners, thereby limiting its product diversification and offerings. Although it has diversified into MCU, fasteners continue to account for more than 80% of revenues.

Company Background:

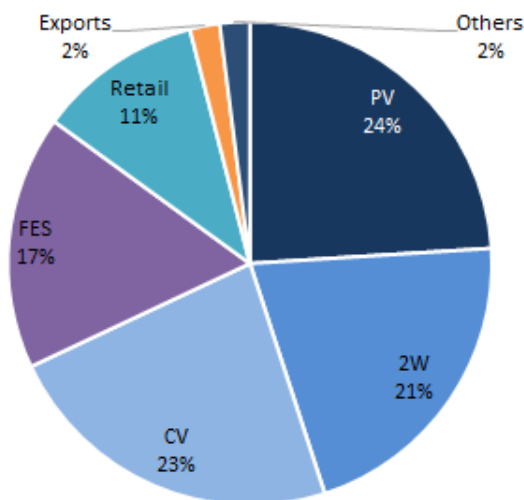
Established in 1979, STL manufactures and markets high tensile cold forged fasteners, primarily for the automobile industry. It currently offers a comprehensive product portfolio consisting of Standard, Chassis, Special and Engine Fasteners. At present, it is positioned as the second largest fastener manufacturer in India, after Sundaram Fasteners. The company caters to leading automotive companies in India and tier-I auto component manufacturers in USA, Europe, South America and the Middle East. STL's product portfolio includes fasteners, which find application in both automotive and non-automotive segments.

STL has three manufacturing plants at Faridabad, Ballabhgarh and Palwal (all in Haryana), with a fourth manufacturing plant near Bengaluru. The company has a total manufacturing capacity of approximately 38,000 MT per annum at its existing plants, with an additional ~10,000 MTPA capacity at its new facility in Karnataka.

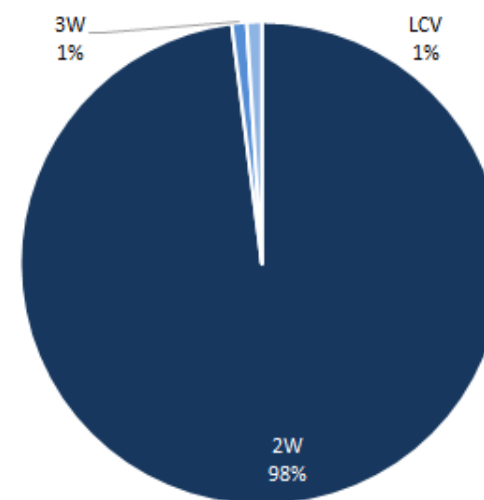
Revenue breakup (Q3FY23)



Fastener business



EV business



(Source: Company, HDFC Sec)



Financials

Income Statement

(Rs cr)	FY21	FY22	FY23E	FY24E	FY25E
Net Revenues	355	510	755	892	1017
Growth (%)	-2.4	43.3	48.1	18.1	14.1
Operating Expenses	294	443	652	765	866
EBITDA	62	67	102	126	151
Growth (%)	1.6	7.7	53.7	23.4	19.7
EBITDA Margin (%)	17.4	13.1	13.6	14.2	14.9
Depreciation	26	27	32	34	37
Other Income	3	3	11	12	14
EBIT	38	42	81	104	129
Interest expenses	8	7	9	9	9
PBT	31	35	72	95	120
Tax	7	9	18	24	30
Adj. PAT	24	26	54	71	90
Growth (%)	-22.8	8.9	107.0	31.0	26.7
EPS	6.7	7.3	15.0	19.7	24.9

Balance Sheet

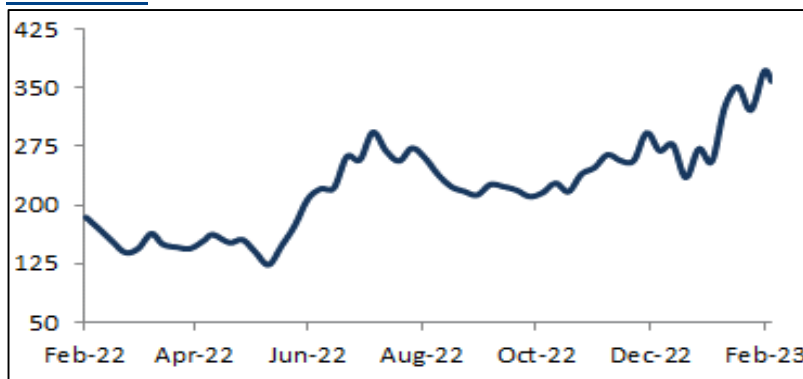
(Rs cr)	FY21	FY22	FY23E	FY24E	FY25E
SOURCE OF FUNDS					
Share Capital	7	7	7	7	7
Reserves	324	349	395	455	532
Shareholders' Funds	331	356	402	462	539
Total Debt	105	109	109	89	64
Net Deferred Taxes	17	16	16	16	16
Other Non-curr. Liab.	17	16	24	29	33
Total Sources of Funds	470	498	552	597	652
APPLICATION OF FUNDS					
Net Block & Goodwill	257	280	273	274	268
CWIP	0	1	1	0	0
Investments	26	23	23	23	38
Other Non-Curr. Assets	13	13	19	22	25
Total Non Current Assets	296	318	316	320	332
Inventories	110	116	182	208	228
Debtors	42	47	72	91	98
Cash & Equivalents	32	23	16	14	36
Other Current Assets	37	46	56	61	65
Total Current Assets	220	232	326	373	428
Creditors	31	32	52	56	61
Other Current Liab & Provisions	16	20	39	40	46
Total Current Liabilities	47	52	90	96	107
Net Current Assets	174	180	236	277	321
Total Application of Funds	470	498	552	597	652



Cash Flow Statement

(Rs cr)	FY21	FY22	FY23E	FY24E	FY25E
Reported PBT	30	35	72	95	120
Non-operating & EO items	-1	-1	2	1	1
Interest Expenses	5	5	9	9	9
Depreciation	26	27	32	34	37
Working Capital Change	-37	-16	-62	-43	-21
Tax Paid	-8	-11	-18	-24	-30
OPERATING CASH FLOW (a)	16	40	35	72	115
Capex	-17	-51	-25	-35	-30
Free Cash Flow	-1	-11	10	37	85
Investments	-7	6	0	0	-15
Non-operating income	-25	6	0	0	0
INVESTING CASH FLOW (b)	-49	-39	-25	-35	-45
Debt Issuance / (Repaid)	31	5	0	-20	-25
Interest Expenses	-7	-6	-9	-9	-9
FCFE	-10	0	1	8	36
Share Capital Issuance	0	0	0	0	0
Dividend	0	-4	-8	-10	-13
Others	0	0	0	0	0
FINANCING CASH FLOW (c)	24	-5	-17	-40	-47
NET CASH FLOW (a+b+c)	-10	-4	-7	-3	23

Price chart



Key Ratios

Particulars	FY21	FY22	FY23E	FY24E	FY25E
Profitability Ratios (%)					
EBITDA Margin	17.4	13.1	13.6	14.2	14.9
EBIT Margin	10.8	8.3	10.7	11.7	12.7
APAT Margin	6.8	5.1	7.2	7.9	8.8
RoE	7.5	7.6	14.3	16.4	17.9
RoCE	9.7	9.4	16.6	19.6	22.3
Solvency Ratio (x)					
Net Debt/EBITDA	1.2	1.3	0.9	0.6	0.2
Net D/E	0.2	0.2	0.2	0.2	0.1
Per Share Data (Rs)					
EPS	6.7	7.3	15.0	19.7	24.9
CEPS	14.0	14.9	24.1	29.3	35.1
BV	92.1	98.8	111.7	128.4	149.7
Dividend	1.0	1.0	2.2	2.9	3.7
Turnover Ratios (days)					
Debtor days	36	32	29	33	34
Inventory days	87	81	72	80	78
Creditors days	27	22	20	22	21
VALUATION (x)					
P/E	53.6	49.2	23.8	18.2	14.3
P/BV	3.9	3.6	3.2	2.8	2.4
EV/EBITDA	21.8	20.5	13.4	10.7	8.6
EV / Revenues	3.8	2.7	1.8	1.5	1.3
Dividend Yield (%)	0.3	0.3	0.6	0.8	1.0
Dividend Payout (%)	15.0	13.8	14.6	14.7	14.8

(Source: Company, HDFC sec)



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 cyclical 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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